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# SWEAT EQUITY: *IN RE AHLERS*

Patrick W. Fischer\*

## I. INTRODUCTION

Agribusiness, America's largest business, employs approximately 25 to 30 million people.<sup>1</sup> Today that sector of the economy faces a bleak financial future, and the family farmer is among those hardest hit.<sup>2</sup> Observers consider the cause of this crisis to be a complex blend of circumstances, including the rises in interest rates<sup>3</sup> and in the amount of debt farmers carry,<sup>4</sup> and the declines in commodity prices, in land prices,<sup>5</sup> and

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1. MINNESOTA CONTINUING LEGAL EDUCATION, FARM CRISIS: 1985 8 (June, 1985) [hereinafter FARM CRISIS].

2. It is estimated that there are approximately 650,000 full-time farmers, of which 40,000 have debts equal to 70% of their assets. Church, *Real Trouble on the Farms*, TIME, Feb. 18, 1985, at 27-28. Approximately 160,000 farmers have debt equal to or above 40% of their assets. *Id.* When the debt to asset ratio reaches the 40% level, creditors usually consider the debtors to be high risk and are not likely to do business with them. *Id.*

3. See FARM CRISIS, *supra* note 1, at 9.

4. Farm debt has risen from a low of \$50 billion in the early 1970's to almost \$200 billion today. See Church, *supra* note 2, at 27. There are many reasons why this has occurred. In the 1970's, the world-wide demand for grain and fiber increased tremendously. Thus, the government encouraged farmers to plant as many acres as possible. Farmers followed the government's advice because the prices for these crops were so high. The farmers then borrowed money to bring more acres into cultivation. Bankers went out and begged farmers to borrow money. As one senator stated: "We had bankers going up and down the road like Fuller Brush salesmen. . . ." *Id.* The farmers borrowed money based on the amount of assets they had, (which included inflated land prices which would later fall dramatically), not by cash flow. WALL STREET JOURNAL REVIEW OF OUTLOOK, 22 (Dec. 6, 1985). Interest rates also became very high in the early 1980's. They reached a high of 21.5% in 1980. See Bland, *Insolvencies in Farming and Agribusiness*, 73 KY. L.J. 795, 796 (1985). See generally Harl, *The Architecture of Public Policy: The Crisis in Agriculture*, 34 U. KAN. L. REV. 425 (1986).

5. In 1981 there was a world-wide recession and a surplus of grain which slashed demand for U.S. grain, subsequently causing commodity prices to fall. When farm prices fell, the land the crops were grown on could no longer support the interest payments for the money borrowed on the land. Thus, as land prices fell, so did the farmer's asset level. See Church, *supra* note 2, at 27. In Minnesota, the price of land dropped an average of 30% between 1981 and 1984. See FARM CRISIS, *supra* note 1, at 8. Even with the land prices adjusted downward, there were many times when no one would purchase the farms. *Id.*

in exports.<sup>6</sup> These factors have caused both a dramatic decrease in farm revenues and a substantial increase in farm costs. As the number of insolvent farmers increases, so does the number of bankruptcy filings as farmers attempt to reorganize.<sup>7</sup> Some experts predict that if drastic steps are not taken quickly, one-third of all American farmers will become insolvent during the next three to four years.<sup>8</sup>

Another consequence of the farm crisis is the changes that have occurred in bankruptcy law. As the number of farm bankruptcy filings increases each year, the number of situations requiring specially tailored solutions also increases. When the major changes that occurred in the Bankruptcy Code in 1978<sup>9</sup> are coupled with the multiplicity of unique situations in farm businesses, the potential interpretation problems are endless.

Many interpretation problems have occurred with regard to two sections of the Bankruptcy Act: § 362 Automatic Stays<sup>10</sup> and § 1129 Reorganization Plans.<sup>11</sup> Section 362 problems occur with regard to adequate protection, (described in § 361)<sup>12</sup> and whether a secured creditor can get the automatic stay lifted in order to recover the collateral which secured the loan.<sup>13</sup> Problems under § 1129 occur most often when the bankruptcy court confirms a reorganization plan which was proposed by the

6. See *supra* note 5 and accompanying text. Other reasons cited for the farm crisis are the grain embargo, strengthening of the dollar, and increased competition from other countries. See FARM CRISIS, *supra* note 1, at 10.

7. See FARM CRISIS, *supra* note 1, at 10.

8. See Harl, *supra* note 4, at 430.

9. The new bankruptcy statute became effective October 1, 1979. See *infra* notes 29-41 and accompanying text for a complete discussion of how the bankruptcy law changed from pre-1978 to post-1978.

10. 11 U.S.C. § 362 (1982 & Supp. III 1985).

11. *Id.* § 1129.

12. *Id.* § 361. As can be seen by the statute, adequate protection is not defined. Rather, the three different ways adequate protection may be provided for are listed. See also *Bankers Life Ins. Co. v. Alyucan Interstate Corp.* (In re *Alyucan Interstate Corp.*), 12 Bankr. 803 (Bankr. D. Utah 1981). This case provides a complete analysis of what constitutes adequate protection and how it is applied.

13. Section 362(d) grants relief from an automatic stay by an injunction when:

(d) On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay—

(1) for cause, including the lack of adequate protection of an interest in property of such party in interest; or

(2) with respect to a stay of an act against property under subsection (a) of this section if—

(A) the debtor does not have an equity in such property; and

(B) such property is not necessary to an effective reorganization.

11 U.S.C. § 362(d) (1982 & Supp. III 1985).

Section 362(b) lists eleven exceptions which will automatically remove a debtor's stay:

(b) The filing of a petition under section 301, 302, or 303 of this title, or of an application

debtor, but was rejected earlier by the creditors because they felt it was unfeasible.<sup>14</sup>

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under section 5(a)(3) of the Securities Investor Protection Act of 1970 (15 U.S.C. 78eee(a)(3)), does not operate as a stay—

- (1) under subsection (a) of this section, of the commencement or continuation of a criminal action or proceeding against the debtor;
- (2) under subsection (a) of this section, of the collection of alimony, maintenance, or support from property that is not property of the estate;
- (3) under subsection (a) of this section, of any act to perfect an interest in property to the extent that the trustee's rights and powers are subject to such perfection under section 546(b) of this title or to the extent that such act is accomplished within the period provided under section 547(e)(2)(A) of this title;
- (4) under subsection (a)(1) of this section, of the commencement or continuation of an action or proceeding by a governmental unit to enforce such governmental unit's police or regulatory power;
- (5) under subsection (a)(2) of this section, of the enforcement of a judgment, other than a money judgment, obtained in an action or proceeding by a governmental unit to enforce such governmental unit's police or regulatory power;
- (6) under subsection (a) of this section, of the setoff by a commodity broker, forward contract merchant, stockbroker financial institution,, (sic) or securities clearing agency of any mutual debt and claim under or in connection with commodity contracts, as defined in section 761(4) of this title, forward contracts, or securities contracts, as defined in section 741(7) of this title, that constitutes the setoff of a claim against the debtor for a margin payment, as defined in section 741(5) or 761(15) of this title, or settlement payment, as defined in section 741(8) of this title, arising out of commodity contracts, forward contracts, or securities contracts against cash, securities, or other property held by or due from such commodity broker, forward contract merchant, stockbroker financial institution,, (sic) or securities clearing agency to margin, guarantee, secure, or settle commodity contracts, forward contracts, or securities contracts;
- (7) under subsection (a) of this section, of the setoff by a repo participant, of any mutual debt and claim under or in connection with repurchase agreements that constitutes the setoff of a claim against the debtor for a margin payment, as defined in section 741(5) or 761(15) of this title, or settlement payment, as defined in section 741(8) of this title, arising out of repurchase agreements against cash, securities, or other property held by or due from such repo participant to margin, guarantee, secure or settle repurchase agreements;
- (8) under subsection (a) of this section, of the commencement of any action by the Secretary of Housing and Urban Development to foreclose a mortgage or deed of trust in any case in which the mortgage or deed of trust held by the Secretary is insured or was formerly insured under the National Housing Act and covers property, or combinations of property, consisting of five or more living units;
- (9) under subsection (a) of this section, of the issuance to the debtor by a governmental unit of a notice of tax deficiency; or
- (9) (sic) under subsection (a) of this section, of any act by a lessor to the debtor under a lease of nonresidential real property that has terminated by the expiration of the stated term of the lease before the commencement of or during a case under this title to obtain possession of such property. (sic)
- (10) (sic) under subsection (a) of this section, of the presentment of a negotiable instrument and the giving of notice of and protesting dishonor of such an instrument.

11 U.S.C. § 362(b) (1982 & Supp. III 1985)(footnotes omitted). See also Comment, *Automatic Stay Under the 1978 Bankruptcy Code: An Equitable Roadblock to Secured Creditor Relief*, 17 SAN DIEGO L. REV. 1113, 1124-26 (1980).

14. When the bankruptcy court confirms the reorganization plan over the undersecured creditor's dissent, it is called a "cram-down." See generally Klee, *All You Ever Wanted to Know About Cram Down Under the New Bankruptcy Code*, 53 AM. BANKR. L.J. 133, 134-36 (1979). Section 1129 governs this problem:

- (b)(1) Notwithstanding section 510(a) of this title, if all of the applicable requirements of

The Eighth Circuit Court of Appeals was confronted with both of these interpretation problems in the case of *In re Ahlers*.<sup>15</sup> The Ahlers' farm had debt that exceeded its assets by a substantial margin<sup>16</sup> and the farm had virtually no chance of financial survival without reorganization under Chapter 11.

After the Ahlers filed for protection under Chapter 11<sup>17</sup> and the automatic stay commenced, the creditors began an action to have the stay lifted by an injunction,<sup>18</sup> claiming that the Ahlers could not give them the protection to which they were entitled. The Eighth Circuit

subsection (a) of this section other than paragraph (8) are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.

(2) For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements:

(A) With respect to a class of secured claims, the plan provides—

(i)(I) Only one that the holders of such claims retain the liens securing such claims, whether the property subject to such liens is retained by the debtor or transferred to another entity, to the extent of the allowed amount of such claims; and

(II) Only one that each holder of a claim of such class receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property;

(ii) for the sale, subject to section 363(k) of this title, of any property that is subject to the liens securing such claims, free and clear of such liens, with such liens to attach to the proceeds of such sale, and the treatment of such liens on proceeds under clause (i) or (iii) of this subparagraph; or

(iii) for the realization by such holders of the indubitable equivalent of such claims,

(B) With respect to a class of unsecured claims—

(i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property.

(C) With respect to a class of interests—

(i) the plan provides that each holder of an interest of such class receive or retain on account of such interest property of a value, as of the effective date of the plan, equal to the greatest of the allowed amount of any fixed liquidation preference to which such holder is entitled, any fixed redemption price to which such holder is entitled, or the value of such interest; or

(ii) the holder of any interest that is junior to the interests of such class will not receive or retain under the plan on account of such junior interest any property.

11 U.S.C. § 1129(b) (1982 & Supp. III 1985).

15. 794 F.2d 388 (8th Cir. 1986).

16. *Id.* at 408-14.

17. The Ahlers filed for protection under Chapter 11 of the Bankruptcy Code on November 30, 1984. This was 14 days after Norwest Bank of Worthington commenced a replevin action against the Ahlers in state court for their equipment and machinery. *Id.* at 392-93.

18. The injunction to lift the stay was first granted by the Bankruptcy Court and later the district court, but was reversed by a three member panel of the Eighth Circuit. *Id.* at 393-94.

Court, however, determined that the Ahlers could provide adequate protection by making monthly payments.<sup>19</sup>

The creditors also tried to stop the proposed reorganization plan from being confirmed. Because the plan allowed the Ahlers to retain ownership of the farm after the debts were paid by recognizing that they were contributing knowledge, expertise, and management skills to the plan, the creditors argued that the plan was not feasible or "fair and equitable."<sup>20</sup> Again, the court held for the Ahlers by finding that the plan was both feasible and "fair and equitable," and that the creditors would be adequately compensated.

The *Ahlers* decision is unique since it marked the first time a court had considered a debtor's labor, expertise, and management skills in determining whether the debtor should be allowed to participate in a reorganization plan and retain an equity interest in the property.<sup>21</sup> Previously, other courts recognized the absolute priority rule as allowing a junior ownership interest to participate only if the debtor<sup>22</sup> could contribute cash to the reorganization plan.<sup>23</sup>

This comment takes an in-depth look at §§ 361, 362, and 1129 of the Bankruptcy Code and examines how the Eighth Circuit has changed the sections as a result of the *Ahlers* decision. First, it will analyze the Eighth Circuit Court's reasoning for approving the delay of adequate protection payments until the foreclosure proceedings are statutorily complete, and why labor, knowledge, and expertise should allow a farmer to own the farm when the reorganization plan is complete. The comment will then discuss adequate protection and the two different theories of what must be included in adequate protection payments. Finally, the absolute priority rule in the "cram down" provisions of § 1129 of the Code will be analyzed to determine whether this rule should be strictly applied to dissenting undersecured creditors.

## II. BACKGROUND

On November 6, 1978, President Carter signed into law H.R.

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19. The court looked at numerous aspects of adequate protection, including when the creditor receives possession of the property and how quickly he can dispose of it. *Id.* at 396-97.

20. The plan must satisfy the "fair and equitable requirement" even if the creditors do not approve of the reorganization plan. *See* 11 U.S.C. § 1129(b)(1) (1982 & Supp. III 1985).

21. *See Ahlers*, 794 F.2d at 401-03.

22. *Id.* at 401-02.

23. *See, e.g., Case v. Los Angeles Lumber Prod. Co.*, 308 U.S. 106, 121-22, *reh'g denied*, 308 U.S. 637 (1939); *Sophian v. Congress Realty Co.*, 98 F.2d 499, 502 (8th Cir. 1938).

8200,<sup>24</sup> the fifth bankruptcy law<sup>25</sup> promulgated under the congressional power to create uniform laws.<sup>26</sup> The 1978 Code was enacted to modernize a bankruptcy system designed "in the horse and buggy era of consumer and commercial credit. . . ."<sup>27</sup> The new Code was desperately needed because of the vast changes that had occurred in the U.S. economy, including the new case law attributed to the adoption of the Uniform Commercial Code and the increased use of credit by Americans.<sup>28</sup> The bill had taken more than ten years to develop and was the first comprehensive change in over forty years.<sup>29</sup>

Two basic goals are common to both the 1978 Act and the previous bankruptcy laws: 1) to give the debtor a fresh start;<sup>30</sup> and 2) to allow a supervised collection and liquidation or reorganization of a debtor's property. The Code provides three ways to liquidate or reorganize the debtor's assets and liability to meet these goals: 1) Chapter 7 (liquidation);<sup>31</sup> 2) Chapter 11 (reorganization);<sup>32</sup> and 3) Chapter 13 (adjustment of debts of an individual with regular income).<sup>33</sup> Most farmers file under

24. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549, reprinted in 1978 U.S. CODE CONG. & ADMIN. NEWS 5787. The act took effect on October 1, 1979, and is also known as the "Edwards Act" because Congressman Don Edwards was the floor manager of the bankruptcy legislation in the House of Representatives. See Klee, *Legislative History of the New Bankruptcy Law*, 28 DE PAUL L. REV. 941 & n.6 (1979).

25. The first bankruptcy act was enacted in 1800, 2 Stat. 19 (1800), but only lasted three years before it was repealed. The next major piece of legislation was the Bankruptcy Act of 1841, 5 Stat. 440 (1841), which lasted until 1843 when it was repealed. The Bankruptcy Act of 1867, 14 Stat. 517 (1867), lasted the longest of the three acts, 11 years, until it too was repealed. The 1867 Act was the first to allow relief for corporations. The Bankruptcy Act of 1898, ch. 541, 30 Stat. 544 (1898), remained in effect until its repeal by the Bankruptcy Act of 1978. It was amended several times on a piecemeal basis, with the most comprehensive changes occurring with the Chandler Act in 1938, 52 Stat. 840 (1938). See Klee, *supra* note 24, at 941 n.1. See generally C. WARREN, *BANKRUPTCY IN THE UNITED STATES HISTORY* (1935) (a complete history of the bankruptcy law in the 19th century).

26. Congress is given power to establish uniform laws for bankruptcy under Article 1, § 8: "The Congress shall have power. . . to establish a Uniform Rule of Naturalization and uniform Laws on the subject of Bankruptcies throughout the United States. . . ." U.S. CONST. art. I, § 8, cl. 4.

27. H. R. REP. NO. 595, 95th Cong., 2d Sess. 3, reprinted in 1978 U.S. CODE CONG. & ADMIN. NEWS 5963, 5965.

28. Public policy on how bankruptcies should be handled was also changing. See Klein, *The Bankruptcy Reform Act of 1978*, 53 AM. BANKR. L.J. 1 (1979).

29. The Bankruptcy Act of 1978 originated in 1968 when Senator Quentin Burdick chaired hearings to determine whether a commission to review the bankruptcy laws was needed. See Klee, *supra* note 24, at 942 & n.14.

30. See *Lines v. Frederick*, 400 U.S. 18, 19 (1970). See also Donnelly, *The New (Proposed?) Bankruptcy Act: The Development of Its Structural Provisions and Their Impact on the Interests of Consumer Debtors*, 18 SANTA CLARA L. REV. 291, 317-20 (1978) (discussing the impact on public interest and the "traditional American concern for human dignity"). See also S. REP. NO. 989, 95th Cong., 2d Sess. 6, reprinted in 1978 U.S. CODE CONG. & ADMIN. NEWS 5787, 5792.

31. 11 U.S.C. § 701-66 (1982 & Supp. III 1985).

32. *Id.* §§ 1101-1174.

33. *Id.* §§ 1301-1330.

Chapter 11 because it does not require a trustee to be appointed<sup>34</sup> and because farmers cannot qualify under Chapter 13.<sup>35</sup>

The Bankruptcy Code gives farmers special protection due to the uncertain and unique nature of their business.<sup>36</sup> Thus, the threshold issue becomes fitting into the Code's definition of a farmer.<sup>37</sup> Once categorized as a farmer, three special provisions help the farmer who is filing for bankruptcy.<sup>38</sup> First, a farmer cannot be forced into bankruptcy by a creditor; the farmer determines when to file. This allows the farmer an opportunity to plan and strategize.<sup>39</sup> Second, creditors cannot force a farmer to go from a Chapter 11 reorganization to a Chapter 7 liquidation. A farmer may do so voluntarily, but cannot be forced.<sup>40</sup> Finally, certain property is exempt under both the Federal Bankruptcy Code and state statutes.<sup>41</sup>

### A. *Automatic Stay*

A fundamental protection for debtors is the automatic stay provided for in section 362<sup>42</sup> of the Bankruptcy Code. This provision has been

34. See Bland, *supra* note 4, at 813-14. The debtor will "act in the shoes of the trustee. . . ." *Id.* at 813. He has all the powers, rights, and performs all the duties and functions of a trustee. *Id.* A trustee for the farm estate will only be appointed if cause is shown. See 11 U.S.C. § 1104(a) (1982).

35. The requirements for a chapter 13 filing are as follows: "1) an individual (not a corporation or partnership) with 2) regular income and 3) unsecured debts totaling less than \$100,000 and secured debts amounting to less than \$350,000." See Bland, *supra* note 4, at 810. Most farmers do not qualify because they are leveraged to a much higher level than the Chapter 13 requirements allow. *Id.*

36. Congress noted the cyclical nature of farming and that "[o]ne drought year or one year of low prices, as a result of which a farmer is temporarily unable to pay his creditors, should not subject him to involuntary bankruptcy." H.R. REP. NO. 595, *supra* note 27, at 322, 1978 U.S. CODE CONG. & ADMIN. NEWS at 6278; see also *In re Beechwood*, 42 F. Supp. 401, 403 (N.J. 1942) ("The exceptional benefits provided for farmers under the Bankruptcy Act were designed for the protection of those who in good faith seek their livelihood from the soil.").

37. In bankruptcy law, a farmer is a person "who receives more than 80% of his gross income during a taxable year from a farming operation which he owns or operates." Bland, *supra* note 4, at 801 (citations omitted); see also *Evans v. Florida Nat'l Bank*, 38 F.2d 627 (5th Cir. 1930).

38. See Bland, *supra* note 4, at 802.

39. *Id.*

40. See *Besler v. Northwest Prod. Credit Ass'n (In re Besler)*, 19 Bankr. 879, 884 (Bankr. D. S.D. 1982) ("A farmer-debtor cannot be converted from a Chapter 11 to an involuntary Chapter 7. . . ."). See also 11 U.S.C. §§ 303(a), 112(c) (1982).

41. See Bland, *supra* note 4, at 802-03.

42. Section 362 reads in pertinent part:

(a) Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title, or an application filed under section 5(a)(3) of the Securities Investor Protection Act of 1970 (15 U.S.C. 78eee(a)(3)), operates as a stay, applicable to all entities, of—

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



part of the Code since 1933 and is one of the most useful tools for a debtor's reorganization or liquidation.<sup>43</sup> Commentators have called it the cornerstone of the Bankruptcy Code.<sup>44</sup>

The intended effect of the automatic stay is to preserve the status quo of the parties as of the date of commencement of the bankruptcy proceeding.<sup>45</sup> As such, the stay has two purposes. First, it provides the debtor with a breathing spell from creditors.<sup>46</sup> By allowing this break, it prevents creditors from taking any action against the debtor which would further disorganize a debtor's efforts to deal with its financial problems.<sup>47</sup> It helps frightened, inexperienced, or ill-counseled debtors who might succumb to creditors' attempts to make the debtors pay instead of utilizing the bankruptcy laws.<sup>48</sup> It also gives the debtor time to analyze the situation and formulate plans for either the repayment of the debts in a reorganization or the liquidation of the business.<sup>49</sup> Second, it provides a systematic and equitable process for all creditors.<sup>50</sup> The stay

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this title, or to recover a claim against the debtor that arose before the commencement of the case under this title;

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

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

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

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

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

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

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

11 U.S.C. § 362 (1982 & Supp. III 1985). For a complete discussion of automatic stays see Kennedy, *Automatic Stays Under the New Bankruptcy Law*, 1980 ANN. SURV. OF BANKR. LAW, 23 (1980).

43. See Comment, *supra* note 13, at 1117. "The first 'automatic stay' was enacted in 1933 as section 75(o) of the first relief for farmers legislation." *Id.* (footnote omitted).

44. See Sessler, *Section 362—The Automatic Stay*, 1986 ANN. SURV. OF BANKR. LAW, 373 (1986).

45. See *United States v. Sayres*, 43 Bankr. 437, 439 (W.D. N.Y. 1984); *In re H & W Enters., Inc.*, 19 Bankr. 582, 587 (Bankr. N.D. Iowa 1982).

46. See, e.g., *John Deere Co. v. Kozak Farms, Inc.* (*In re Kozak Farms, Inc.*), 47 Bankr. 399, 402 (W.D. Mo. 1985); *In re Lee*, 35 Bankr. 452, 456 (Bankr. N.D. Ga. 1983) (the stay is concerned primarily with temporary protection of the debtor).

47. See *In re Haffner*, 25 Bankr. 882, 887 (Bankr. N.D. Ind. 1982). See also *Kozak Farms*, 47 Bankr. at 402.

48. *In re Holland*, 21 Bankr. 681, 688 (Bankr. N.D. Ind. 1982); see also H.R. REP. NO. 595, *supra* note 27, at 342, 1978 U.S. CODE CONG. & ADMIN. NEWS at 6298-99.

49. *In re Frigitemp Corp.*, 8 Bankr. 284, 288-89 (S.D. N.Y. 1981).

50. See, e.g., *Holtkamp v. Littlefield* (*In re Holtkamp*), 669 F.2d 505, 508 (7th Cir. 1982) ("The purpose of the automatic stay is to preserve what remains of the debtor's insolvent estate and to

will keep one creditor from pursuing a remedy against the debtor to the disadvantage of other creditors with claims against the same debtor.<sup>51</sup> By refusing to allow a single creditor to take any portion of the debtor's estate, the Code allows the estate to stay in one piece.<sup>52</sup>

Although it is difficult to lift an automatic stay once it is put into effect,<sup>53</sup> the Code does allow relief in certain instances. Under subsection (d) of § 362<sup>54</sup> the court, on request of a party in interest, may grant relief from the stay by terminating, annulling, modifying, or conditioning an automatic stay for cause.<sup>55</sup> Typically, cause is shown in one of two ways.<sup>56</sup> The first occurs when inadequate protection of an interest in property can be established.<sup>57</sup> This aspect is one of the most often litigated areas of the Code. The second way, also with respect to property, provides a stay will be lifted if two requirements are met: 1) the debtor does not have any equity in the property; and 2) the property is not nec-

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provide a systematic equitable liquidation procedure for all creditors secured as well as unsecured."); In re White Motor Credit Corp., 37 Bankr. 631, 637 (N.D. Ohio) *affirmed*, 761 F.2d 270 (6th Cir. 1984); Central Trust Co. v. Mr. D. Realty Co. (In re Mr. D. Realty Co.), 27 Bankr. 359, 364 (Bankr. S.D. Ohio 1983) (creditors concerned over the protection of the status quo); see also H.R. REP. NO. 595, *supra* note 27, at 340, 1978 U.S. CODE CONG. & ADMIN. NEWS at 6296-97; S. REP. NO. 989, *supra* note 30, at 54-55, 1978 U.S. CODE CONG. & ADMIN. NEWS at 5840-41.

51. See Triangle Management Serv. v. Allstate Sav. & Loan Ass'n, 21 Bankr. 699, 700 (N.D. Calif. 1982).

52. Donovan v. LaPorta (In re LaPorta), 26 Bankr. 687, 690 (Bankr. N.D. Ill. 1982).

53. There are eleven exceptions that will prevent an automatic stay from going into effect: (1) criminal actions or proceedings against the debtor; (2) collection of alimony, maintenance, and support from non-estate property; (3) any act to perfect an interest in property to a limited extent; (4) governmental actions to enforce policy or regulatory powers; (5) enforcement of non-money judgments obtained in governmental, police, or regulatory proceedings; (6) set-offs involving mutual debts and claims in certain securities; (7) set-offs by a repo participant; (8) foreclosure of certain properties by the Secretary of Housing and Urban Development; (9) issuances of notices of tax deficiency; (10) acts by lessors; and (11) presentments of negotiable instruments. 11 U.S.C. § 362(b) (1982 & Supp. III 1985).

54. On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay—

(1) for cause, including the lack of adequate protection of an interest in property of such party in interest; or

(2) with respect to a stay of an act against property, under subsection (a) of this section, if—

(A) the debtor does not have an equity in such property; and

(B) such property is not necessary to an effective reorganization.

*Id.* § 362(d).

55. See H.R. REP. NO. 595, *supra* note 27, at 344, 1978 U.S. CODE CONG. & ADMIN. NEWS at 6300.

56. For other grounds under which cause can be shown, see 2 COLLIER ON BANKRUPTCY, ¶ 362.07[d][1] (15th ed. 1985) (hereinafter "COLLIER").

57. See 11 U.S.C. § 362(d)(1) (Supp. III 1985); see also 11 U.S.C. § 361 (1982 & Supp. III 1985). See generally 2 COLLIER, *supra* note 56, ¶ 362.07[d][1].

essary for an effective reorganization.<sup>58</sup>

### B. *Adequate Protection*

Section 361 of the Bankruptcy Code describes the adequate protection of a creditor's interest in a debtor's estate.<sup>59</sup> The purpose of adequate protection is to "assure the maintenance, and the recoverability of the lien value in the interim period between the filing of the petition and the acceptance of a plan of reorganization."<sup>60</sup> Since a debtor could continually use the creditor's collateral during a Chapter 11 proceeding, its value could be depreciated or consumed in its entirety.<sup>61</sup> The section was primarily designed to relieve a secured creditor's fear of losses.

The Code does not define what constitutes adequate protection or when it should be calculated. The Code also does not specify the method and timing of valuation of the collateral.<sup>62</sup> Section 361 does, however, provide a non-exclusive list<sup>63</sup> of three types of adequate protection: 1) periodic or lump sum cash payments;<sup>64</sup> 2) an additional or replacement lien;<sup>65</sup> or 3) any other type of relief which will result in a realization

58. See 11 U.S.C. § 362(d)(2)(A) & (B) (1982). See generally 2 COLLIER, *supra* note 56, ¶ 362.07[d][1].

59. When adequate protection is required under section 362, 363, or 364 of this title of an interest of an entity in property, such adequate protection may be provided by—

(1) requiring the trustee to make a cash payment or periodic cash payments to such entity, to the extent that the stay under section 362 of this title, use, sale, or lease under section 363 of this title, or any grant of a lien under section 364 of this title results in a decrease in the value of such entity's interest in such property;

(2) providing to such entity an additional or replacement lien to the extent that such stay, use, sale, lease or grant results in a decrease in the value of such entity's interest in such property; or

(3) granting such other relief, other than entitling such entity to compensation allowable under section 503(b)(1) of this title as an administrative expense, as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property.

11 U.S.C. § 361 (1982 & Supp. III 1985).

60. *Aegean Fare, Inc. v. Commonwealth (In re Aegean Fare, Inc.)*, 34 Bankr. 965, 969 (Bankr. D. Mass. 1983).

61. See, e.g., *Fruehauf Corp. v. Yale Exp. Sys., Inc. (In re Yale Exp. Sys., Inc.)*, 384 F.2d 990 (2d Cir. 1967).

62. Adequate protection was not defined in the Code due to the extensive debates that took place over the methods and timing of valuation. Each case is so unique that Congress finally just decided to let the courts make the ultimate decision. See *General Elec. Mtg. Corp. v. South Village, Inc. (In re South Village, Inc.)*, 25 Bankr. 987, 995 (Bankr. D. Utah 1982), for a complete discussion of this debate and the consequences of the decision of Congress.

63. See *In re Cooper*, 22 Bankr. 718, 720 (Bankr. E.D. Pa. 1982); *In re Aurora Cord & Cable Co., Inc.*, 2 Bankr. 342, 346-47 (Bankr. N.D. Ill. 1980).

64. 11 U.S.C. § 361(1) (Supp. III 1985). Section 361 derived the notion from *In re Bermec Corp.*, 445 F.2d 367 (2d Cir. 1971), that periodic cash payments to the creditor should be made "to the extent that the stay or the grant of a lien results in a depreciation of the value of the collateral." Klein, *supra* note 28, at 20. See also *In re Kertennis*, 40 Bankr. 895 (Bankr. D. R.I. 1984).

65. 11 U.S.C. § 361(2) (1982). See, e.g., *In re Serbus*, 48 Bankr. 5 (Bankr. D. Minn. 1984) (lien

of an "indubitable equivalent" of the creditor's interest.<sup>66</sup> Because each bankruptcy case is unique and equitable factors must be considered,<sup>67</sup> Congress left this determination to the courts. Also, by not defining adequate protection, the debtor is allowed greater flexibility in determining a method of protection.<sup>68</sup> A secured party seeking payments cannot call upon the courts to devise a scheme to provide adequate protection.<sup>69</sup> Because Congress did not intend to put the courts in an administrative role, the device to supply adequate protection must be proposed by the debtor or the trustee.<sup>70</sup>

The courts are split between three different methods to determine what constitutes adequate protection and which interests are to be protected.<sup>71</sup> The first theory, the opportunity cost theory, considers the consequences of the automatic stay. By delaying the creditor's opportunity to repossess the collateral, sell it, and reinvest the proceeds from the sale, the creditor loses the interest the money would have generated if it had been available for reinvestment.<sup>72</sup> Under this theory, adequate protection should be allowed for the foregone opportunity to make additional money.

The second theory, the maintenance of value theory, is the majority view.<sup>73</sup> Under that approach, adequate protection is found only if the

on future crops is not acceptable); *In re Berg*, 42 Bankr. 335 (Bankr. D. N.D. 1984) (a first lien on crops); *In re Magnus*, 50 Bankr. 241 (Bankr. D. N.D. 1985) (a lien on depreciable equipment).

66. 11 U.S.C. § 361(3) (1982). See *In re Martin*, 761 F.2d 472, 477-78 (8th Cir. 1985).

67. See, e.g., *Alibon Prod. Credit Ass'n v. Langley (In re Langley)*, 30 Bankr. 595, 605 (Bankr. N.D. Ind. 1983); *Cooper*, 22 Bankr. at 720; see also H.R. REP. NO. 595, *supra* note 27, at 339, 1978 U.S. CODE CONG. & ADMIN. NEWS at 6295:

This section does not specify how value is to be determined nor does it specify when it is to be determined. These matters are left to case-by-case interpretation and development. It is expected that the courts will apply the concept in light of the facts of each case and general equitable principles.

*Id.*

68. See Comment, *Adequate Protection of the Undersecured Creditor During the Automatic Stay in Chapter 11 Cases: Compensation for Opportunity Cost or Maintenance of the Value of the Collateral?*, 5 J. OF L. & COM. 259, 259-60 (1985).

69. See *American Security Bank v. Robson (In re Robson)*, 10 Bankr. 362, 365 (Bankr. N.D. Ala. 1981); *In re Saint Peter's School*, 16 Bankr. 404, 410 (Bankr. S.D. N.Y. 1982).

70. See H.R. REP. NO. 595, *supra* note 27, at 338, 1978 U.S. CODE CONG. & ADMIN. NEWS at 6295.

71. See Comment, *Adequate Protection of Time Value for Undersecured Creditors During the Automatic Stay in Bankruptcy: Where are We After American Mariner?*, 2 BANKR. DEV. J. 341, 344 (1985).

72. *Midlantic Nat'l Bank v. Anchorage Boat Sales, Inc. (In re Anchorage Boat Sales, Inc.)*, 4 Bankr. 635, 643 (Bankr. E.D. N.Y. 1980).

73. See, e.g., *Imperial Bank v. El Patio, Ltd. (In re El Patio)*, 6 Bankr. 518, 523 (Bankr. C.D. Cal. 1980); *Fort Worth Mtg. Corp. v. Cantrup (In re Cantrup)*, 32 Bankr. 1004, 1005 (Bankr. D. Colo. 1983); *Aegean Fare, Inc. v. Commonwealth (In re Aegean Fare, Inc.)*, 34 Bankr. 965, 968 (Bankr. D. Mass. 1983); *Barclays Bank v. Saypol (In re Saypol)*, 31 Bankr. 796, 800 (Bankr. S.D.

value of the collateral is maintained. If the collateral is depreciating or is being consumed, then adequate protection should be provided by the debtor.<sup>74</sup>

The third theory has only been used by the Eighth Circuit.<sup>75</sup> This method allows the bankruptcy courts to decide between the two theories described above on a case-by-case basis. This approach adopts a more equitable analysis which acknowledges that each case has unique factors that must be carefully considered.<sup>76</sup>

### 1. Opportunity Cost Theory

*In re American Mariner Industries, Inc.*<sup>77</sup> presented the latest and most comprehensive discussion of the argument for the opportunity cost theory. The court analyzed at length why an unsecured creditor should be given compensation when his right to regain the secured collateral has been delayed.

Two main arguments were set forth in *American Mariner*.<sup>78</sup> The first considered the statutory language of § 361 and the legislative history behind it.<sup>79</sup> In reading that section of the Act, the court focused on the language "*an interest of an entity in property. . . to the extent that the stay. . . results in a decrease in the value of such entity's interest in such property.*"<sup>80</sup> Finding, as other courts have, that this language is ambigu-

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N.Y. 1983); *First Fed. Sav. & Loan Ass'n v. Shriver* (In re Shriver), 33 Bankr. 176, 182-83 (Bankr. N.D. Ohio 1983); *General Elec. Mtg. Corp. v. South Village, Inc.* (In re South Village, Inc.), 25 Bankr. 987, 994 (Bankr. D. Utah 1982); *In re Pine Lake Village Apt. Co.*, 19 Bankr. 819, 825 (Bankr. S.D. N.Y. 1982); *Bankers Life Ins. Co. v. Alyucan Interstate Corp.* (In re Alyucan Interstate Corp.), 12 Bankr. 803 (Bankr. D. Utah 1981).

74. See, e.g., *Alibon Prod. Credit Ass'n v. Langley* (In re Langley), 30 Bankr. 595, 604 (Bankr. N.D. Ind. 1983); *Metropolitan Life Ins. Co. v. Monroe Park* (In re Monroe Park), 17 Bankr. 934 (D. Del. 1982); *United Virginia Bank v. Virginia Foundry Co.* (In re Virginia Foundry Co.), 9 Bankr. 493 (W.D. Va. 1981); see generally O'Toole, *Adequate Protection and Postpetition Interest in Chapter 11 Proceedings*, 56 AM. BANKR. L.J. 251 (1982) (giving a historical perspective of post-petition interest).

75. See *In re Briggs Transp. Co.*, 780 F.2d 1339 (8th Cir. 1985). This is the main case that has advocated this position.

76. *Id.* at 1349.

77. *Crocker Nat'l Bank v. American Mariner Indus., Inc.* (In re American Mariner Indus., Inc.), 734 F.2d 426 (9th Cir. 1984). In 1978, Crocker National Bank made a loan to American Mariner Industries which was secured by a perfected interest in basically all of its assets. American Mariner filed for reorganization at which time Crocker was owed approximately \$370,000, with collateral securing the loan worth only \$110,000. *Id.* at 427.

78. *Id.* at 429-34.

79. See 11 U.S.C. § 361(1)(2) (1982 & Supp. III 1985); see also, Fortgang & Mayer, *Valuation in Bankruptcy*, 32 U.C.L.A. L. REV. 1061, 1070-72 (1985).

80. *American Mariner*, 734 F.2d at 430 (emphasis added). The court started its analysis by recognizing that the language of a statute controls and then applied the plain meaning rule to the statute. It further looked at the legislative history for persuasive language to support its conclusion.

ous, the court then looked at the legislative history to determine the intent of Congress.<sup>81</sup> Since the House Report stated that the creditor should be allowed the "benefit of his bargain" and receive "*in value* essentially what he bargained for,"<sup>82</sup> the court concluded the term "value" meant that the creditor should receive the present value of his investment at the point he could have otherwise repossessed the collateral absent the automatic stay.<sup>83</sup> Value is to be measured in the contractual sense and not as a tangible asset.<sup>84</sup> A creditor making a loan assumes that if the debtor defaults on the loan, the collateral will be returned and the creditor's losses reduced by disposing the collateral. If the law did not permit a creditor to get the collateral back, the creditor then loses the opportunity to dispose of the collateral, reinvest the money, and make a profit. Allowing the creditor to receive adequate protection, (i.e. interest for the time value of the money lost because of the automatic stay) means the creditor receives the value of the transaction as initially bargained.<sup>85</sup>

The second argument set forth by *American Mariner* was based upon the historical and present nature of adequate protection and on the phrase "indubitable equivalent" found in § 361(3).<sup>86</sup> Judge Hand's opin-

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*Id.* at 430-32. For an analysis of the plain meaning rule see *Watt v. Alaska*, 451 U.S. 259, 265-66 (1981).

81. See *American Mariner*, 734 F.2d at 430-32.

82. The House report states:

*Secured creditors should not be deprived of the benefit of their bargain.* There may be situations in bankruptcy where giving a secured creditor an absolute right to his bargain may be impossible or seriously detrimental to the bankruptcy laws. Thus, this section recognizes the availability of alternate means of protecting a secured creditor's interest. Though the creditor might not receive his bargain in kind, the purpose of the section is to insure that the secured creditor receives in value essentially what he bargained for.

H.R. REP. NO. 595, *supra* note 27, at 339 (emphasis added), 1978 U.S. CODE CONG. & ADMIN. NEWS at 6295; see also S. REP. NO. 989, *supra* note 30, at 49, 1978 U.S. CODE CONG. & ADMIN. NEWS at 5835. Courts have continually looked at this language and have interpreted either for or against the opportunity cost theory. See *In re Pine Lake Village Apt. Co.*, 19 Bankr. 819, 827 (Bankr. S.D. N.Y. 1982) for Judge Schwartzberg's opinion of this section:

A mortgage transaction is a voluntary undertaking; the lender participates with the understanding that the mortgage contract creates a relationship that extends over a number of years. . . . Adequate protection relates to preservation of the collateral value, and not to compensation for the loss of a better business opportunity. As long as the collateral value is constant, the mortgagee will receive the benefit of his bargain.

*Id.*

83. The court found that "[v]alue is another term intended to have broad scope in the context of providing adequate protection to secured creditors." *American Mariner*, 734 F.2d at 431.

84. *Id.* at 430-31. See *General Elec. Mfg. Corp. v. South Village, Inc.* (In re South Village, Inc.), 25 Bankr. 987, 992 (Bankr. D. Utah 1982).

85. See *Metropolitan Life Ins. Co. v. Monroe Park* (In re Monroe Park), 17 Bankr. 934, 940-41 (D. Del. 1982) (by not allowing the foreclosure on the property, the lender was losing interest of approximately \$36,000 per month). See also *United Virginia Bank v. Virginia Foundry Co.* (In re Virginia Foundry Co.), 9 Bankr. 493, 497-98 (W.D. Va. 1981).

86. *American Mariner*, 734 F.2d at 432-34.

ion in *In re Murel Holding Corp.*,<sup>87</sup> is considered the origin of adequate protection. It looked at two aspects of adequate protection: 1) the amount given as adequate protection must be completely compensatory; and 2) the principal amount of the loan must be paid in full.<sup>88</sup> The *American Mariner* court interpreted the "indubitable equivalent" language to mean that both interest and collateral must be paid. This analysis originated in the legislative history of the "cram-down" provision, a section which also contains the same phrase.<sup>89</sup> Since the record stated that the "indubitable equivalent" language was intended to follow the strict approach taken by Judge Learned Hand in *In re Murel Holding Corp.*,<sup>90</sup> the court concluded that Congress knew what it meant when it included the phrase "indubitable equivalent" in § 361: creditors should be paid interest if a delay occurs because of bankruptcy proceedings.<sup>91</sup>

## 2. Maintenance of Value Theory

The arguments for the maintenance of value theory are largely based on alternate interpretations of key aspects of the opportunity cost theory. The leading case is *In re South Village, Inc.*,<sup>92</sup> in which Judge Mabey

87. 75 F.2d 941 (2d Cir. 1935). In this case, Metropolitan Life Insurance Company held an apartment house mortgage on which the debtors defaulted. Foreclosure was stopped by a bankruptcy filing while a reorganization plan was worked out. The plan called for an extension of time for payments to be made along with other conditions. Judge Hand held that the creditor was not adequately protected and that the extension should not be granted. *Id.* at 942-43.

88. In construing so vague a grant, we are to remember not only the underlying purposes of the section, but the constitutional limitations to which it must conform. It is plain that "adequate protection" must be completely compensatory; and that payment ten years hence is not generally the equivalent of payment now. Interest is indeed the common measure of the difference, but a creditor who fears the safety of his principal will scarcely be content with that; he wishes to get his money or at least the property. We see no reason to suppose that the statute was intended to deprive him of that in the interest of junior holders, unless by a substitute of the most *indubitable equivalence*.

*Murel*, 75 F.2d at 942 (emphasis added).

89. See *supra* note 14 for the complete text of § 1129(b)(2)(A)(iii). *American Mariner* found that:

In its final form, however, 11 U.S.C. § 1129(b)(2)(A)(i)(II) clearly requires deferred cash payments under a reorganization plan to equal the present value of the allowed claim. The "indubitable equivalent" requirement appears in section 1129(b)(2)(A)(iii) as an alternative to deferred payments and carries with it, from its original context in *Murel*, the requirement of compensation for present value.

*American Mariner*, 734 F.2d at 433. The legislative record indicates that the cram-down provision is based upon a present value analysis. See H.R. REP. NO. 595, *supra* note 27, at 414-15, 1978 U.S. CODE CONG. & ADMIN. NEWS at 6370-71.

90. See S. REP. NO. 989, *supra* note 30, at 127, 1978 U.S. CODE CONG. & ADMIN. NEWS at 5913.

91. *American Mariner*, 734 F.2d at 435.

92. 25 Bankr. 987 (Bankr. D. Utah 1982). South Village, Inc. is the owner of a shopping mall on which General Electric Mortgage Corporation (GEMC) has a lien. After a filing for bankruptcy occurred, GEMC tried to get the stay lifted because it was an undersecured creditor. The debt was \$4,369,000 and the value of the mall was \$4,340,000. GEMC asked that it be paid for the present

discussed the definition of "value" and "interest in property."<sup>93</sup> The proponents of this theory consider value as a tangible asset and not as a cash equivalent,<sup>94</sup> and have found support for their approach in the legislative history. When revising the Code, the Bankruptcy Commission described adequate protection as protection from "a decrease in the value of the asset not as a monetary unit."<sup>95</sup> The House Report cited numerous examples such as: "the decrease in value of the . . . property involved,"<sup>96</sup> and "a means of realizing the value of the original property, if it should decline during the case."<sup>97</sup> Because of these statements, the *South Village* court concluded that "value" and "interest in property" meant only a decrease in existing collateral.<sup>98</sup>

The legislative history of § 361 also gives substantial support to the "maintenance of value theory." First, the concept of adequate protection is a codification of the rule from *In re Bermec*,<sup>99</sup> a case of "economic depreciation" and protection of the status quo, not of opportunity costs.<sup>100</sup> Second, when discussing subsection (1) of § 361, the Senate and House Reports state that "the use of periodic payments may be appropriate where, for example, the property in question is *depreciating at a relatively fixed rate*. The periodic payments would be to *compensate for the depreciation*. . . ."<sup>101</sup> The legislative history also shows that during the

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value of money that it was losing by not being able to sell the mall and reinvest the proceeds. The court held against this request, reasoning that only the maintenance of the value of the property should be allowed. *Id.* at 988-96. Another case that is heavily relied upon is *Bankers Life Ins. Co. v. Alyucan Interstate Corp.* (In re Alyucan Interstate Corp.), 12 Bankr. 803 (Bankr. D. Utah 1981), which was also written by Judge Mabey.

93. Judge Mabey recognized that the interpretation of these phrases is the key to determining the protection required.

If the interest in property is determined according to the worth of tangible assets, such as the "allowed secured claim," then the decrease in value may be any depreciation of this claim. But if the interest in property embraces not only tangible assets but also intangible rights, such as the right to foreclose, liquidate, and reinvest, then the decrease in value may include opportunity cost.

*General Elec. Mfg. Corp. v. South Village, Inc.* (In re South Village, Inc.), 25 Bankr. 987, 989 (Bankr. D. Utah 1982) (footnote omitted).

94. *See id.* at 992.

95. "The Commission proposal described 'adequate protection,' not as protection of the value of money, but as protection 'to the extent of the anticipated decrease in the value of the collateral as a result of use.'" *South Village*, 25 Bankr. at 992 (quoting Report of the Commission on the Bankruptcy Laws of the United States, H. DOC. NO. 93-137, pt. II, at 237 (1973)).

96. H.R. REP. NO. 595, *supra* note 30, at 339, 1978 U.S. CODE CONG. & ADMIN. NEWS at 6296.

97. *Id.* at 339-40, 1978 U.S. CODE CONG. & ADMIN. NEWS at 6296.

98. *South Village*, 25 Bankr. at 994-95.

99. 445 F.2d 367 (2d Cir. 1971).

100. *See Comment, supra* note 71, at 349-50.

101. H.R. REP. NO. 595, *supra* note 27, at 339, 1978 U.S. CODE CONG. & ADMIN. NEWS at 6296; S. REP. NO. 989, *supra* note 30, at 54, 1978 U.S. CODE CONG. & ADMIN. NEWS at 5840



hearings on the Code, Congress was aware of the opportunity cost theory but did not act to make any changes to § 361 to protect undersecured creditors<sup>102</sup> in a way that was consistent with that approach.

A recent Fifth Circuit case, *In re Timbers of Inwood Forest Associates, Ltd.*,<sup>103</sup> also held that interest should not be allowed on debts accruing during a bankruptcy proceeding. The court did an in-depth analysis of both the legislative and case law history of § 361 and § 362,<sup>104</sup> then refuted *American Mariner's* reasoning by looking at many of the same factors that the court did in *South Village*. One problem recognized by the court was that of determining how and when interest should be charged on the debts of the debtor.<sup>105</sup> The court reasoned that because the Code provides no guidance, determining when interest would begin and what interest rate should be applied becomes very subjective and therefore should not be allowed. There was also concern that if interest payments were allowed, an adverse impact on the orderly distribution of the debtor's assets would result.<sup>106</sup> Payment of interest would also result in the premature distribution of unencumbered assets of the estate to the undersecured creditors. This would unfairly take assets away from possible distributions to the unsecured creditors.<sup>107</sup>

### 3. Eighth Circuit Approach

The Eighth Circuit has taken a position that is a compilation of the opportunity cost theory and the maintenance of value theory. In the case of *In re Briggs Transportation Co.*,<sup>108</sup> the Eighth Circuit held that the Bankruptcy Code does not give an undersecured creditor, as a matter of law, the right to interest payments from the debtor because of the lost opportunity costs that have accrued due to a bankruptcy filing.<sup>109</sup> The

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(emphasis added). The key is to determine the meaning of depreciation. The Supreme Court defined it in *Lindheimer v. Illinois Bell Tel. Co.*, 292 U.S. 151, 167 (1934) as "loss [of value], not restored by current maintenance, which is due to all the factors causing the ultimate retirement of property. These factors embrace wear and tear, delay, inadequacy, and obsolescence." *Id.*, quoted in Comment, *supra* note 68, at 268.

102. See *South Village*, 25 Bankr. at 1000.

103. *United Sav. Ass'n v. Timbers of Inwood Forest Assocs. (In re Timbers of Inwood Forest Assocs.)*, 793 F.2d 1380 (5th Cir. 1986).

104. *Id.* at 1393-1401.

105. *Id.* at 1402-03.

106. *Id.* at 1382.

107. *Id.*

108. 780 F.2d 1339 (8th Cir. 1985). See also Anderson, *Adequate Protection of Opportunity Cost After In re Briggs*, 19 CREIGHTON L. REV. 765 (1986).

109. *Briggs*, 780 F.2d at 1340. The trial court mandated that undersecured creditors were entitled to interest payments as a matter of law. The court based its decision on *American Mariner* which had been decided shortly after the bankruptcy court had given its decision. *Id.* at 1341.

court stated that the opportunity cost theory should be utilized on a case-by-case basis, thus allowing greater flexibility in determining whether to allow interest payments for lost opportunity costs.<sup>110</sup>

The court gave no specific rules as to how each case should be analyzed, but instead gave a list of non-exclusive factors that should be considered as guidelines when determining the applicability of granting opportunity costs. Those factors include "the nature of the collateral and the proposed use of the collateral in the interim,"<sup>111</sup> "the quality of the collateral or the length of the stay," "whether the collateral's lien value is demonstrated to be appreciating, depreciating or remaining relatively stable," "whether taxes or other payments designed to keep the collateral free of statutory liens are being paid,"<sup>112</sup> and whether the chances of a successful reorganization are great or slight.<sup>113</sup> By using this set of factors and any others that may be relevant, the courts are able to reconstruct the bargain between the creditor and debtor and thus equitably determine what interests must be protected during the automatic stay.<sup>114</sup>

While it is admirable that the court attempted to fashion an equitable solution to this problem, the result is that courts facing these situations have little or no guidance on how to decide these cases.<sup>115</sup> Given the uncertainty of this approach, both debtors and creditors are hard pressed to predict what will occur in situations involving undersecured collateral.<sup>116</sup>

### C. Reorganization Plan

When Congress revised the Bankruptcy Code in 1978, the former Chapters 10, 11, and 12 were consolidated into a single unit, Chapter 11,<sup>117</sup> which was designed to govern all business reorganizations. The

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110. Flexibility was legislated into the Bankruptcy Code by the very fact that the term "adequate protection" resists precise definition. This reflects congressional recognition that myriad factors are taken into account by the parties in entering into a security agreement and a wide spectrum of circumstances may exist at the time a debtor files a petition.

*Id.* at 1348-49 (footnote omitted).

111. *Id.* at 1349.

112. *Id.*

113. *Id.*

114. See Anderson, *supra* note 109, at 774.

115. See Briggs, 780 F.2d at 1351. This is the position that Judge Gibson took in his dissent. Judge Gibson felt this could allow the bankruptcy courts too much latitude in determining whether or not to allow lost opportunity cost payments. *Id.*

116. *Id.* at 1352.

117. One of the most significant characteristics of the revamped Chapter 11 is its speed and flexibility. This can be seen in the increased number of cases that were being filed under old Chapter

reason for the change was two-fold: to eliminate a primary source of litigation in large reorganization cases,<sup>118</sup> and to clarify which chapter governs the reorganization of public or private corporations.<sup>119</sup>

One basic assumption of the Code is that it is preferable to reorganize a business rather than allow it to be liquidated.<sup>120</sup> Both creditors and debtors attempt to structure a plan that is fair to all parties involved. Once a debtor has structured a plan (with or without the creditor's approval), it is confirmed in one of two ways: 1) the acceptance method, in which the twelve requirements enumerated in the Code are met and the creditors confirm the plan;<sup>121</sup> or 2) the cram-down method,<sup>122</sup> used when a creditor or a group of creditors refuse to confirm a plan and, under § 1129(b), the plan is confirmed over the creditor's objection, thus allowing the business to continue. The plan must be fair and equitable<sup>123</sup>

11 and Chapter 12. See B. WEINTRAUB & A. RESNICK, *BANKRUPTCY LAW MANUAL*, § 8.03, 8-8 (1980) [hereinafter "MANUAL"]. Also, by consolidating these chapters, the bankruptcy courts were given greater leeway in dealing with troubled businesses. *Id.* The bankruptcy commission took the best provisions of these chapters and consolidated them into Chapter 11. Chapter 11:

integrate[d] aspects of both "the best interests of creditors" rule of Chapter XI and the "absolute priority rule" of Chapter X. When every member of a class of creditors or equity holders does not agree to a plan, the plan must be in the "best interests" of [that class]. . . . If a class of creditors or interest holders does not accept the plan by a vote of a minimum percentage of its members, the plan may still be imposed or "crammed down" on that class as long as the absolute priority requirement is met as to the nonassenting class.

*Id.* at ¶ 8.03, 8-8 - 8-9 (footnotes omitted).

118. See 5 COLLIER, *supra* note 56, ¶ 1100.01[2].

119. See *id.* ¶ 1100.01, n.22; see also MANUAL, *supra* note 117, ¶ 8.05.

120. [I]t is often preferable to encourage and facilitate rehabilitation of businesses in financial trouble instead of providing for liquidation only. From a broad perspective, rehabilitation is better for the economy because it minimizes unemployment and waste of business assets. It is much more productive to use assets in the industry for which they were designed instead of selling them as distressed merchandise at liquidation sales. Also, rehabilitating a business is in the best long-term interest of creditors and shareholders.

MANUAL, *supra* note 117, ¶ 8.01 (footnote omitted). See also *Charlestown Sav. Bank v. Martin* (In re Colonial Realty Investment Co.), 516 F.2d 154, 158 (1st Cir. 1975); *Bass v. Dick* (In re Dick), 296 F.2d 912, 914 (7th Cir. 1961); see generally, Blair, *Classification of Unsecured Claims in Chapter 11 Reorganization*, 58 AM. BANKR. L.J. 197 (1984).

121. The first eleven requirements are set forth in § 1129(a) and the twelfth is found in § 1129(d). Subsection (d) states in part:

Notwithstanding any other provision of this section, on request of a party in interest that is a governmental unit, the court may not confirm a plan if the principal purpose of the plan is the avoidance of taxes or the avoidance of the application of section 5 of the Securities Act of 1933 (15 U.S.C. 77e).

11 U.S.C. § 1129 (d) (Supp. III 1985).

122. See *supra* note 14 for the complete text of Bankruptcy Code § 1129 which governs this area. See also Klee, *supra* note 14, at 134.

123. The Code is fairly explicit in specifying whether a plan is fair and equitable with respect to a dissenting class. The statute states that the requirement that a plan is fair and equitable "includes" several factors. However, the legislative history makes clear that some factors which are "fundamental" to fair and equitable treatment of a dissenting class were omitted from the statute to "avoid complexity." For example, a requirement contained in an earlier version of the Code would have assured a dissenting class that no senior

and cannot discriminate unfairly<sup>124</sup> against each class of claims that has not accepted the plan. Only claims of the dissenting class and the classes junior to the dissenting classes are affected.

Subdivision (b)(2) of § 1129 divides the dissenting class of creditors into three categories: secured claim holders,<sup>125</sup> unsecured claim hold-

class receives more than 100% of its claims, i.e., that it is not provided for more than in full. While the deletion of this standard may be beneficial to understanding the statutory language, it is not clear that the result "avoids complexity."

Klee, *supra* note 14, at 142 (footnotes omitted); see also Blum, *The "Fair and Equitable" Standard for Confirming Reorganizations Under the New Bankruptcy Code*, 54 AM. BANKR. L.J. 165 (1980).

124. The meaning of "unfair discrimination" is unclear in the Code. However, the Report of the House Judiciary Committee discussed unfair discrimination:

The plan may be confirmed under clause (iv) [§ 1129(b)(2)(B)(iv)] in those circumstances if the class is not unfairly discriminated against with respect to equal classes and if junior classes will receive nothing under the plan. . . . One aspect of this test that is not obvious is that whether one class is senior, equal, or junior to another class is relative and not absolute. Thus from the perspective of trade creditors holding unsecured claims, claims of senior and subordinated debentures may be entitled to share on an equal basis with the trade claims. However, from the perspective of the senior unsecured debt, the subordinated debentures are junior.

This point illustrates the lack of precision in the first criterion which demands that a class not be unfairly discriminated against with respect to equal classes. From the perspective of unsecured trade claims, there is no unfair discrimination as long as the total consideration given all other classes of equal rank does not exceed the amount that would result from an exact aliquot distribution. Thus if trade creditors, senior debt, and subordinate debt are each owed \$100 and the plan proposes to pay the trade debt \$15, the senior debt \$30, and the junior debt \$0, the plan would not unfairly discriminate against the trade debt nor would any other allocation of consideration under the plan between the senior and junior debt be unfair as to the trade debt as long as the aggregate consideration is less than \$30. The senior debt could take \$25 and give up \$5 to the junior debt and the trade debt would have no cause to complain because as far as it is concerned the junior debt is an equal class.

However, in this latter case the senior debt would have been unfairly discriminated against because the trade debt was being unfairly overcompensated. . . . Application of the test from the perspective of senior debt is best illustrated by the plan that proposes to pay trade debt \$15, senior debt \$25, and junior debt \$0. Here the senior debt is being unfairly discriminated against with respect to the equal trade debt even though the trade debt receives less than the senior debt. The discrimination arises from the fact that the senior debt is entitled to the rights of the junior debt which in this example entitle the senior debt to share on a 2:1 basis with the trade debt.

. . . .

The criterion of unfair discrimination is not derived from the fair and equitable rule or from the best interests of creditors test. Rather it preserves just treatment of a dissenting class from the class's own perspective.

H.R. REP. NO. 595, *supra* note 27, at 416-17, 1978 U.S. CODE CONG. & AD. NEWS at 6372-73, quoted in Blair, *supra* note 120, at 206-07. The article also points out that an objective standard will be used to interpret the "unfair discrimination" test.

An interpretation of unfair discrimination as described in the preceding discussion provides an objective standard of protection for dissenting classes of unsecured creditors and equity holders. Without an objective standard, the courts would be required to provide a subjective one, presumably under the good faith requirement, to assure fair treatment of dissenting classes where other equally-ranked classes accept the plan. The considerable detail of section 1129 suggests that Congress intended the confirmation requirements to rely principally on objective standards.

*Id.* at 210 (footnotes omitted).

125. 11 U.S.C. § 1129(b)(2)(A) (1982 & Supp. III 1985).

ers,<sup>126</sup> and holders of an ownership interest.<sup>127</sup> Under each of the three categories, the statute lists what is considered "fair and equitable;" it does not define unfair discrimination.<sup>128</sup> If the debtor requests that the court confirm the plan over the creditor's objections, the court is required to do so if the interests of the dissenting creditors are protected according to the statutory requirement set out for each category.<sup>129</sup>

Section 1129(b)(2)(B) requires the debtor to meet one of two requirements of the "fair and equitable" standard.<sup>130</sup> The claim must provide each holder of a claim to receive or retain property that has a present value equal to the amount of the unsecured claim.<sup>131</sup> In the alternative, a junior claim will not receive or retain any interest in the debtor's property, although the unsecured claims must be accounted for in full before any junior interest can be considered.<sup>132</sup> This section is quite different from secured claims because it does not require the claim to be paid in cash, but rather in property or other items of value equal to its claim.

Classifying a creditor as possessing either an unsecured claim, a secured claim, or an ownership interest is an application of a slightly modified version of the absolute priority rule.<sup>133</sup> In *Northern Pacific Railway*

126. *Id.* § 1129(b)(2)(B).

127. *Id.* § 1129(b)(2)(C).

128. *See* Klee, *supra* note 14, at 141.

129. *See Id.* at 142.

130. *See* 5 COLLIER, *supra* note 56, ¶ 1129.03[4][a].

131. *See* Fortgang & Mayer, *supra* note 79, at 1063. This article gives a good discussion of this requirement and the present value concept.

132. *See* 5 COLLIER, *supra* note 56, ¶ 1129.03[1]. "[A] senior class will not be able to give up value to a junior class over the dissent of an intervening class unless the intervening class receives the full amount, as opposed to value, of its claims or interests." *Id.*

Alternatively, under clause (ii), the court must confirm the plan if the plan provides that holders of any claims or interests junior to the interests of the dissenting class of impaired unsecured claims will not receive any property under the plan on account of such junior claims or interests. As long as senior creditors have not been paid more than in full, and classes of equal claims are being treated so that the dissenting class of impaired unsecured claims is not being discriminated against unfairly, the plan may be confirmed if the impaired class of unsecured claims receives less than 100 cents on the dollar (or nothing at all) as long as no class junior to the dissenting class receives anything at all. Such an impaired dissenting class may not prevent confirmation of a plan by objection merely because a senior class has elected to give up value to a junior class that is higher in priority than the impaired dissenting class of unsecured claims as long as the above safeguards are met.

*Id.* ¶ 1129.03[4][e], quoting 124 Cong. Rec. H.11,105 (daily ed. Sept. 28, 1978); S17,421 (daily ed. Oct. 6, 1978).

133. *See* *In re Ahlers*, 794 F.2d 388, 401 (8th Cir. 1986). The difference is that the relaxed standard permits senior classes to give value to junior classes so long as no dissenting intervening class receives less than the full amount of its claims. Klee, *supra* note 14, at 143, n.80. For a complete history of how the absolute priority rule developed through equity receivership see 6 COLLIER ON BANKRUPTCY at 28-33 (14th ed. 1940).

*Co. v. Boyd*,<sup>134</sup> the Court first said that if a class of creditors dissent, their claims must be provided for in full before a junior class can receive an equity interest or retain or receive any property.<sup>135</sup> The Supreme Court later amended the absolute priority rule to allow a junior class to participate in a plan and receive an equity interest even if the unsecured creditors were not paid in full, provided that the junior class "contributed money or money's worth."<sup>136</sup> In *Case v. Los Angeles Lumber Products Co.*,<sup>137</sup> the court allowed the shareholders of a corporation to contribute money to the business organization and receive an interest in proportion to their contribution.<sup>138</sup> In order for a plan to be successful, it requires additional money that may only be available if the debtor is allowed to contribute additional capital.<sup>139</sup> The Supreme Court explained that cap-

134. 228 U.S. 482 (1913). This is one of the most famous cases in corporate reorganization law. The case involved financing on a thirty-three mile section of track. Boyd was an unsecured creditor of a discontinued company. The plan of the reorganization provided that the old shareholders would participate if they infused some cash into the new company. It made no provisions for any of the unsecured creditors. There had been a transfer of assets from the old company to the new company and the creditors of the old corporation couldn't reach the new assets. *Id.* at 487. The Supreme Court held that this was a fraudulent conveyance and it allowed Boyd to pursue remedies against the assets of the new company. *Id.* 507-10. See generally 3 NORTON, BANKRUPTCY LAW & PRACTICE § 63.21 (Callaghan). The principle set out in *Boyd* was not new. It was startling only because for a number of years it had been ignored. *Id.* at 502.

135. For a complete analysis and historical perspective on the rule, see generally Blum & Kaplan, *The Absolute Priority Doctrine in Corporate Reorganizations*, 41 U. CHI. L. REV. 651 (1974).

136. See *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106, 122, *reh'g denied*, 308 U.S. 637 (1939).

137. *Id.* Other cases have developed this concept. See *Consolidated Rock Prods. Co. v. Du Bois*, 312 U.S. 510 (1941); *Group of Inst'l Investors v. Chicago Milwaukee St. P. & Pac. R.R.* 318 U.S. 523 (1943). See generally Blum, *Full Priority and Full Compensation in Corporate Reorganizations: A Reappraisal*, 25 U. CHI. L. REV. 417 (1958).

138. The *Los Angeles Lumber* case stated that:

[T]his Court stress[es] the necessity, at times, of seeking new money "essential to the success of the undertaking" from the old stockholders. Where that necessity exists and the old stockholders make a fresh contribution and receive in return a participation reasonably equivalent to their contribution, no objection can be made.

*Los Angeles Lumber*, 308 U.S. at 121 (footnote omitted).

139. See *id.* at 121, citing *Kansas City Terminal Ry. Co. v. Central Union Trust Co.*, 271 U.S. 445 (1926) which stated that:

Generally, additional funds will be essential to the success of the undertaking, and it may be impossible to obtain them unless stockholders are permitted to contribute and retain an interest sufficiently valuable to move them. In such or similar cases the chancellor may exercise an informed discretion concerning the practical adjustment of the several rights.

*Id.* *Los Angeles Lumber* also stated:

It is, of course, clear that there are circumstances under which stockholders may participate in a plan of reorganization of an insolvent debtor. This Court, as we have seen, indicated as much in *Northern Pacific Ry. Co. v. Boyd*, *supra*, and *Kansas City Terminal Ry. Co. v. Central Union Trust Co.*, *supra*. Especially in the latter case did this Court stress the necessity, at times, of seeking new money "essential to the success of the undertaking" from the old stockholders. Where that necessity exists and the old stockholders make a fresh contribution and receive in return a participation reasonably equivalent to their contribution, no objection can be made.

*Los Angeles Lumber*, 308 U.S. at 121.

ital contributions by the debtor are appropriate since there is usually a shortage of money in a reorganization. Since *Los Angeles Lumber* was decided, other courts have only allowed equity interest when the debtor's contribution has been in the form of money.<sup>140</sup>

### III. AHLERS DECISION

#### A. Factual Background

James and Mary Ahlers own 560 acres of the approximately 840 acres of land they farm near Worthington, Minnesota.<sup>141</sup> Two major creditors hold most of the debt on the Ahlers farm.<sup>142</sup> Federal Land Bank (FLB) has the largest claim against the Ahlers with approximately \$524,000 outstanding secured by first mortgages on four parcels of land.<sup>143</sup> Norwest Bank of Worthington (Norwest) has outstanding loans of approximately \$450,000 secured by a second mortgage on the farmland, second liens on crops, livestock, other farm proceeds, and a first lien on machinery.<sup>144</sup>

The Ahlers' financial condition declined significantly in the early 1980's<sup>145</sup> due to many of the same forces that plagued all family farmers. The value of both their land and machinery declined significantly<sup>146</sup> from

140. See, e.g., *In re U.S. Truck Co., Inc.*, 47 Bankr. 932, 941-43 (E.D. Mich. 1985); *In re Landau Boat Co.*, 13 Bankr. 788, 791-93 (Bankr. W.D. Mo. 1981); *Buffalo Sav. Bank v. Marston Enters.* (In re Marston Enters.), 13 Bankr. 514, 518 (Bankr. E.D. N.Y. 1981) (allowing cash to be contributed for an equity position by the old stockholders). See also *In re Potter Material Servs., Inc.*, 781 F.2d 99 (7th Cir. 1986).

141. *In re Ahlers*, 794 F.2d 388, 392 (8th Cir. 1986).

142. There are three other creditors to whom the Ahlers also owed money: John Deere Credit Corporation (\$35,791), secured by a combine; Commodity Credit Corporation (\$3,337), secured by a grain bin; and General Motors (\$2,900), secured by an automobile. *Id.*

143. The mortgages were taken out between December, 1965 and January 1982. *Id.* at 392. The principal balances on the parcels of land as of November 30, 1984 were:

| Parcels              | Principal Balance   |
|----------------------|---------------------|
| Parcel A (240 acres) | \$335,403.00        |
| Parcel B (160 acres) | 152,168.00          |
| Parcel C (80 acres)  | 31,500.00           |
| Parcel D (80 acres)  | 6,783.00            |
|                      | <u>\$524,854.00</u> |

*Id.* FLB's security interests are not cross-collateralized. *Id.*

144. These loans had been entered into between May, 1982 and April, 1984. *Id.* All of Norwest's security interests are cross-collateralized. *Id.*

145. *Id.*

146. The court noted the dramatic decline in land prices:

According to the highly respected publication of the University of Minnesota, Dion and Raup, *The Minnesota Rural Real Estate Market in 1985*, Minnesota Agricultural Economics, No. 650, Jan. 1986, average land values in southwest Minnesota increased from \$844 per acre in 1975 to \$2,083 per acre in 1981. They fell to \$1,401 per acre in 1984, and to \$967 per acre in 1985.

the time the loans were obtained. Further, the price of crops declined and bad weather reduced yields. The Ahlers were unable to make interest payments on the loans to the secured creditors and this, along with the decrease in the value of their assets, caused the loans to become undersecured.<sup>147</sup>

On November 16, 1984, Norwest began a replevin action against the Ahlers to gain possession of their machinery and equipment.<sup>148</sup> Fourteen days later, on November 30, 1984, the Ahlers filed a petition for reorganization under Chapter 11 of the Bankruptcy Code.<sup>149</sup> By filing for reorganization, an automatic stay was imposed and the replevin action was halted. Subsequently, both Norwest and FLB filed for relief from the stay, and after a hearing, the bankruptcy court granted their motion to lift the stay.<sup>150</sup> The court concluded that the Ahlers could not make the adequate protection payments and therefore were not entitled to the protection of an automatic stay.<sup>151</sup>

Many related motions and orders were subsequently filed and decided by the bankruptcy court.<sup>152</sup> The automatic stay remained ineffective. The Ahlers then appealed to the United States District Court of Minnesota to reinstate the stay and to allow the reorganization plan to be

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*Id.* at 392, n.1.

147. *Id.* at 392.

148. The action was in state court pursuant to MINN. STAT. ANN. § 565.23 (West Cum. Supp. 1985). *Ahlers*, 794 F.2d at 392-93.

149. *Ahlers*, 794 F.2d at 393. The Ahlers retained possession of their assets and continued to operate their farm as debtors in possession pursuant to §§ 1107 & 1108 of the Bankruptcy Code. Appellants' Brief on Appeal at 1, *In re Ahlers*, 794 F.2d 388 (8th Cir. 1986).

150. The bankruptcy court held the hearing for both creditors' motions on February 27, 1985 and ordered the stay lifted on March 15, 1985. *Ahlers*, 794 F.2d at 393. The court found that the Ahlers had debts totaling \$1,042,301 and assets of only \$696,499. *See* Bankruptcy Court Decision on March 15 at 2.

151. The bankruptcy court determined that in order for the stay not to be lifted, the Ahlers would have to provide the adequate protection payments. After hearing conflicting testimony over the market value of the four parcels of land, the court found that the Ahlers would need to make monthly payments of \$3,800. Bankruptcy Court Decision on March 15 at 6. The Ahlers' only offer of adequate protection to FLB was an offer to apply for a government program which guaranteed 80% of the FLB debt. However, the court decided that was not a good faith offer of adequate protection. *See* Appellants' Brief on Appeal at 8. The Ahlers conceded that they could not make the payments and thus the court lifted the stay for FLB's claim. The court also lifted the stay for Norwest because the Ahlers could not pay the monthly adequate protection payments. Appellants' Brief on Appeal at 9. The district court's determination of the amounts due for adequate protection were based upon *Crocker Nat'l Bank v. American Mariner Indus., Inc.* (In re American Mariner Indus., Inc.), 734 F.2d 426 (9th Cir. 1984), and *Land Lease v. Briggs Transp. Co.* (In re Briggs), 35 Bankr. 210 (D. Minn. 1984) which utilized a lost opportunity cost analysis. *Petition for Rehearing and Suggestion for Rehearing en Banc* at 3.

152. The main motion that was made by the two parties was to allow the bankruptcy court to handle Norwest's replevin action and remove it from state court. *Ahlers*, 794 F.2d at 393.



approved.<sup>153</sup> The court did not reinstate the stay and instead found the proposed reorganization plan to be "utterly unfeasible."<sup>154</sup> The Ahlers appealed the decision to the Eighth Circuit Court of Appeals which, on July 2, 1986, reversed and remanded it back to the district court.<sup>155</sup>

On appeal, three primary issues faced the Eighth Circuit. The first was whether the automatic stay should have been lifted since adequate protection payments could not be made by the Ahlers.<sup>156</sup> The second issue was whether the reorganization plan by the Ahlers was feasible.<sup>157</sup> The third issue concerned the absolute priority rule with regard to reorganization plans.<sup>158</sup> With respect to this last issue, the court considered whether to allow a junior ownership interest to participate in a reorganization plan with no contribution of capital when a class of dissenting senior creditors would receive less than the full value of their claims.<sup>159</sup>

## B. Adequate Protection

The court's analysis of the *Ahlers* case began by determining whether the Ahlers' situation demanded that adequate protection payments be made. Once it decided that payments must be made, the court determined three dates: 1) when adequate protection payments must begin; 2) the date of the valuation of collateral for adequate protection purposes; and 3) the timing of adequate protection payments.<sup>160</sup> In setting these dates, the court used § 362(d)<sup>161</sup> of the Bankruptcy Code which identifies when an automatic stay can be lifted because of inadequate protection of a creditor's interest.

The Eighth Circuit Court, agreeing with the Bankruptcy Court, decided that adequate protection payments were needed<sup>162</sup> and should con-

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153. *Id.*

154. Petition for Rehearing and Suggestion for Rehearing en Banc at 4.

155. *Ahlers*, 794 F.2d at 403.

156. *Id.* at 393. The court had to determine when and how adequate protection should be calculated, and when the payments should start in the unique situation of farming. *Id.* at 395-97.

157. Norwest and FLB contended that even if their interests in Ahlers' assets were adequately protected during the automatic stay, the Ahlers' reorganization plan was not feasible. *Id.* at 397.

158. *Id.* at 399.

159. *Id.* at 401-03.

160. *Id.* at 394-97. The court also had to decide a minor issue of whether unencumbered growing crops could constitute adequate protection. *Id.* at 397. The bankruptcy court said they could not but the Eighth Circuit decided differently in *In re Martin*, 761 F.2d 472 (8th Cir. 1985) and therefore the Eighth Circuit Court allowed the crops to be used as collateral. *Id.*

161. 11 U.S.C. § 362(d) (1982 & Supp. III 1985). See *supra* note 13 for the complete text of the statute.

162. The court stated that a bankruptcy court, in determining what constitutes adequate protection, must:

determine the date when the creditor, absent the filing of a bankruptcy petition, could have

sist of interest payments for lost opportunity costs that occurred because of the bankruptcy filing.<sup>163</sup> The court was reluctant to agree with the Bankruptcy Court's conclusion and did so only because of its previous holding in the case of *In re Briggs*,<sup>164</sup> which allowed bankruptcy courts the flexibility to make this determination. By considering interest as a form of protection, the creditor receives the benefit of the bargain<sup>165</sup> and is placed in a position similar to the one it would have been in if bankruptcy had not been filed.<sup>166</sup>

The *Ahlers* court, however, disagreed with the bankruptcy court as to when the payments should begin.<sup>167</sup> The *Ahlers* court stated that adequate protection payments would not be allowed until the time at which the creditor would be allowed to retrieve and sell the collateral as determined by the state foreclosure law. If protection payments were made prior to that time, the creditor would receive an unbargained for benefit.<sup>168</sup> Two exceptions exist to that rule. First, if the foreclosure is

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taken possession of the collateral under state law and could have sold it to a third party, the amount that the creditor would have realized at this sale, and the creditor's expected return upon reinvestment.

*Ahlers*, 794 F.2d at 395.

163. The bankruptcy court based its conclusion on the premise that "due to the automatic stay, the Federal Land Bank and Norwest were unable to immediately foreclose, liquidate the collateral, and reinvest the liquidation proceeds." *Id.* The bankruptcy court made this decision based upon *Crocker Nat'l Bank v. American Indus., Inc. (In re American Mariner Indus., Inc.)*, 734 F.2d 426 (9th Cir. 1984). *Id.*

164. 780 F.2d 1339 (8th Cir. 1985). See *supra* notes 108-116 and accompanying text for an analysis of this case.

165. The debtor should not be allowed to stop or delay a debtor's right to retrieve the collateral, sell it, and reinvest the proceeds, by filing for bankruptcy. *Ahlers*, 794 F.2d at 395. This would unduly burden the creditor and not allow him to receive the benefit of his bargain. *Id.*

The concept of providing a secured creditor with adequate protection in the form of interest on the value of the collateral is premised on the theory that a secured creditor bargains for the right to take possession of the collateral and sell it in the event that the debtor defaults.

*Id.*

166. *Id.* at 395. The legislative history behind adequate protection confirms this position. The House Report on § 361 states: "[t]hrough the creditor might not receive his bargain in kind, the purpose of the section is to insure that the secured creditor receives in value essentially what he bargained for." H.R. REP. NO. 595, *supra* note 27, at 339, 1978 U.S. CODE CONG. & AD. NEWS at 6295.

167. The bankruptcy court held:

that the Federal Land Bank was entitled to monthly adequate protection interest payments as of January 1, 1985 (*date of the Ahlers' post-petition default on the Federal Land Bank loans*), and that Norwest was entitled to monthly adequate protection interest payments as of February 27, 1985 (*date of the evidentiary hearing*). It found that the Ahlers did not have sufficient funds to make these monthly payments. . . . Accordingly, it granted the Federal Land Bank's and Norwest's motions for relief from the automatic stay.

*Ahlers*, 794 F.2d at 395 (emphasis added).

168. *Id.* at 395. The court acknowledged this problem and came to the same conclusion that the *American Mariner* court did. *Id.* *American Mariner* stated: "to avoid overcompensating the secured creditor, the timing of adequate protection should take account of the usual time and expense

started before the debtor files for bankruptcy, the foreclosure filing day will be the measuring point.<sup>169</sup> Second, if the foreclosure proceeding has not started before the bankruptcy filing, the day when the creditor moves for adequate protection in bankruptcy court becomes the measuring point.<sup>170</sup>

According to Minnesota law, which governed the *Ahlers* case, a mortgagor is entitled to possession of all rents and profits from the real estate for a twelve month redemption period following the foreclosure sale of the property.<sup>171</sup> At the earliest, a foreclosure sale can take place six weeks from the time a foreclosure proceeding begins.<sup>172</sup> Here, since Norwest and FLB could not gain possession, sell the farm land, and reinvest the proceeds for a minimum of one year and six weeks after they initiated the foreclosure, no adequate protection payments of interest would be due until that time.<sup>173</sup>

Minnesota law does not allow creditors to take possession of farm machinery and equipment if the debtor is dependent on it to make a living.<sup>174</sup> Although it could have been liquidated, the Ahlers kept the machinery.<sup>175</sup> The court, however, required that adequate protection payments be made on the Ahlers' farm machinery. According to Minne-

involved in repossession and sale of collateral." *Crocker Nat'l Bank v. American Mariner Indus., Inc.* (In re American Mariner Indus. Inc.), 734 F.2d 426, 435, n.12 (9th Cir. 1984). The *Ahlers* court reasoned that "a debtor can, by filing a bankruptcy petition, preclude or delay a secured creditor from exercising this right and reinvesting the liquidation proceeds, the creditor has been deprived of this benefit of its bargain." *Ahlers*, 794 F.2d at 395.

169. *Ahlers*, 794 F.2d at 395.

170. *Id.* The court based its decision on *Grundy Nat'l Bank v. Tandem Mining Corp.*, 754 F.2d 1436, 1441 (4th Cir. 1985). *Ahlers*, 794 F.2d at 395-96 & n.6. The *Grundy* Court stated that a hardship is imposed upon the debtor by making the petition for adequate protection the measurement date. This allows the creditor the option to file for adequate protection payments months after the bankruptcy petition has been filed, thus forcing the debtor to be unfairly liable for large makeup payments. If the creditor wants protection, he should then be diligent in filing for it. *Id.*

171. Section 580.23(b)(2) states in pertinent part, "when lands have been sold in conformity with the preceding sections of this chapter the mortgagor, the mortgagor's personal representatives or assigns, within 12 months after such sale, may redeem such lands in accordance with the provisions of payment of subdivision 1. . . ." MINN. STAT. ANN. § 580.23 (West Supp. 1987).

172. Section 580.03 states, "Six weeks' published notice shall be given that such mortgage will be foreclosed by sale of the mortgaged premises or some part thereof, and at least four weeks before the appointed time of sale a copy of such notice shall be served. . . ." *Id.* § 580.03 (West 1947).

173. *Ahlers*, 794 F.2d at 396.

174. *Id.*

175. MINN. STAT. ANN. § 565.251 states:

The court may allow the respondent to retain or regain possession of the property without filing a bond and may stay the action by the claimant for a reasonable period of time *not to exceed six months* if the following conditions are met:

(1) the respondent is unable to make the required payments due to unforeseen economic circumstances beyond the respondent's control;

(2) *the respondent is dependent on the use of the property to earn a living.*

MINN. STAT. ANN. § 565.251 (West Supp. 1987) (emphasis added).

sota law, the Ahlers' grain and livestock could also be sold immediately upon filing for bankruptcy; the court said adequate protection payments would be required if the grain and livestock were not sold or if there were a significant delay in doing so.<sup>176</sup>

Next, the court addressed the issue of when valuation of the collateral for adequate protection should occur.<sup>177</sup> The court overruled the bankruptcy court's decision to value everything as of the date of the petition and instead decided that valuation should take place as of the date when the collateral could be sold by the creditor.<sup>178</sup> Thus, the farm land and machinery should be valued when state law would allow the sale, while the grain and livestock would be valued upon the date of the petition for bankruptcy.<sup>179</sup>

Finally, the court considered the timing of adequate protection payments in light of the cyclical nature of farming. The court determined that because a farm does not realize any money until crops or livestock are sold, monthly payments should not be required.<sup>180</sup> Under the Eighth Circuit's analysis, the Ahlers would not have to pay adequate protection payments until they sold their crops or livestock.

### C. Reorganization Feasibility Analysis

The courts may also lift an automatic stay if a reorganization plan is unfeasible.<sup>181</sup> The district court, pursuant to the Eighth Circuit's order to review the Ahlers' plan for feasibility, held that the plan was not feasible and, therefore, the stay should be lifted.<sup>182</sup> The Eighth Circuit judges

176. *Ahlers*, 794 F.2d at 396.

177. *Id.* at 396-97.

178. *Id.*

179. *Id.*

180. This does not mean that adequate protection begins at this point. Instead, adequate protection accumulates from an appropriate date set by the court, and the payment of the accumulated amount is made when the farmer receives payment for the sale of crops or livestock. *Id.* at 397, n.11.

181. See 11 U.S.C. § 362(d)(2) (1982 & Supp. III 1985) which states:

(d) On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay—

(1) for cause, including the lack of adequate protection of an interest in property of such party in interest; or

(2) with respect to a stay of an action *against property*, if—

(A) the *debtor* does not have an equity in such property; and

(B) *such property is not necessary to an effective reorganization.*

*Id.* (emphasis added).

182. The district court analyzed the plan on the basis of the factors outlined in *United Properties, Inc. v. Emporium Dep't Stores, Inc.*, 379 F.2d 55 (8th Cir. 1967). See *Ahlers*, 794 F.2d at 398. The court listed five main factors that should be evaluated: 1) ratio of current assets to current liabilities; 2) solvency of the debtor; 3) evidence that debtor could operate at a profit; 4) cash flow;

overruled the district court's findings and remanded the case back to the bankruptcy court for review in accordance with their opinion.<sup>183</sup>

The rationale behind finding a plan unfeasible lies in judicial interpretation of the phrase "necessary to an effective reorganization"<sup>184</sup> in § 362(d)(2)(B). Several courts<sup>185</sup> have held that a debtor must "not only show that the property in question is essential to the reorganization plan, but also that an effective reorganization is realistically possible."<sup>186</sup> If the reorganization is not realistically possible, the automatic stay should not be enforced.<sup>187</sup>

The Eighth Circuit Court overruled the district court, stating that the court had misunderstood the law.<sup>188</sup> In determining if the automatic stay could be lifted, the district court had used the value of the collateral at the time that adequate protection values were determined rather than at the time the plan was confirmed.<sup>189</sup> In a case such as *Ahlers* where the value of the collateral changed, the feasibility of the plan may be vastly different depending on the date of valuation. Once the values of the collateral were reviewed and the secured debt was restructured to reflect present values of the collateral under § 506(a),<sup>190</sup> the Court believed the

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and 5) capable management and satisfactory economic conditions. *United Properties*, 379 F.2d at 66-71. The district court looked primarily at factors one and four to find the plan totally unfeasible because current assets exceeded liabilities and the Ahlers could not expect a positive cash flow. *Ahlers*, 794 F.2d at 398.

183. *Ahlers*, 794 F.2d at 399. The Eighth Circuit Court believed that the Ahlers might be able to propose a feasible reorganization plan. "While the Ahlers current liabilities do exceed their current assets, it appears probable that once their secured debt is restructured to reflect present values of land and equipment. . . they can repay that debt over a reasonable period of time with interest and make substantial payments to unsecured creditors." *Id.*

184. *See supra* note 13.

185. *See, e.g.*, *Albany Partners, Ltd. v. W.P. Westbrook (In re Albany)* 749 F.2d 670, 673 (11th Cir. 1984); *In re Discount Wallpaper Center, Inc.*, 19 Bankr. 221, 222 (Bankr. M.D. Fla. 1982).

186. *Ahlers*, 794 F.2d at 399. *See also* *In re Dublin Properties*, 12 Bankr. 77, 80 (Bankr. E.D. Pa. 1981). "If no reorganization of the debtor is feasible, then no property of that debtor can be necessary for that end." *Id.*

187. *Ahlers*, 794 F.2d at 398.

188. *Id.* (citing *Martin*, 761 F.2d at 475).

189. The court based its decision on when to evaluate collateral on the Senate Report on the Bankruptcy Act. The Report stated in pertinent part:

While courts will have to determine value on a case-by-case basis, [11 U.S.C. § 506(a)] makes it clear that valuation is to be determined in light of the purpose of the valuation and the proposed disposition or use of the subject property. This determination shall be made in conjunction with any hearing on such disposition or use of property or on a plan affecting the creditor's interest. To illustrate, a valuation early in the case in a proceeding under sections 361-363 would not be binding upon the debtor or creditor at the time of confirmation of the plan. Throughout the bill, references to secured claims are only to the claim determined to be secured under this subsection, and not to the full amount of the creditor's claim.

S. REP. NO. 989, *supra* note 30, at 68, 1978 U.S. CODE CONG. & ADMIN. NEWS at 5854.

190. Section 506(a) states:

Ahlers would be able to repay the entire secured debt and a substantial portion of the amount owed the unsecured creditors.<sup>191</sup>

#### D. *Absolute Priority Analysis*

The absolute priority rule was the third main issue the court addressed.<sup>192</sup> FLB and Norwest contended that they should get relief from the stay because no feasible reorganization plan could be approved.<sup>193</sup> Both creditors were substantially undersecured initially and the reorganization plan would threaten a still greater portion of their individual unsecured claims. Further, Norwest and FLB argued that under the cram-down provision of § 1129(b), the Ahlers would not be successful in having the plan confirmed over their objections.<sup>194</sup> Since the reorganization plan called for the Ahlers to retain an interest in the farm without repaying the unsecured creditors in full, the reorganization plan would not satisfy the "fair and equitable" requirement under § 1129(b)(1).<sup>195</sup>

Since the two creditors could not agree to a single plan, the court first considered whether the plan could be confirmed over their objections.<sup>196</sup> Section 1129(b) allows a bankruptcy court to confirm the plan over the objections of creditors if two factors are met: 1) the plan does not discriminate unfairly; and 2) the plan is fair and equitable with regard to each objecting class of creditors.<sup>197</sup>

To determine if a reorganization plan will meet the test, the court must consider the type of creditors in the dissenting class.<sup>198</sup> Here, the reorganization plan had to provide for both the secured and unsecured

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An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

11 U.S.C. § 506(a) (1982).

191. *Ahlers*, 794 F.2d at 399.

192. *See id.* at 399-403.

193. Norwest and FLB, as undersecured creditors, would not accept the reorganization plan because the Ahlers could pay their claims in full. Therefore, they contended that confirmation could not occur under 11 U.S.C. § 1129(a)(8)(A). *Id.* at 401.

194. *See supra* note 14 and accompanying text.

195. *See id.* *See also Ahlers*, 794 F.2d at 399.

196. *See Ahlers*, 794 F.2d at 399-403.

197. 11 U.S.C. § 1129(b)(1) (1982).

198. There are three types of creditors listed in § 1129: 1) secured claims; 2) unsecured claims; and 3) class of interest. Each class has special rules that must be considered. *See* 11 U.S.C. § 1129(b) (1982 & Supp. III 1985).

creditors since both were represented. Regarding the unsecured creditor, § 1129(b)(2)(B) requires that one of two requirements be met for the plan to be confirmed:<sup>199</sup> 1) either the class of unsecured creditors must retain property equal to their allowed claim; or 2) there must be no junior claims or interests participating in the plan or retaining an interest in the debtor's property.<sup>200</sup> Norwest and FLB argued that under the proposed reorganization plan, the Ahlers' would retain an equitable ownership interest junior to the undersecured creditors without providing for full recovery of the unsecured senior creditors.<sup>201</sup>

The court disagreed with the position of Norwest and FLB, and held that the "fair and equitable" test could be met even though the Ahlers retained an equitable interest.<sup>202</sup> The court based its decision on the Supreme Court's modification of the absolute priority rule<sup>203</sup> which allowed a junior creditor to retain an ownership interest even though senior creditors may receive less than their allowed claim.<sup>204</sup> In reaching that conclusion, the *Ahlers* court looked at previous cases which allowed a debtor to make a fresh contribution of capital to the creditors in exchange for an equitable ownership interest based on the amount contributed.<sup>205</sup> In all but one of the cases the court examined, fresh capital was injected into the reorganization plan; in *Los Angeles Lumber*,<sup>206</sup> however, the Supreme Court stated that the contribution could be other than money.<sup>207</sup>

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199. See *Ahlers*, 794 F.2d at 400-01.

200. *Id.* at 401. See 11 U.S.C. § 1129(b)(2)(B)(ii) (Supp. III 1985). If no junior claims or interest participate in the plan, then the plan can provide for any treatment of the class of unsecured creditors. *Ahlers*, 794 F.2d at 401.

201. Norwest and FLB also contended that the "fair and equitable" standard could not be satisfied because "the Ahlers could not provide the unsecured creditors with property equal to the allowed amount of their claims." *Ahlers*, 794 F.2d at 401.

202. *Id.*

203. The absolute priority rule was established in *Northern Pac. R.R. v. Boyd*, 228 U.S. 482 (1913). The rule provides that a dissenting class of creditors must be paid in full before any junior class can receive or retain any property under the plan. *Ahlers*, 794 F.2d at 401.

204. *Ahlers*, 794 F.2d at 401-03.

205. See *Kansas City Terminal Ry. Co. v. Central Union Trust Co.*, 271 U.S. 445 (1926). The court recognized that in order for some reorganization plans to be feasible, the stockholders may have to be allowed to inject new capital into the business. *Id.* at 455. See also *Sophian v. Congress Realty Co.*, 98 F.2d 499, 502 (8th Cir. 1938) (for the stockholders to retain an interest in the business, it must appear that some compensatory additional capital has been made or they have an equitable interest, after the rights of the creditors are fully protected, in the estate); *Buffalo Sav. Bank v. Marston Enters.* (In re *Marston Enters.*), 13 Bankr. 514, 517-18 (Bankr. E.D. N.Y. 1981) (new capital contributed to the business for reorganization will not violate the "fair and equitable" standard).

206. 308 U.S. 106 (1939). This case involved a complicated group of holding companies and the parent company in which liabilities exceeded assets by a substantial margin. *Id.* at 109-12.

207. The Court stated:

Using the *Los Angeles Lumber* reasoning, the court found that the Ahlers' efforts in managing and operating the farm were necessary for its reorganization and that this "in-kind" contribution could be factored into the farm's worth.<sup>208</sup> Further, by allowing the farm to continue to operate, its worth was greater than the liquidated value of its assets.<sup>209</sup> The court reasoned that if this method of determining the net worth were not allowed, then most farmers could not take advantage of the bankruptcy act.<sup>210</sup>

The only remaining issue was whether the farmers' in-kind contribution was reasonably equivalent to the ownership interest the farmer would retain under the reorganization plan. Although there is no mathematical formula for making such a calculation, the farmer's labor, experience, and expertise could be assigned a monetary value. The court found it difficult to value the total retained ownership interest, but eventually used criteria from *In re U.S. Truck Co.*<sup>211</sup> and *In re Landau Boat Co.*<sup>212</sup> to determine the retained interest: 1) the future economic viability of the debtor as reorganized; and 2) the possibilities that the debtor will be profitable.<sup>213</sup>

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It is, of course, clear that there are circumstances under which stockholders may participate in a plan of reorganization of an insolvent debtor. This Court, as we have seen, indicated as much. . . . [T]his Court stress[es] the necessity, at times, of seeking new money "essential to the success of the undertaking" from the old stockholders. Where that necessity exists and the old stockholders make a fresh contribution and receive in return a participation reasonably equivalent to their contribution, no objections can be made.

*Id.* at 121 (footnote omitted). The court went on to state:

In view of these considerations we believe that to accord "the creditor his full right of priority against the corporate assets" where the debtor is insolvent, the stockholder's participation must be based on a contribution in money or in money's worth, reasonably equivalent in view of all the circumstances to the participation of the stockholder.

*Id.* at 122 (emphasis added).

208. *Ahlers*, 794 F.2d at 402.

209. The court reasoned:

[I]f the plan is rejected, the unsecured creditors will get nothing, whereas they will receive annual payments if the plan is approved and is successful. The Ahlers' farm operation and management skills are something of a value which would disappear if their farm was liquidated. Because that value cannot be captured for creditors in the event of liquidation, fairness is not violated if their Chapter 11 plan leaves that value in their hands. This view also recognizes the broad rehabilitative purposes of the Bankruptcy Act—to give a debtor with a reasonable chance of success an opportunity for a fresh start.

*Id.* at 402.

210. *Id.*

211. 47 Bankr. 932 (E.D. Mich. 1985). U.S. Truck Company is an intra-state trucking company primarily engaged in shipping supplies and parts for the auto industry. The debtor filed for bankruptcy because it could not get the wage concession it wanted from the union members that drove its trucks. *Id.* at 934.

212. 13 Bankr. 788 (Bankr. W.D. Mo. 1981).

213. See *U.S. Truck*, 47 Bankr. at 941-42. *Landau Boat* states that:

The commercial value of property consists in the expectation of income from it. . . . Such criterion is the appropriate one here, since we are dealing with the issue of solvency arising



Applying these criteria to the Ahlers' situation, the court concluded that no profit or benefit would be realized until the reorganization plan was complete and the amounts due the secured creditors were paid in full. Any excess profit above that anticipated in the reorganization plan would be distributed to the unsecured creditors until the principal of their debts were paid in full without interest.<sup>214</sup> If any secured property was sold during the time the plan was in effect, any excess above that which was due to the secured creditor would be shared according to the amount of unsecured creditor's contribution of capital and the owner's interest at the time of the sale.<sup>215</sup> The court remanded the case back to the bankruptcy court for compliance.

#### IV. ANALYSIS AND CONSEQUENCES

##### A. Adequate Protection

Congress allowed the courts to decide when adequate protection payments should begin according to the equities of each individual case.<sup>216</sup> The *Ahlers* court balanced the equities and made the only logical determination it could have made: it decided that adequate protection would not be allowed on property until all the statutory foreclosure proceedings were complete.<sup>217</sup>

Filing a bankruptcy petition should neither lengthen nor shorten the time in which a creditor will be allowed to have the collateral returned.<sup>218</sup> If FLB and Norwest had been allowed to receive adequate protection payments earlier than the statutory redemption period, they would have received more than what they bargained for in the original transaction.<sup>219</sup> The legislative history of § 361 specifically states that the

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in connection with reorganization plans involving productive properties. . . . The criterion of earning capacity is the essential one. . . if the allocation of securities among the various claimants is to be fair and equitable. . . .

*Landau*, 13 Bankr. at 792-93 (quoting *Consolidated Rock Products v. DuBois*, 312 U.S. 510, 526 (1941)). See generally *In re The Alison Corp.*, 9 Bankr. 827 (Bankr. S.D. Cal. 1981).

214. *Ahlers*, 794 F.2d at 403. If the excess was given to the equitable interest it would receive more than the value of its contribution. *Id.*

215. *Id.*

216. See *supra* note 67.

217. See *Ahlers*, 794 F.2d at 395-96. See also *In re Bear Creek Ministorage, Inc.*, 49 Bankr. 454, 458-59 (Bankr. S.D. Tex. 1985). See generally *Doty v. Pulliam (In re Pulliam)*, 54 Bankr. 624, 625-26 (W.D. Mo. 1985).

218. See generally *General Elec. Mfg. Corp. v. South Village, Inc. (In re South Village, Inc.)*, 25 Bankr. 987, 996 n.14 (Bankr. D. Utah 1982). "The date of the petition, however, may be irrelevant to opportunity cost which would accrue only from the date upon which the creditor—absent the stay—could first liquidate the collateral whenever that might be." *Id.*

219. The *American Mariner* court noted that "to avoid overcompensating the secured creditor, the timing of adequate protection should take account of the usual time and expense involved in

party seeking adequate protection be allowed the benefit of the bargain;<sup>220</sup> it does not suggest that the creditor should get more than initially bargained for.

The court must balance the interests involved to reach an equitable decision; it would not be fair for the debtor to pay money that would not be due absent bankruptcy. By making payments due earlier than anticipated, the debtor is denied a breathing spell from the creditors and thus, the policy objectives supporting the automatic stay are not achieved.<sup>221</sup> Early payments deplete any cash resources a debtor may have and could drastically reduce the chances for an effective reorganization.<sup>222</sup> If a creditor were allowed to receive protection payments, then that possibility would serve as an incentive to force the debtor into bankruptcy since the creditor would be entitled to both the collateral and the payments already made by the debtor. Neither interest payments for the lost opportunity to reinvest the money nor the decline in the value of the collateral due to depreciation or consumption should be allowed until foreclosure proceedings are complete and the redemption period has ended.<sup>223</sup> Interest payments should be made if the creditor's collateral was not returned to the creditor after the foreclosure redemption period had passed.<sup>224</sup> The court seemed hesitant to follow the opportunity cost theory but did so because of the decision in *In re Briggs*<sup>225</sup> which allowed the bankruptcy court discretion as to what theory to use.

While the arguments for both the opportunity cost and maintenance of value theories are compelling, the latter seems most convincing. First, the argument that the creditor should receive the value of the "benefit of

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repossession and sale of collateral." *Crocker Nat'l Bank v. American Mariner Indus., Inc.* (In re American Mariner Indus., Inc.), 734 F.2d 426, 435, n.12 (9th Cir. 1984). Using this language to interpret the *Ahlers* case, the court followed the analysis by looking at the statute which governs foreclosure proceedings. *Ahlers*, 794 F.2d at 396.

220. See *supra* note 82 and accompanying text.

221. *Local Loan Co. v. Hunt*, 292 U.S. 234, 244-45 (1934) (that is to afford the debtor a "new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt").

222. See Gordanier, *The Indubitable Equivalent of Reclamation: Adequate Protection for Secured Creditors under the Bankruptcy Code*, 54 AM. BANKR. L.J. 299, 302-03 (1980)

A business in financial difficulties so grave that its managers are considering bankruptcy probably will have either sold outright or pledged as collateral all assets of any value. . . . It is difficult to perceive how a secured creditor is justly to be compensated for the impairment of collateral which almost inevitably results from the debtor's use of that collateral during reorganization.

*Id.*

223. See *supra* notes 167-170 and accompanying text.

224. *Ahlers*, 794 F.2d at 395.

225. 780 F.2d 1339 (8th Cir. 1985).

the bargain" is tenuous at best<sup>226</sup> because each time a loan is made, the creditor realizes that there is a chance that the debtor might become unable to pay or even go into bankruptcy. To avoid adverse consequences, the rate of interest charged by the creditor contains a "risk percentage," which is a small percentage for loans that are uncollectible.<sup>227</sup> Further, if a creditor anticipates a decrease in the value of the collateral, additional collateral may be initially required.<sup>228</sup> Because the creditor has an opportunity to allocate the risk when negotiating the loan, and instead chooses to bear the losses resulting from a debtor's insolvency, the court should not be forced to provide relief. Finally, by making the debtor pay interest, the court violated the intent of Congress that the automatic stay give the debtor a breathing spell.<sup>229</sup>

The "indubitable equivalent" argument set forth in *American Mariner* has not been widely accepted.<sup>230</sup> Both judges and commentators have found it unlikely that Congress meant the phrase to require compensation to be made for present value since that language was not used.<sup>231</sup>

In applying the argument from *American Mariner* that the meaning of "indubitable equivalent" in § 1129 must carry over to § 361, the court failed to look at the context in which the phrase was placed in the statute.<sup>232</sup> As noted above, the term comes from Judge Hand's opinion in *In re Murel Holding Co.*, a case dealing with cram-down provisions and not with adequate protection.<sup>233</sup> The § 1129 cram-down provisions require the protection of present value. In contrast, § 361 does not require the use of indubitable equivalent, and it is instead merely the method by which protection may be provided.<sup>234</sup>

226. See Comment, *supra* note 71, at 359; see also Note, *Adequate Protection Becomes a Creditor's Tool: In re American Mariner Industries, Inc.*, 21 WILLIAMETTE L. REV. 149, 165 (1985).

227. See Comment, *supra* note 71, at 359.

228. *Id.*

229. See *supra* notes 46-48 and accompanying text.

230. See, e.g., *General Elec. Mfg. Corp. v. South Village, Inc. (In re South Village, Inc.)*, 25 Bankr. 987, 991 n.4 (Bankr. D. Utah 1982).

231. See Comment, *supra* note 71, at 361.

232. See *Barclays Bank v. Saypol (In re Saypol)*, 31 Bankr. 796, 802 (Bankr. S.D. N.Y. 1983) ("It thus appears that the term 'indubitable equivalent' was added merely to afford the court with flexibility to prevent the secured creditor from being unduly harmed by erosion of the value of the collateral during the stay."). The court also found that it makes little, if any, sense to read anything more into "indubitable equivalent" in the adequate protection context of § 362(d). Such a reading would expand the intent manifested in the legislative history far beyond its intended meaning and be inconsistent with the scheme for allowance of secured claims. *Id.*

233. *First Fed. Sav. & Loan Ass'n v. Shriver (In re Shriver)*, 33 Bankr. 176, 183 (Bankr. N.D. Ohio 1983).

234. If the stay is responsible for a decline in value, Section 361 states three illustrative methods for providing adequate protection. Some courts, however, have not looked be-

*American Mariner* refers to the Congressional use of the *Murel* case as its source for the definition of indubitable equivalent in § 361(3) though it is used in § 1129(b)(2)(A)(iii).<sup>235</sup> Once again, the court used a case out of context. *Murel* dealt specifically with a cram-down situation for which Congress intended § 1129(b)(2)(A)(iii) definitions to be applied.<sup>236</sup> Further, the use of indubitable equivalence and protection of present value is mandatory in § 1129, while in § 361(3) it is merely a permissive method.<sup>237</sup> Finally, the legislative history shows that Congress knew about the present value situation but chose not to change the language of the statute.<sup>238</sup>

### B. Reorganization Plan

The court's decision to allow experience, knowledge, and labor to be considered part of a reorganization plan was a novel approach. From this commentator's research, no previous court has allowed this method, and predictably, it has provoked both praise and criticism.

Three arguments support the Eighth Circuit's decision to modify the strict rule or absolute priority rule: 1) the case law modifying the absolute priority rule; 2) the legislative history of the reorganization of § 1129 of the Bankruptcy Act of 1978; and 3) the § 1129(b)(2)(B)(ii) definition of what is considered property.

The first argument is typified by *Case v. Los Angeles Lumber Prod-*

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yond its trilogy of alternatives. Others have insisted on a showing of indubitable equivalence. These approaches miss the mark: they violate the nonprescriptive character of Section 361, and may simply exchange one imponderable for another. Indubitable equivalence is not a method; nor does it have substantive content. Indeed, something "indubitable" is more than "adequate"; "equivalent" is more than "protection"; hence, the illustration may eclipse the concept. At best, it is a semantic substitute for adequate protection and one with dubious, not indubitable application to the question of relief from the stay.

*Bankers Life Ins. Co. v. Alyucan Interstate Corp.* (In re Alyucan Interstate Corp.), 12 Bankr. 803, 809 (Bankr. D. Utah 1981).

235. See *supra* notes 86-91 and accompanying text.

236. H.R. REP. NO. 595, *supra* note 27, at 414-15, 1978 U.S. CODE CONG. & ADMIN. NEWS at 6370-71; S. REP. NO. 989, *supra* note 30, at 127, 1978 U.S. CODE CONG. & ADMIN. NEWS at 5913.

237. Section 361 states in part: "When adequate protection is required under section 362, 363 or 364 of this title of an interest of an entity in property, such adequate protection may be provided by. . ." 11 U.S.C. § 361 (Supp. III 1985) (emphasis added). Section 1129 states: "For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements. . ." 11 U.S.C. § 1129(b)(2) (Supp. III 1985) (emphasis added).

238. See *Bankruptcy Act Revision: Hearings on H.R.31 and H.R.32 Before the Subcomm. on Civil and Constitutional Rights of the House Comm. on the Judiciary*, 94th Cong., 2d Sess. 1943, 2116-17 (1976); *Bankruptcy Reform Act of 1978: Hearings on S.2266 and H.R.8200 Before the Subcomm. on Improvements in Judicial Machinery of the Senate Comm. on the Judiciary*, 95th Cong., 1st Sess. 490, 599 (1977).

ucts Co.,<sup>239</sup> a landmark case previously discussed and relied upon by the Ahlers court. In Ahlers, the court relied upon the language of *Los Angeles Lumber* which stated that the contribution could be in "money's worth." In *Los Angeles Lumber*, the shareholders argued that they should be allowed to participate and obtain new stock because the shareholders' financial standing and influence in the community would be beneficial to the bondholders and that they could thereby provide continuity of management.<sup>240</sup> Because both of these items were difficult to value, the court did not allow the shareholders to retain an equitable interest. From the court's discussion of this subject, it appears that if a value could have been attached to these two intangibles, the court might have allowed the new shareholders an equity position.<sup>241</sup> The valuing of a farmer's labor, knowledge, and experience would be less difficult to measure in the Ahlers case, however, because professional farm managers could provide an accurate estimate as to the worth of the Ahlers' services. Given the ease with which a value could be determined, it seems likely that a court would allow the contributor of non-capital assets to retain an equitable interest.

The second argument, the legislative history of the Bankruptcy Code, gives the strongest indication that the Ahlers decision was correct. The language of the 1978 Code itself does not offer any assistance in defining either the fair and equitable requirement for unsecured creditors or a modified version of the traditional absolute priority rule.<sup>242</sup> Congressional records are not helpful in making this determination either; no assistance can be found regarding the statute itself, or anything else pertaining to the absolute priority rule. Since there is nothing in the latest legislative materials or statute, then prior enactments of the Bankruptcy Code should be analyzed to determine what the statute means.<sup>243</sup>

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239. See *supra* notes 118-20 and accompanying text.

240. Case v. Los Angeles Lumber Prod. Co., 308 U.S. 106, 122, *reh'g denied*, 308 U.S. 637 (1939).

241. *Id.* at 122-23.

242. See *supra* note 14.

243. The Amicus Brief at 16-17, *In re Ahlers*, 794 F.2d 388 (8th Cir. 1986), expresses the proposition:

For, while the best evidence of what was intended by a state will generally consist of the words selected by the legislature, courts may look to legislative history for further evidence "in order to determine whether giving the words their natural significance leads to an unreasonable result plainly at variance with the policy of the legislation as a whole." *United States v. American Trucking Association*, 60 S.Ct. 1059, 1064 (1940). See also, *Ozawa v. United States*, 43 S.Ct. 65 (1922); *Chatwin v. United States*, 66 S.Ct. 233 (1946). In situations where the legislative intention apparently expressed in a statute is doubtful, the court may look to preceding statutory enactments dealing with the amount needed to fund the Chapter 11 plan was sufficient to allow the shareholders to participate in the reorgani-

The last major change in bankruptcy law occurred in 1952 when Congress eliminated the "fair and equitable" requirement under Chapter 11 because it did not allow closely-held businesses or individual creditors to utilize that Chapter. The section was thus amended to read:

Confirmation of an arrangement shall not be refused solely because the interest of a debtor, or if the debtor is a corporation, the interests of its stockholders or members will be preserved under the arrangement.<sup>244</sup>

The House record stated that if this was not changed, many small corporations and individuals would not be able to utilize the relief provided by these chapters. Both the Senate and the House flatly rejected the strict application of the absolute priority rule found in the *Boyd* and *Los Angeles Lumber* cases.<sup>245</sup> Congress would only allow the absolute priority rule to be used under Chapter 10 when dealing with certain types of corporate reorganizations where it considered the absolute priority rule to be appropriate.

The law remained unchanged until the 1978 revision in which Congress recognized that many large corporations escaped the absolute priority rule by filing for bankruptcy under Chapter 11. The 1978 Code consolidated chapters 10, 11, and 12 to stop corporations from utilizing bankruptcy to a creditor's disadvantage.<sup>246</sup> Some general discussion surrounds the confirmation of a plan over the objection of creditors, but the Code does not specifically address how the absolute priority rule would be applied to debtors who previously qualified under the old chapters 11 and 12. Since there was no legislative discussion about the absolute priority rule by the 1978 Congress, it appears reasonable to consider the 1952 changes and conclude that the absolute priority rule is not to be strictly applied to individual debtors.<sup>247</sup> As stated before, Congress' reason for combining all three sections was to eliminate corporate loopholes, and not to shut off bankruptcy help for individual debtors such as farmers. If the absolute priority rule is strictly applied, little relief is available to individual debtors such as the Ahlers, and the public policy goals behind Chapter 11 are frustrated. Individual debtors would be unable to start over if the absolute priority rule is strictly applied.

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zated corporation. See also *In re Landau Boat Company*, 13 B.R. (sic) 788 (Bankr. W.D. Mo. 1981) and *Matter of U.S. Truck Company, Inc.*, 47 B.R. (sic) 932 (E.D. Mich. 1985).

*Id.*

244. 11 U.S.C. § 366 (1952).

245. See *In re Star City Rebuilders, Inc.*, 62 Bankr. 983, 988 (Bankr. W.D. Va. 1986).

246. See H.R. REP. NO. 595, *supra* note 27, at 250-54, 1978 U.S. CODE CONG. & ADMIN. NEWS at 6209-13.

247. See Amicus Brief at 23-24, *In re Ahlers*, 794 F.2d 388 (8th Cir. 1986).

The final argument comes from *In re Star City Rebuilders, Inc.*,<sup>248</sup> where defining what is considered "property" under the cram-down provision becomes critical. In that case, a reorganization plan, allowing unsecured creditors to receive no less than 5% of their claims, was confirmed over their objections. The owners of the common stock of the bankrupt company would continue to own the stock and keep whatever future rights would accrue upon the plan's completion, but they would not receive any dividends or other monetary compensation from the ownership of the stock while the plan was in effect.<sup>249</sup> The court allowed the previous owners to retain possession of the stock because they felt it was not tangible property as defined in § 1129(b)(2)(B)(ii), and thus its ownership did not affect the reorganization plan.<sup>250</sup>

In categorizing stock as intangible property, the court appears to have used the definition of property as a means to argue policy and justify the stock ownership. The policy arguments raised by the court are supported by the legislative history discussed above. By allowing the owners of small corporations, like Star City Rebuilders, to retain ownership of stock and have some vested interest in running the business, the court provided an automatic incentive. Without it, owners would not have an interest in rehabilitating the business and generating income to repay both the secured and unsecured creditors; instead they would liquidate and the unsecured creditors would receive less than if the owners attempted to revive the business.<sup>251</sup> While it may be more feasible to liquidate the business in some situations, the justification for doing so should not be simply the strict construction of § 1129. The debtor would have few remaining options thus violating Congress' intent to allow the possibility of reorganizing the business.

The court founded its decision on equitable policy considerations when it allowed the Ahlers to retain their farm after the creditor's interests were paid to a certain extent. If the court had not allowed the Ahlers to keep their property, then the Bankruptcy Code would have foreclosed any avenues of rehabilitation for the farmer debtor.

Judge Gibson's dissent highlights many of the arguments against the Ahlers court's interpretation of the cram-down provision.<sup>252</sup> As discussed, § 1129(b)(2)(B)(ii) does not allow a debtor to participate in a

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248. 62 Bankr. 983 (Bankr. W.D. Va. 1986).

249. *Id.* at 984.

250. *Id.* at 988-89.

251. *Id.* at 984.

252. *Ahlers*, 794 F.2d at 404, 406-08.

plan unless the unsecured claims are paid in full, thus protecting unsecured creditors from suffering losses greater than those which may have been predicted. Judge Gibson viewed *Los Angeles Lumber* as a narrow window in which the absolute priority rule can be circumvented by allowing for a contribution of labor, experience, and knowledge<sup>253</sup> in exchange for capital. But the only time this window should be opened is when money is contributed to the business for an ownership interest.<sup>254</sup>

In other cases in which the reorganization plan has allowed a debtor an equity stake in the business, the debtor has given cash or capital of a tangible value. No other case has yet allowed labor to be used as a tangible asset with an accurate value.<sup>255</sup> Because capital, not labor, is the basis for exchange in our economy, the use of labor as the debtor's contribution does not afford the creditor with the measure of protection provided by capital contributions. If the reorganization plan becomes unfeasible in the future, the capital contribution could be liquidated and the creditor could receive something in return; labor may not be liquidated to protect the creditor.

Further, capital must be contributed in total before the reorganization plan is approved, while if labor is allowed, the creditors cannot be certain that the farmer will work for the entire length of the plan. In confirming the plan, the court in effect makes the farmer a servant to the farm. A future court may face the question of whether it may order the specific performance of labor obligations in the event that the farmer is no longer able to contribute labor and expertise to the farm.<sup>256</sup>

Finally, the creditor does not receive the full benefit of the bargain. Cash was loaned with the expectation of some return, even within bankruptcy. No creditor issuing a loan could reasonably foresee that a debtor would be allowed to retain an interest in the business without a capital contribution or that an unsecured creditor would not be paid the full amount that is due. By allowing the bankrupt debtor an equity interest in the business, the court irresponsibly expands the capital contribution exception to the absolute priority rule. The result is a clear violation of the "fair and equitable" requirement<sup>257</sup> and invites unpredictability into

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253. *Id.* at 406-07.

254. *See id.* at 407.

255. The court in *Los Angeles Lumber* stated: "[Such items] have no place in the asset column of the balance sheet of the new company. They reflect merely vague hopes or possibilities. As such, they cannot be the basis for issuance of stock to otherwise valueless interests." *Case v. Los Angeles Lumber Prod. Co.*, 308 U.S. 106, 122-23, *reh'g denied*, 308 U.S. 637 (1939) (footnote omitted).

256. *Ahlers*, 794 F.2d at 407 (citing *Karrick v. Hannaman*, 168 U.S. 328, 335-36 (1897)).

257. *Id.*



the debtor-creditor allocation of risk.

## V. CONCLUSION

Allowing lost opportunity cost interest payments on a case-by-case basis is not consistent with the legislative history and case law surrounding the Bankruptcy Code. The arguments supporting the strict application of the absolute priority rule in § 1129 seem consistent with the intent of the reorganization provisions. Previous courts allowing a junior interest to have an equity claim have allowed the debtor to only contribute cash. By allowing labor instead of capital, the *Ahlers* court allows too many variables to remain open, thus making it impossible to determine the feasibility of a proposed bankruptcy reorganization plan. Although the 1952 change in the cram-down provisions evidences some intent to soften the impact of the rules, Congress surely realized the problems that would occur with regard to unsecured creditors under § 1129(b)(2)(B) if it allowed a flexible application of the "fair and equitable" requirement. Although Congress could have changed the statute to allow for individual debtors, it instead enacted Chapter 13, for which most farmers do not qualify, to assist individual debtors.

With the recent adoption of Chapter 12 of the Bankruptcy Code, it appears that Congress has now acknowledged that the current Code cannot adequately deal with the problems of farmers. Cases like *Ahlers* do not clarify the law, they only perpetuate its misapplication. Ultimately, only legislative action like the enactment of Chapter 12 can adequately remedy the situation. In the interim, the courts should not be allowed to step out of their bounds and interpret laws on such weak and varied precedent.