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Kenneth B. Axe

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PENETRATING THE IRON CURTAIN: REPRESENTING SECURED CREDITORS IN CHAPTER 11 REORGANIZATION PROCEEDINGS

KENNETH B. AXE*

I. INTRODUCTION

In recent years the incidence of Chapter 11 bankruptcy reorganizations has clearly been on the rise as insolvent businesses have sought to deal with cash flow problems and other difficulties under the protections afforded by the United States Bankruptcy Code.1 Thus, the general practitioner who previously may have had little cause to deal with such proceedings is increasingly confronted with a maze of unfamiliar laws and procedural rules in the bankruptcy court, a forum different from that in which he or she may be accustomed to practice.

Typically, bankruptcy filings come unexpectedly, although the signs may be present to a perceptive creditor. On the eve of a crisis caused by some precipitating event, such as impending action by tax authorities or repossession of collateral by a secured creditor, the debtor seeks immediate protection of the court with little or no advance warning to its creditors. The Code provides for immediate relief through simplified procedures for filing a petition in bank-

ruptcy. Even with notice of an impending bankruptcy filing, there is generally little a creditor can do to prepare for the reorganization or to fortify its position.\(^2\)

This article will examine remedies available to a secured creditor in a Chapter 11 reorganization proceeding. The rights available to this type of creditor have been chosen as the focus of this discussion because of the great leverage the Code affords that party. Although the discussion assumes that the debtor and secured creditor are adversaries as a result of their conflicting interests in either using the property or foreclosing upon the collateral, this is not always true. The purpose of this article then is to give an overview of the proceedings and to offer some insights into practice and procedure in bankruptcy court. Because of the article's broad scope, it will only survey the relevant statutory and case law.\(^3\)

II. AN OUTLINE OF THE CHAPTER 11 REORGANIZATION

In order to understand the rights and remedies afforded by the Code to a secured creditor, one must first become acquainted with how a reorganization is intended to function. The following is a brief description of the reorganization proceeding.

A Chapter 11 proceeding is commenced when the debtor files a petition with the clerk of the bankruptcy court.\(^4\) Schedules listing assets and liabilities of the debtor as of the date of filing and a statement of financial affairs must both

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2. If, for example, the creditor obtains an additional lien for an antecedent debt, the lien may constitute a voidable preference. 11 U.S.C. § 547 (1982).

3. One caveat is that Congress still has not defined the bankruptcy courts' jurisdiction following the decision of the United States Supreme Court in Northern Pipeline Constr. Co. v. Marathon Pipeline Co., 458 U.S. 50, stayed, 103 S. Ct. 199 (1982), which struck down the courts' jurisdiction under 28 U.S.C. § 1471 (1982). Currently, the bankruptcy courts act as referees under a delegation of authority by the district courts by emergency rule. The rule has now universally been upheld by the courts as constitutional. See, e.g., White Motor Corp. v. Citibank, N.A., 704 F.2d 254 (6th Cir. 1983); Moody v. Martin, 27 Bankr. 991 (W.D. Wis. 1983).

4. 11 U.S.C. § 301 (1982). This article assumes the filing of a voluntary petition. Involuntary Chapter 11 cases are also possible under 11 U.S.C. § 303(a) (1982) and present many of the same dilemmas to a secured creditor.
be filed with the court within fifteen days of filing the petition.\(^5\)

Upon filing the petition in bankruptcy, the debtor receives instantaneous and automatic relief in the form of an automatic stay barring, \textit{inter alia}, collection actions.\(^6\) This filing creates an estate of the debtor consisting of all property, tangible and intangible, then owned by the debtor. The estate includes all causes of action and all property within the possession of creditors.\(^7\) The creditors may be required by court order to turn over property to the estate.\(^8\)

Under the amendments made by the 1978 Bankruptcy Reform Act,\(^9\) the debtor is allowed to operate the business as a new entity — the "debtor in possession" — which is endowed with most of the rights, remedies and duties of a court-appointed trustee under the Code.\(^10\) The rationale for this appointment is the debtor's experience in operating the business and the beneficial effect of such continued operation upon the chances for a successful reorganization.

The ultimate goal of a reorganization, distinguishing it from a liquidation under Chapter 7, is the formulation and confirmation of a plan of reorganization allowing the business or individual to restructure debts and continue operating for the benefit of unsecured creditors and the economy in general. To this end, the debtor must circulate an approved disclosure statement to its creditors, which acts as a prospectus.\(^11\) Although the Code provides a limited period for the debtor's filing of a plan, in practice, extensions are liberally granted.\(^12\) Generally, creditors do not have sufficient infor-

\begin{itemize}
  \item \(^5\) 11 U.S.C. § 521(1) (1982); Bankr. R.P. 1007(c). An extension of time may be granted for cause, after giving notice to specified parties. \textit{Id.}
  \item \(^6\) 11 U.S.C. § 362(a) (1982).
  \item \(^7\) Id. § 541(a), (c)-(d).
  \item \(^8\) Id. § 542. To determine the effect of a turnover order on a lien perfected by possession, see U.C.C. § 9-305 (1981).
  \item \(^10\) 11 U.S.C. §§ 1101(1), 1106-1108 (1982). As a trustee, the debtor in possession may be subject to liability for breach of fiduciary duty, and is also subject to criminal sanctions under 18 U.S.C. §§ 152-155 (1982), for unlawful acts such as concealment of assets and embezzlement. The term debtor is used for convenience in the text unless a distinction exists, as for example, in a discussion of postpetition conduct by the debtor acting as debtor in possession and exercising the powers of a trustee.
  \item \(^12\) One hundred twenty days are afforded to the debtor as an exclusive period in which to file a plan, and one hundred eighty days are granted in which to have it
\end{itemize}
mation with which to formulate a plan, although liquidation plans are possible.\textsuperscript{13}

Following circulation of the reorganization plan, balloting by creditors and notice of a hearing,\textsuperscript{14} the plan must meet certain minimum requirements in order to be confirmed by the court. The debtor must generally obtain a minimum number of votes in favor of the plan among each class of creditors.\textsuperscript{15} Under certain circumstances, a dissenting creditor or class of creditors may be forced to accept a plan under what is colloquially referred to as a "cram-down."\textsuperscript{16} In practice, most debtors elect to forego the uncertainties of a "cram-down" in favor of negotiated treatment of creditors under an agreed upon plan. Finally, a successful debtor obtains confirmation of a plan and pays off its creditors under this restructuring of debts.\textsuperscript{17}

It should be noted at the outset that the purpose of a Chapter 11 proceeding is to allow the recovery of businesses and to simultaneously create an environment in which creditors, especially unsecured creditors who might receive little if anything in liquidation, are likely to receive greater payments. To this end, the Code grants a respite or "breathing space" for a debtor to reorganize.\textsuperscript{18} It is during this period of uncertain duration in which the interest of a secured creditor is at greatest risk.

\textsuperscript{13} See 11 U.S.C. § 1121(b), (c)-(d) (1982). For a case in which extension of the exclusive period was ultimately denied, see In re Ravenna Indus., Inc., 20 Bankr. 886 (Bankr. N.D. Ohio 1982).


\textsuperscript{15} See id. §§ 1124, 1126.

\textsuperscript{16} See id. §§ 1124, 1129(b).

\textsuperscript{17} Id. § 1129(a).

III. PRELIMINARY NOTICE TO THE CREDITOR: THE FIRST MEETING OF CREDITORS AND FILING OF SCHEDULES AND CLAIMS

In most cases, a creditor first learns of the filing of a Chapter 11 bankruptcy petition through a notice from the court informing the creditor that a petition has been filed, an automatic stay is in place, and a "first meeting" of the creditors has been scheduled for a specified date.\(^\text{19}\) Before the meeting of creditors, however, the debtor is required to file sworn schedules of assets and liabilities and a statement of financial affairs covering such topics as insider trading, preferences and diversion of assets. The schedules are due from the debtor within fifteen days of filing the petition in bankruptcy.\(^\text{20}\) They may be amended at a later time.\(^\text{21}\) Unlike Chapter 7 proceedings, the schedules constitute prima facie evidence of a creditor's claim.\(^\text{22}\) Therefore, a creditor should press the debtor in possession to amend the schedules if they are incorrect or file its own claim as additional insurance against a later dispute over the amount of its claim.

Depending upon their accuracy and thoroughness, the schedules may provide invaluable information to creditors' counsel regarding the debtor's assets, liabilities, secured status, comparison of secured and unsecured debts to assets, cash flow, losses, and greatest sources of pressure, as well as the debtor in possession's likely relationship with trade creditors. These factors may affect the likelihood of the business' continued operation. Schedules vary widely in terms of information provided, in part depending upon the complexity of the debtor's business affairs and the extent of its efforts at compiling the schedules. Thus, counsel for creditors are advised to carefully review the schedules before the first meeting of creditors.

The first meeting of creditors must be held within twenty to forty days from the date the order for relief is entered.\(^\text{23}\)

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\(^{20}\) Id. § 521(1); Bankr. R.P. 1007(b)-(c), 1008.
\(^{21}\) Bankr. R.P. 1009.
\(^{22}\) 11 U.S.C. § 1111(a) (1982). This provision does not apply to unliquidated, contingent or disputed claims, for which proof of a claim should be filed.
\(^{23}\) Id. § 341(a); Bankr. R.P. 2003(a). This time period cannot be reduced. Bankr. R.P. 9006(c)(2).
The debtor's attorney will usually begin the meeting with a short statement as to the cause of the reorganization and the direction of any possible plans of the debtor. The debtor is then required to testify under oath and submit to examination by creditors. The meeting is ordinarily presided over by the clerk rather than the bankruptcy judge.

The meeting may also provide an important source of information for creditors. The creditor's counsel may use this opportunity to confirm that the collateral is insured and protected, and to learn of its location, use and maintenance. In addition, counsel may inquire about the potential for a decline in the value of collateral, especially inventory, cash, and accounts receivable. Counsel may also inquire whether the debtor has any thoughts about a possible plan; the debtor's answers will not, of course, be binding. However, the debtor may be estopped from later disclaiming any representations made or assurances given to creditor who have relied upon them to their detriment. Counsel should also be alert to other creditors' concerns for early indications of sources of trouble in the reorganization.

Under section 1102(a)(1) and (2) of the Bankruptcy Code, the court will appoint a creditors' committee of the seven largest unsecured creditors. They are afforded certain powers, including the right to obtain counsel, the cost of which eventually may be reimbursed by the debtor as a cost of administration. If a secured creditor believes that it may be undersecured because of the value of its collateral on the date of filing, it may be able, on the basis of its unsecured claim, to exert additional leverage on the debtor by serving on the creditors' committee.

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24. 11 U.S.C. § 343 (1982). On motion, other persons may also be required to submit to examination under Bankruptcy Rule 2004. In an appropriate case, the debtor may even be apprehended and brought in for examination under Bankruptcy Rule 2005.


26. While a plan may be filed with the petition, in practice it is quite unusual because of the "11th hour" nature of most filings.


28. See id. § 506(a) regarding bifurcation of claims. See also Bankr. R.P. 3012.

29. However, the presence of such a creditor on the committee might constitute a conflict of interest as the creditor will seek the greatest return on its secured claim, to the detriment of unsecured creditors.
IV. THE PRIMARY BATTLEGROUND: RELIEF FROM STAY UNDER SECTION 362 OF THE BANKRUPTCY CODE

After the petition in bankruptcy is filed, an automatic stay is imposed. The stay has serious ramifications for all creditors. The automatic stay is consistent with the policy of the Code to afford "breathing space" to a debtor in which to reorganize and sort out its business affairs. Under section 362(b), the Code also enjoins the commencement or continuation of judicial, administrative or other proceedings (such as arbitration), including the issuance or employment of process against the debtor, or attempts to recover a prepetition claim against the debtor. Similarly, attempts to enforce a prepetition judgment against the debtor or the property of the estate are barred. Also barred are attempts to perfect and secure other interests. In effect, the stay prevents perfection of secured liens and debt collection, including replevin, garnishment, demands and foreclosures.

Among exceptions to the scope of the stay are all governmental actions under an agency's police or regulatory powers (as opposed to debt collection) and enforcement of such judgments, other than money judgments. Criminal prosecutions against the debtor are also not enjoined unless they

32. The following are not allowed: any act to obtain possession of property of the estate; any act to create, perfect or enforce a lien against property of the estate; any act to create, perfect or enforce against the property of the debtor a lien to the extent it secures a prepetition claim; any act to collect, assess or recover a prepetition claim against the debtor; the setoff of any prepetition debt owing to the debtor against any claim against the debtor; and the commencement of proceedings before the United States Tax Court concerning the debtor. 11 U.S.C. § 362(a) (1982).
involve debt collection, such as restitution for a bad check. A debt may also be accelerated under a contractual provision for default as long as no action is taken to collect on the debt. The cases are in conflict over whether the automatic stay tolls periods of redemption under state law, although statutes of limitation are extended.

Under section 362(c), the stay is in effect until the property in question is no longer property of the estate, the case is closed or dismissed, or a discharge is granted. Violation of the automatic stay subjects a creditor to contempt sanctions, even if such action is taken with no knowledge of the stay. However, the likelihood of imposition of contempt sanctions under such circumstances is slight.

State court actions involving secured creditors which are pending, but stayed, may be removed to the bankruptcy court under Code section 1478. In addition, some prepetition claims may be commenced as adversary proceedings in bankruptcy court.

42. Bankr. R.P. 7001-7087 govern procedure in such cases. An interesting question is whether a state court may be permitted to continue solely for the purpose of
As the previous discussion indicates, the Code reverses the usual procedure in which a party must first make an adequate showing of irreparable harm to a court in order to be entitled to injunctive relief. Since the intent of section 362 is to afford the debtor immediate protection to prevent diminution of the estate, with its impact upon chances for a successful rehabilitation, the Code presumes the likelihood of such harm and automatically imposes the stay. If the stay is challenged, however, the burden shifts to the debtor to justify continued imposition of the injunction.43 The grounds for relief from the stay, contained in Code sections 362(d)(1) and (2), are discussed in detail in the following subsection.

A. Substantive Bases for Relief from Stay

1. The Initial Question: Perfection of the Lien

In considering whether to seek relief from stay, the first question is whether the creditor’s claim is actually secured.44 A recent granting of a lien, if not contemporaneous with the debt, is suspect and may be open to challenge as a voidable preference.45 Failure to perfect a lien means that while the lien may constitute an enforceable interest against the debtor, it is rendered subordinate to the positions of other secured creditors with perfected interests who might otherwise hold liens junior to those of the unperfected creditor. An unperfected lien may also be set aside by the debtor under section 544(a)(1) which imputes the avoidance powers of a lien creditor under state law to the debtor in possession acting as trustee.

determining the question of priority of conflicting security interests in a declaratory judgment action.


44. A creditor is not entitled to adequate protection under section 362 if its security interest is unperfected on the date of filing. Cable Sys., Inc. v. Coors of the Cumberland, Inc., 19 Bankr. 313, 320 (Bankr. M.D. Tenn. 1982).

45. See 11 U.S.C. § 547(b)-(c) (1982). See also id. § 545 (voidable statutory liens). New prepetition liens are not voidable if given for new value as purchase money security interests. Id. § 547(c)(3). They are also not voidable if they constitute a perfected security interest in inventory, a receivable or proceeds of either under a continuing security agreement, except to the extent the secured creditor has improved its position to the detriment of unsecured creditors. Id. § 547(c)(5). An action to determine validity of a lien is an adversary proceeding. BANKR. R.P. 7001.
The debtor in possession may thus upset an unperfected security interest under these powers for the benefit of remaining creditors through enlargement of the assets of the estate available to fund a plan. This is an especially prevalent practice with regard to disguised security interests under the Uniform Commercial Code which, although denominated as "lease arrangements," may be found to constitute purchase agreements with the lodging of title in the debtor.46

Finally, it should be noted that Code section 552(b) provides an exception to the general rule contained in section 552(a) that property acquired by the estate or the debtor after commencement of the case is not subject to a lien resulting from a prepetition security agreement. Section 552(b) permits prepetition security interests in proceeds of prepetition collateral under a continuing security agreement unless the court, after notice and a hearing and based on the equities of the case, orders otherwise.47

2. Relief for Cause, Including Lack of Adequate Protection of the Creditor's Interest

Section 362(d)(1) provides the first basis for relief from stay: relief may be granted for cause, including lack of adequate protection of the interest of a secured party under section 361. Although the term "cause" is not defined in the Code, the courts have construed it to include bad faith in the filing of a petition in bankruptcy when the debtor has no means of reorganizing and it can be shown that the petition was filed solely to harass or delay creditors from realization


47. The historical and revision notes to 11 U.S.C. § 552 (1982) indicate that the intended exception to continuation of a security interest occurs when value is added by the estate to collateral; for example, where raw materials are converted to inventory, or inventory to accounts, at a cost to the estate. The secured creditor is not to receive a windfall at the expense of unsecured creditors.
of their interests.\(^{48}\) However, failure to make payments after filing of the petition does not by itself constitute cause for relief.\(^{49}\)

The concept of adequate protection, as provided by section 361, means that regardless of whether the secured creditor is undersecured or oversecured on the date of filing, his position should not deteriorate simply because the automatic stay is imposed, such that he suffers a loss of property or the benefit of his bargain. This rule of law is based upon the fifth amendment’s constitutional prohibition against deprivation of property without due process.\(^ {50}\) The benchmark for determining whether one is adequately protected is the value of the lien rather than the amount of the debt as of the date of filing.\(^ {51}\)

When determining the necessity of protecting the creditor's position, the courts often speak in terms of whether an “equity cushion” exists. This concept, sometimes also called a “value cushion,” is based upon a measurement of equity in the property available to protect the interest of the secured creditor from diminution of the collateral through depreciation.

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\(^{49}\) In re Household Fin. Corp. v. Adams (In re Adams), 27 Bankr. 582 (D. Del. 1983). Failure to make payments may have the effect of “eating away” at the equity cushion, as interest accrues on the principal balance of the claim under 11 U.S.C. § 506(b) (1982).

\(^{50}\) See Wright v. Union Cent. Life Ins. Co., 311 U.S. 273 (1940); Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555 (1935); 11 U.S.C. § 361 historical and revision notes (1982);

tion or depletion (for example, consumption of inventory in the debtor's business operations without adequate replacement) during the reorganization. For this purpose, only the moving party's lien, rather than senior or junior liens, is relevant.\textsuperscript{52} However, the courts have held that even where there is an equity cushion, if it is declining and is likely to be eliminated, the debtor may still be ordered to provide adequate protection, as a \textit{quid pro quo} for continuation of the stay.\textsuperscript{53}

The Code does not precisely define the measure of valuation to be considered by the courts.\textsuperscript{54} The drafters' comments indicate that this ambiguity was purposely intended by Congress in order to allow flexibility to determine the issue on a case-by-case basis. Therefore, a creditor is likely to argue for the employment of liquidation or forced sale value on the theory that the court should consider what the creditor may recover if ultimately forced to repossess the collateral following unsuccessful reorganization attempts.

As with other cases where valuation is at issue, the court may consider evidence such as offers to purchase and the testimony of the owner to determine whether a party is adequately protected. However, the testimony of a qualified appraiser is generally required. This testimony is necessary because the amount of the lien against the property is seldom at issue and, therefore, the value of the property is usually the focus in such proceedings. A party is not estopped from employing one measure of valuation at one stage in the proceedings and a different one at a later stage.\textsuperscript{55} Valuation of a claim as of the date of filing may be determined by means of a motion brought by the debtor or creditor at any

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  \item \textsuperscript{52} An excellent discussion of this concept, and of the means of determining equity for adequate protection purposes as opposed to the alternative ground for relief from stay under 11 U.S.C. § 362(d)(2) (1982), is provided in La Jolla Mortgage Fund v. Rancho El Cajon Assocs., 18 Bankr. 283 (Bankr. S.D. Cal. 1982).
  \item \textsuperscript{53} See, e.g., id. at 288. A minority of courts have taken the position that a secured creditor is entitled to preservation of the status quo during the reorganization proceedings, including the amount of any equity cushion which exists on the date of filing. Cf. Sanders v. Tucker (\textit{In re} Tucker), 5 Bankr. 180, 183 (Bankr. S.D.N.Y. 1980) (collateral to debt ratio must be considered).
  \item \textsuperscript{54} The value of the collateral is the amount to be realized "from the most commercially reasonable disposition practicable under the circumstances." Schiavoni v. Beneficial Consumer Discount Co. (\textit{In re} Schiavoni), 19 Bankr. 51, 52 (Bankr. E.D. Pa. 1982) (Chapter 13).
  \item \textsuperscript{55} See 3 \textsc{Collier on Bankruptcy} § 506.04[1], at 506-18 (3rd ed. 1984).
\end{itemize}
stage in the proceedings. A creditor may also argue that a debtor, based upon past behavior, will not protect its collateral; therefore, the court should disregard the legal fiction that the debtor in possession is a distinct entity. Under appropriate circumstances, it may even request appointment of a trustee under section 1104(a).

There is no time limit for bringing a motion for relief from stay. However, after considering the risks and benefits of foregoing action in the short term and the chance of a successful request for relief, a creditor is well-advised to seek immediate relief to protect its position. When deciding the question of adequate protection, the court may consider means of protecting the creditor's interest proposed by the parties, including personal guarantees and mortgages offered by corporate principals. While the Code suggests types of protection under section 361, the list is not exclusive. Under the doctrine of marshaling of assets, a creditor may be forced to move against the debtor's principals prior to obtaining relief from stay.

3. Preservation of Cash Collateral

Under section 362(d)(1) of the Bankruptcy Code, a creditor may also seek to obtain "cash collateral" as protection. Section 363(a) defines the term "cash collateral" as including proceeds of collateral in which the estate and another entity have an interest, including postpetition proceeds of prepetition collateral under section 552. Section 363(c)(2) prohibits use of cash collateral by the debtor in possession without an order from the court or consent of the creditor, while section 363(4) requires the debtor to segregate and account for the cash collateral. A creditor may use these requirements as a lever with which to bargain with the debtor for the creditor's consent to use of the cash collateral.

57. Id. § 102(3). See also id. § 361 historical and revision notes.
58. Cf. In re Multiple Servs. Indus., Inc., 18 Bankr. 635 (Bankr. E.D. Wis. 1982) (trustee's motion in Chapter 7 granted; bank ordered to marshall security to preserve assets for unsecured creditors).
Despite this clear prohibition against the use of cash collateral, the debtor is unlikely to apply to the court for permission to use cash collateral and risk losing by bringing the issue to the attention of the creditor. Typically, the debtor needs to use cash generated by accounts receivable to remain in business, especially if poor cash flow was a precipitating factor in filing, since suppliers usually force the debtor in possession to operate on a C.O.D. basis. Recognizing this reality, and that spent cash cannot be replaced and its proceeds cannot be easily traced, the drafters placed these broad prohibitions and protections in the Code.

Time may be of the essence to a creditor concerned with possible depletion of cash collateral. A debtor who is losing money may be tempted to deplete inventory and cash from accounts receivable by using them in its business operations at a continued loss. The risk to the debtor is not great, as the Code fails to back such prohibitions with clear sanctions for a violation. Therefore, a cautious creditor should request an immediate court order enjoining use of cash collateral without an accounting and, as suggested by the list of possibilities in section 361, seek adequate protection through either a provision for replacement of the security, a superior lien, or cash payments. Once cash collateral is gone, there is seldom any recourse or remedy left for the creditor.60

In determining whether to continue the stay, the court will take into account the debtor's need to use such collateral to effect a reorganization, the Code's policy favoring reorganization whenever possible, and the creditors need to protect his collateral.61 A court may condition continuing the stay on: payments under section 361(1); provision of addi-


tional or replacement liens under section 361(2); secured personal guarantees of third parties; or, relief other than the granting of administrative status under section 503(b)—generally considered unreliable protection. This last alternative must result in realization of the undefined "indubitable equivalent" of the creditor's interest. A secured creditor should therefore consider exerting the leverage afforded by the Code in order to obtain as adequate protection a perfected security interest in the debtor in possession's postpetition accounts receivable.

4. Relief from Stay of Acts Against Property: Lack of Equity and Necessity for Effective Reorganization

Code section 362(d)(2) provides an alternative ground for relief from the automatic stay, specifically with respect to an act against property. The statute provides that the court may grant such relief if the debtor has no equity in the property and the property is not necessary to an effective reorganization. The burden of proving lack of equity is upon the moving party. The burden for proving all remaining grounds for continuing the stay under section 363(d)(2) is upon the debtor.

In determining the question of equity for this purpose, the court will aggregate all liens against the property, not only those of the moving party. Since the amount of the claim or lien against the property is usually not at issue under section 506(a), the value of the collateral is again typically the central issue in such proceedings.


64. 11 U.S.C. § 362(g) (1982). Although the burden is on the debtor to show good faith, in practice the courts require the moving party to establish a prima facie case of lack of good faith in the filing of the petition. See Ordin, supra note 48, at 1841.

In considering the use of section 362(d)(2) as an alternative basis for relief, a court may look at whether there are substitutes for the property such as leased equipment or vehicles. However, the court is not limited to considering the debtor’s need for the property. Courts have held that inherent in the question of an effective reorganization is whether there is any prospect for a viable reorganization in the first place. Thus, they may examine such factors as whether the debtor is capable of obtaining supplies necessary for ongoing operations, whether business operations have irrevocably ceased, whether the debtor has maintained sufficient clientele to continue in business, the extent of the debtor’s assets and cash flow, its incurring of substantial postpetition debts, continuing losses, and excessive administrative expenses which will be incurred in liquidating under a plan of reorganization rather than under Chapter 7 of the Code. A court may be more lenient toward the debtor on this issue, depending upon the stage in the proceedings when the question is raised. Because of the flexibility afforded by Code section 361, a creditor may also request that the court condition continuation of the stay upon the debtor’s filing of a plan by a certain date.

A finding on both elements is necessary to receive relief under section 362(d)(2). A court may continue the stay even if the estate has no equity in the property, if the property is necessary for reorganization. It should be recognized that time may be of the essence both to avoid harm to the collateral and to convince the court of the gravity of the situation and of the irrevocable harm to the creditor’s interests if the reorganization is allowed to proceed without the granting of relief. Because of the court’s tendency to give a nascent reorganization the benefit of the doubt, prospects of success may appear dim for the creditor. However, it is still in the creditor’s interest to attempt to obtain relief since this may increase the credibility of the creditor if a renewal of the mo-

68. One court refers to this policy as “the rehabilitative ideal.” In re Barrington Oaks Gen. Partnership, 15 BANKR. 952, 964 (Bankr. D. Utah 1981) (footnote omitted). See also supra note 30.
tion for relief is made with the court. The secured party may also be entitled to a super-priority position under Code section 507(b) if the court in retrospect determines that the adequate protection given or found as required by section 362 was actually insufficient to prevent harm to the creditor’s position.

A creditor with a claim to most of the assets of the debtor may decide that the burden of establishing insufficient equity is easier to meet with regard to obtaining relief from stay than the burden it faces in either establishing grounds for a dismissal of the debtor’s petition or conversion to a Chapter 7 proceeding. Furthermore, a creditor considering moving for relief from stay must also consider that failure to act in a timely fashion may result in subsequent actions prejudicial to its interests, from both the debtor and other creditors, such as a later dismissal or conversion.

B. Procedure for Obtaining Relief from Stay Under Section 362 of the Code and the Bankruptcy Rules

Under Bankruptcy Rule 4001, relief from stay is sought through a motion filed with the court. A responsive pleading is unnecessary. Service must be made on the debtor in possession and such persons as the court directs. Typically, such notice is given to all interested parties, including the debtor’s attorney and the holders of all other liens on the property, which may include federal, state and local tax authorities. Service of all notices may be made by first class mail unless otherwise indicated by the rules.

In a unique provision, the Code in section 102(1) permits the court to grant an interested party relief without a hearing assuming there is no objection. Unless otherwise specified in the Code, section 102(1)(A) provides that there must be such notice and opportunity to request a hearing as is “appropriate in the particular circumstances.” While length of notice is not specified, the Bankruptcy Court for the Eastern District of Wisconsin has indicated that in the ordinary case,

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fifteen days should be allowed for filing objections and requests for hearing. If the need for relief is considered urgent, a hearing date may be obtained and a notice of motion may be served which announces the date of the hearing rather than merely the opportunity for a hearing.

Under section 362(e), the court may hold either a preliminary or a final hearing at which evidence may be taken. The court may continue the stay after determining at the preliminary hearing that the party opposing relief has a reasonable probability of prevailing on the motion at the final hearing. Thus the court will look for the presence of factual issues such as valuation of the collateral, perfection of the security interest, the existence of adequate protection, or other legal issues which cannot be properly determined at the preliminary hearing. Absent a waiver of these deadlines by the parties, the court must grant the requested relief within thirty days of the motion, or schedule a final hearing within thirty days of the preliminary hearing.

The bankruptcy rules provide for ex parte relief from the stay under certain specified limited circumstances. After relief is granted the moving party must immediately give oral notice to the debtor in possession and ensure that it obtains copies of the order granting relief. The adverse party may then appear and move for reinstatement of the stay on two days notice to the party obtaining relief.

The rules provide for discovery in adversary proceedings. Therefore, time permitting, the secured party may wish to employ interrogatories or depositions to establish value, use and protection of the collateral, its location, and the possibility or probability of a successful reorganization.

73. This requirement is promulgated by the bankruptcy court for the Eastern District of Wisconsin and can be found in “Notice of Change in Procedure for Seeking Relief from the Automatic Stay and for Lien Avoidance under Section 522(f),” paragraph 3.b.
74. See Bankr. R.P. 4001(b).
75. See Bankr. R.P. 4001(c). The moving party must show that immediate and irreparable harm will occur before there is a chance for the adverse party or his or her attorney to be heard. The movant’s attorney must also certify to the court in writing the efforts, if any, which have been made to give notice, as well as reasons why further notice should not be required.
76. See Bankr. R.P. 7026-7037 (these rules make specified sections of the Federal Rules of Civil Procedure applicable).
While the Code does not provide the applicable standard of proof, it would seem that in the normal case involving valuation, the proper standard would be the ordinary civil burden of establishing the facts by a clear preponderance of the evidence. When fraud or bad faith is alleged as “cause,” the middle standard of clear and convincing evidence would arguably apply.

Under Code section 554(b) and Bankruptcy Rule 6007, a party moving for relief from stay on the basis of lack of equity may also join with its motion, a motion to direct the debtor in possession to abandon the property to the debtor. The basis for such a motion is that the property is of inconsequential value or is burdensome to the estate. If successful, the property is “abandoned” and reverts to the possession of the debtor. The secured party can then commence or continue the appropriate steps to foreclose on the assets and obtain possession of the collateral.

V. CREDITOR PROBES AND POSTURING: EXERTING PRESSURE ON THE DEBTOR TO DETERMINE THE PROBABILITIES OF SUCCESS AND CONCESSION

A. Motion For Adequate Protection

Before the debtor in possession may continue the automatic stay,77 use, sell or lease property outside of the ordinary course of business, use cash collateral78 or obtain credit in return for certain specified types of consideration,79 the Code requires that the creditor’s interest in property of the estate be protected. Rather than moving for relief from stay, a creditor concerned about depreciation or depletion of its collateral during the reorganization proceedings may move that specific types of adequate protection be provided by the debtor if such protection is available. The burden is upon the creditor to demonstrate that its interests are not adequately protected. A controversy exists, however, over whether a creditor may receive compensation as adequate protection for the delay in use of its property. The compen-

78. Id. § 363(c)(2).
79. Id. § 364.
sation would be measured by the income the creditor could have earned from the property's use if it were free from the restrictions of the bankruptcy proceedings.80

B. Relief for Breach of the Debtor's Duty to File Financial Reports

Code section 704(7) and Bankruptcy Rule 2015 require that the debtor in possession as trustee file periodic financial statements with the court, including statements of receipts and disbursements, and any other information which the court demands. Creditors should monitor such reports in order to uncover warning signs of a debtor's worsening economic position or a diversion of assets through use, sale or lease outside the ordinary course of business without court authorization. Failure to file such a report may be a clear warning of worsening business conditions or poor bookkeeping practices. It may also constitute grounds for dismissal, conversion, or appointment of a trustee or examiner.81

C. Collateral Assault on the Debtor: Enforcement of Personal Guarantees

Although not strictly within the scope of the bankruptcy proceedings, a secured party with a personal guarantee by the principals of a corporate or partnership debtor may consider independent enforcement of such guarantees. The creditor's motivation may be both to recover on the guarantees and to exert additional leverage on the debtor, albeit indirectly, in order to receive cooperation in the bankruptcy proceedings. The creditor must also be aware of the potential for driving the individual into a personal bankruptcy as


well. While the general rule is that the automatic stay does not bar actions against third parties who have not filed in bankruptcy, under certain circumstances the court may enjoin such proceedings under its general equitable powers, particularly when the debtor can show that defending against a collateral action will impair efforts to rehabilitate.\textsuperscript{82}

\subsection*{D. Removing the Debtor: Appointment of a Trustee or Examiner}

Under section 1104(a), the court may order appointment of a trustee for cause at any time before confirmation of a plan, on request of a party in interest and after notice and a hearing. Cause is defined as, but is not limited to, fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management. In the alternative, the court may order appointment of a trustee if the appointment is in the best interest of the creditors, any equity holders or any interest of the estate. The court may make such appointment only on the request of a party in interest, not sua sponte.\textsuperscript{83} The burden of proof is upon the moving party.\textsuperscript{84}

In evaluating the interests of the parties, the court may look at continued losses, preferences, transactions with related entities, depletion of the estate or postpetition transfer of assets without permission. In determining whether to grant the motion, courts primarily weigh the need for protecting creditors and other interested parties against the costs and expenses of appointment.\textsuperscript{85} The statute also provides for appointment of an examiner under certain circumstances.


\textsuperscript{83} \textit{In re} Mandalay Shores Coop. Housing Ass'n, 22 Bankr. 202, 207 (Bankr. M.D. Fla. 1982).

\textsuperscript{84} \textit{In re} Crescent Beach Inn, Inc., 22 Bankr. 155, 159 (Bankr. D. Me. 1982).

E. Pulling the Plug: Conversion or Dismissal of the Proceeding

Code Section 1112(b) provides for conversion to a Chapter 7 liquidation or dismissal of Chapter 11 proceedings for cause, on request of a party in interest and after notice and a hearing. 86

This section lists several examples of “cause” and includes, inter alia: (1) continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation; or (2) inability to effectuate a plan. 87 Grounds for dismissal or conversion may also include the bad faith of the debtor 88 or lack of authority to file the petition in bankruptcy. 89 Generally, the likelihood of success on such a motion is greater at a later stage in the proceedings, when inability to effectuate a plan is more evident and the court is less likely to give the debtor further breathing space in which to devise a plan. If in fact the case is converted, counsel should be alert to requirements under Chapter 7 which may not apply in the Chapter 11 proceeding. 90

F. Objections to Authority Necessary to Continue Business Operations: Use, Sale or Lease of Property, and Obtaining Credit

Code Section 363(c) provides that, with the exception of cash collateral, the debtor may use, sell or lease property of the estate in the ordinary course of business without court authorization. This section grants unimpeded authority to use and dispose, in the ordinary course of business, property

86. If the debtor is a former or an eleemosynary institution, the court cannot convert the case to Chapter 7 without a request by the debtor. See 11 U.S.C. § 1112(c) (1982).
90. For example, under Chapter 7, an undersecured creditor must file a proof of claim within 90 days of the Section 341 meeting, or risk loss of payments for the deficiency. 11 U.S.C. § 501(a) (1982); BANKR. R.P. 3002.
which has been pledged as collateral. In all other cases, the trustee must first obtain court permission, after notice and a hearing.\textsuperscript{91} Further, the debtor may use, sell or lease property outside the ordinary course of business notwithstanding any liens if applicable nonbankruptcy law permits sale of the property, the creditor consents, the sale price is greater than the aggregate of all liens, the lien is in bona fide dispute, or the creditor can be compelled to accept a money satisfaction of its interest.\textsuperscript{92} In such cases the creditor's lien attaches to the proceeds of the sale.

Under section 364, the debtor may also obtain unsecured credit in the ordinary course of business without court authorization. If credit cannot be so obtained, with court permission the debtor may seek to invoke a series of increasingly burdensome measures to secure the bankruptcy lender. These measures include providing a lien on unencumbered assets, providing the lender with a priority claim under section 507, or providing a senior lien on collateral if the present secured creditor is given adequate protection.\textsuperscript{93}

\textbf{G. The Case of the Land Contract Chameleon: Executory Contract or Security Interest?}

Protecting the interest of a vendor on a land contract, also sometimes known as an installment land sale contract or contract for deed, provides a special situation in bankruptcy. Many courts have held that such contracts are in fact executory contracts and as such are subject to Code section 365.\textsuperscript{94} If so, the contract cannot be assumed by the debtor in possession with court approval unless the debtor first cures any defaults or provides adequate assurance of

\textsuperscript{91} 11 U.S.C. § 363(b) (1982).
\textsuperscript{92} Id. § 363(f). The cost of the sale may be satisfied out of the property and the creditor's lien. Id. § 506(c). See also In re Trim-X, Inc., 695 F.2d 296 (7th Cir. 1982).
\textsuperscript{93} 11 U.S.C. § 364(d) (1982). The debtor has the burden of showing adequate protection. Id. § 364(d)(2).
prompt curing of such defaults, and further provides ade-
quately assurance of future performance under the contract. If on request of a party in interest, the debtor may be com-
pelled by the court to elect to assume or reject the contract within a specified time. If rejected, the vendor is allowed to proceed against the property and is given an unsecured claim for damages caused by such rejection.

Determining whether the contract is executory depends on state law and the degree of the debtor's performance to date under the agreement. For example, if all payments have been made and all that remains is for the vendor to tender the deed, a court is more likely to construe the contract as executed and as constituting security for performance of the agreement, similar to a mortgage. The court may also consider the equities of the situation in determining whether to grant relief from the stay, including the loss of equity in the property during the reorganization proceedings, any adverse impact upon other creditors if relief is granted, and the likelihood of a successful reorganization.

VI. Final Stage: Confrontation or Cooperation?

The ultimate goal of any reorganization proceeding is to obtain court confirmation of a plan of reorganization which restructures the debts of the debtor. The Code provides a limited period in which the debtor has the exclusive right to file a plan, after which any interested party may file a plan. For the secured creditor, the importance of this provision is not the possibility of obtaining dismissal or conversion, for the purpose of this initial period is to allow for exclusivity and not to set a strict deadline. Rather, this section provides the creditor with leverage to exert pressure on the debtor by threatening to file his own plan, including a plan of

96. Id. § 365(d)(2); Bankr. R.P. 6006.
97. 11 U.S.C. § 365(g), (j) (1982). Special provisions apply to protect the pur-
chaser when the debtor is the seller. Id. § 365(i).
liquidation.99

A. Approval of the Disclosure Statement

The debtor must obtain court approval of a written disclosure statement prior to submitting a plan to the creditors for balloting. The debtor must transmit a disclosure statement to each creditor before soliciting approval of a plan. The court may approve a disclosure statement without a valuation or appraisal of the debtor’s assets. The court must first determine, however, after notice and a hearing, whether the disclosure statement which serves as a prospectus contains adequate information. This is defined by the Code as sufficient information under the circumstances and in light of the debtor’s nature and history and condition of its books to “enable a hypothetical reasonable investor typical of the holders of claims or interests of the relevant class to make an informed judgment about the plan.”100 Typically a disclosure statement will include a history of the debtor’s operations, including the events which led to the filing in bankruptcy, a description of the bankruptcy plan and an attempt to persuade the particular class that it is in that class’ interest to vote for the plan. Different disclosure statements may be provided to different classes of claims.

A secured creditor may object to approval of a disclosure statement.101 The hearing on the disclosure statement may be used to obtain information on treatment of other secured parties and to force disclosure of information which a creditor deems necessary in order to determine whether to vote for the plan.

B. Classification and Treatment of Claims Under the Plan of Reorganization

The Code divides claims or interests into those which are impaired under a proposed plan and those which are not. Section 1124 defines when a claim has been impaired. Gen-

100. Id. § 1125(a).
erally, a claim is impaired when the plan proposes to alter the legal, equitable and contractual rights of the creditor. Conversely, a claim is unimpaired by a proposed plan if the plan reverses any acceleration by curing defaults, reinstates the original maturity of claims and compensates for damages resulting from the default, or if the plan cashes out the claims of the class. The major significance of claims being labeled unimpaired is that an unimpaired class of creditors is generally deemed to have voted for the plan. This may have significant consequences for the debtor in determining whether the plan has been accepted by the requisite number of creditors and classes.

An outline of the contents of a plan of reorganization is contained in section 1123 of the Code. The plan must designate particular classes of claims. Each such claim must be placed in a particular class only if it "is substantially similar to the other claims or interests of such class." Further, the debtor cannot discriminate between the creditors in each class with respect to the treatment of the claims unless the holder of a claim agrees to less favorable treatment.

A plan must also provide for adequate means for its execution, such as retention by the debtor of property of the estate, transfer of property of the estate, transfer of property to other entities, merger or consolidation, or sale of all or any part of the property. The debtor may also propose to satisfy or modify a lien, cure or waive a default, extend a maturity date or change an interest rate, notwithstanding any acceleration or "ipso facto" clause. Creditors must carefully scrutinize the plan’s provisions in order to determine whether it is feasible. Beyond this skeletal framework, the Code provides the debtor with great flexibility in devising a plan.


105. Id. § 1123(a)(5).

106. Id.
The plan may be modified at any time before confirmation. The provision for modification allows the possibility of negotiated treatment in a plan. Often the debtor will circulate a proposed plan with a proposed or approved disclosure statement in order to solicit comments and to “test the waters” before putting the plan to a final vote. This testing minimizes the risk of rejection of the debtor’s plan and the acceptance of a creditor’s plan, or even dismissal or conversion. Circulation of a disclosure statement is therefore frequently the initial stage of negotiation of treatment of various creditors under the plan, in what is typically a long process of compromise. In the alternative, a series of plans may be necessary before confirmation can be obtained.

C. Acceptance or Rejection of the Plan, Election Under Section 1111(b), and Confirmation

Prior to implementation, the plan must be accepted by the creditors and an order must be secured which confirms the plan after notice and hearing. In order to conclude that a class of “impaired” claims has accepted the plan, it must be demonstrated that creditors who hold at least two-thirds in amount and more than one-half in number of the claims allowed by the court in each class have accepted the plan. This includes only creditors who actually voted. Thus, it is in the debtor’s interest to negotiate with creditors in order to obtain their vote. Creditors are particularly sensitive to receiving what they perceive to be fair treatment of their claims not only within classes but among secured creditors within differing classes. Therefore, a plan which proposes less advantageous treatment of a creditor’s particular interest as opposed to similarly situated creditors belonging to different classes is likely to be vigorously opposed by some or all such creditors.

Code section 1129 provides a list of requirements which must be met before the court can confirm a plan. In order to determine the proper treatment of a secured creditor, one

107. *Id.* § 1127; BANKR. R.P. 3019.
109. 11 U.S.C. § 1126(c). The court may void a rejection which is not in good faith. See *id.* § 1126(e).
must first determine the value of its secured claim under section 506(a). If the creditor was undersecured as of the date of filing, its claim will ordinarily be bifurcated into two claims — secured and unsecured. If the debtor chooses to contest the valuation of a secured claim, which would if successful create a large unsecured claim, the debtor risks alienating that creditor. As a result, it may be unable to procure the requisite number of votes in favor of the plan from the class of unsecured creditors. Typically, the debtor will count on obtaining the votes of at least the class of unsecured creditors by convincing them that they will receive a more favorable distribution under the proposed plan than they would in the event of a liquidation.

In arguing the value of its secured claim, a secured creditor must keep in mind that if the claim is oversecured under section 506(b), it may also be entitled to receive interest and attorneys fees under its contract with the debtor to the extent the claim is oversecured.

The Code again demonstrates its built-in flexibility with regard to valuation of a secured claim since it does not provide what measure of valuation should be employed at this particular point in the reorganization proceedings. Thus, the creditor who initially argued for use of liquidation value on a motion for adequate protection may later argue for use of a higher going concern or fair market value if the reorganized debtor seeks to continue use of the property in its reorganized business operations. In the words of the Code, the "value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property." The question of valuation in most large reorganization questions is resolved through negotiations in light of the uncertainty of the outcome of a court decision and the inherent risks for all concerned.

110. See Bankr. R.P. 3018(d). In addition, "if the holder of the unsecured deficiency claim votes against the plan, the class of unsecured claims must be paid in full before old equity can receive anything" under section 1129(b)(2)(B)(ii). Broude, Cramdown and Chapter 11 of the Bankruptcy Code: The Settlement Imperative, 39 Bus. Law. 441, 447 (1984).


112. 3 Collier on Bankruptcy ¶ 506.04, at 506-22 n.5 (3d ed. 1983).
Under the "best interest" test,\textsuperscript{113} each holder of a claim or interest in a claim must have either accepted the plan or received or retained property not lower in value than the creditor would have received if the debtor liquidated under Chapter 7 on the effective date of the plan. An alternative to this provision is available for a secured creditor. Code Section 1111(b)(1)(A) provides that a secured creditor may be treated as a recourse creditor, regardless of its contractual or state law rights. The intention is to allow the creditor to obtain the benefit of any increases in the value of the collateral which secures its claim, so that it may receive the full amount of its claim during the life of the plan.\textsuperscript{114}

Section 1111(b)(2) allows a class of secured creditors to waive the recourse provision and choose, by means of a two-thirds vote, to waive any unsecured deficiency under section 506(a) and to be treated as fully secured under the plan.\textsuperscript{115} The election is not available where the collateral is to be sold under the plan or section 363.\textsuperscript{116} The election may have serious consequences for the debtor, and affords additional leverage to the secured creditor. In order to be left unimpaired under section 1124, an electing creditor must receive the present cash payment of its entire claim, secured and unsecured portions alike. If the creditor is impaired, and it votes against the plan, its objection may be overcome only if certain requirements are met by the plan.\textsuperscript{117}

Thus, under section 1129(a)(7)(B), an undersecured creditor who has made the section 1111(b)(2) election to be treated as a fully secured creditor must receive property under the plan with a present value at least equal to the creditor's interest in the collateral, and totaling the full amount of its claim. If, for example, a claim for $100,000 is secured by collateral worth $50,000, the creditor must re-

\begin{itemize}
  \item \textsuperscript{115} The election must be made before approval of the disclosure statement, or at such time as the court allows. Bankr. R.P. 3014. See generally Broude, supra note 110, at 447.
  \item \textsuperscript{117} See generally Kaplan, supra note 114, at 270; Broude, supra note 110.
\end{itemize}
ceive payments over the life of the plan totaling at least the allowed amount of the claim ($100,000), with a present value equal to the value of its collateral ($50,000 plus interest during the plan).

D. "Cram-Down" of Dissenting Creditors

Ordinarily, to obtain confirmation, each class must have accepted the plan under the requirement set forth in section 1126, or must be left unimpaired under section 1124.118 However, an exception is provided for a so-called "cram-down" of a dissenting class of creditors by the court, if certain prerequisites are met. Under section 1129(b)(1), a court may confirm the plan regardless of dissenting classes if at least one class other than insiders has accepted the plan and the plan is fair and equitable to those classes of claims that are impaired and have not accepted the plan. Insiders include classes deemed to have accepted the plan under section 1126(f) because their claims are unimpaired under Section 1124.119

The Code specifically defines “fair and equitable” treatment of secured creditors. Such creditors must first retain their lien, “whether the property subject to such lien is retained by the debtor or transferred to another entity, to the extent of the allowed amount of such claim,”120 unless a sale under section 363(k) is proposed, in which case the lien must attach to the proceeds of the sale. In addition, each secured creditor must “receive on account of such claim deferred cash payments totalling at least the allowed amount of such claim, of a value, as of the effective date of the plan,” 121 at least equal to the value of the creditor’s interest in the estate’s interest in the property. In the alternative, the plan must provide for the realization by the secured creditors of the “indubitable equivalent” of their claims, a term which is

118. 11 U.S.C. § 1129(a)(8) (1982). The court may also reject a plan not proposed in good faith. Id. § 1129(a)(3).
119. Id. at § 1129(a)(10). But see In re Pine Lake Village Apartments, 19 Bankr. 819, 829 (Bankr. S.D.N.Y. 1982) (at least one impaired class must affirmatively accept the plan).
not defined by the Code, and has seen few judicial interpretations to date.\textsuperscript{122}

In practice, when the debtor proposes periodic payments to secured creditors over the life of the plan, the present value of the deferred cash payments or income must be determined in order to ascertain whether the creditor will realize the present value of its interest. This rule is based upon the time value of the money, and the fact that a creditor could invest such funds and obtain a return on its investment but for the imposition of the stay and of the bankruptcy plan. Therefore, the debtor will typically propose payment of the amount of the claim as principal with interest over the life of the plan, possibly with a "balloon" payment of the balance of principal and interest at the end of some specified term.

The battle typically comes down to whether an appropriate interest rate has been proposed by the debtor in its plan.\textsuperscript{123} For example, if a plan proposes deferred payments totalling $100,000 to a secured creditor with an allowed claim for the same amount secured by collateral of equal value, it cannot be confirmed over the creditor's objection. While the payments equal the amount of the claim, the present value of $100,000 in deferred payments without interest is less than the amount of the creditor's interest in the collateral.

The Code does not define the measure of a proper discount or interest rate. There is a dearth of cases defining such interest rates under Chapter 11 of the Code. While there are many decisions regarding the proper interest rate in cases under Chapter 13, the relevance of these cases to a major business reorganization is questionable. In addition, it must be noted that the results of these cases vary widely.\textsuperscript{124} In general, section 1129(b) requires that the appropriate dis-


\textsuperscript{123} See generally Klee, \textit{All You Wanted to Know About Cramdown Under the Bankruptcy Code}, 53 AM. BANKR. L.J. 133 (1979).

count rate be based upon the risk, the term of the plan, and market conditions. In addition, a court may consider "the rehabilitative ideal" of the Code in seeking to uphold an interest rate which makes the plan feasible.\textsuperscript{125}

In what appears to be the most logical reading of this statute, at least one court has held that the rate of interest should correspond to that which would be charged or obtained by a creditor making a loan to a third party upon terms similar to the duration, collateral and risk of the "loan" proposed under the terms of the plan.\textsuperscript{126} Because of the risk involved, the appropriate interest rate may be greater than that applicable under the initial agreement or the prevailing prime rate at the time of confirmation. Thus, the secured creditor may show that a proposed interest rate is unsatisfactory by submitting evidence as to the appropriate interest rate which would be charged by other institutional lenders. Another court has looked to the interest rate charged by the Internal Revenue Service as a relevant factor or benchmark in setting the discount rate.\textsuperscript{127}

Finally, regardless of whether the debtor is forced to invoke the cram-down provision, the court must determine if the plan is feasible. Unless proposed in the plan, a plan may not be confirmed if it is likely to be followed by liquidation, or the need for further reorganization of the debtor or any successor.\textsuperscript{128} In making this determination the courts will consider:

(1) the adequacy of capital structure; (2) the earning power of the business; (3) economic conditions; (4) the ability of management; (5) the probability of continuation of the same management; and (6) any other related matters which may determine prospects of a sufficiently successful opera-

\textsuperscript{125} In re Barrington Oaks Gen. Partnership, 15 Bankr. 952, 964-66 nn.30-31 (Bankr. D. Utah 1981). This case contains an excellent discussion of the problem of selecting an appropriate interest rate. \textit{Id}.


\textsuperscript{127} See \textit{In re} Nite Lite Inns, 17 Bankr. 367, 373 (Bankr. S.D. Cal. 1982).

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tion to enable performance of the provisions of the plan.129 Another factor is whether the monthly net income is sufficient to pay the carrying charges proposed under its treatment of creditors. Good faith of the debtor is irrelevant if the debtor cannot prove the plan is feasible.130 Expert testimony may be necessary to prove feasibility if challenged.131

As a result of the uncertainties created by the Code's provisions for "cram-down" and the ambiguity surrounding the appropriate discount rate and valuation of collateral, the debtor usually negotiates an agreement with its creditors in the majority of cases in which plans are confirmed.132 According to the generally recognized authority on this provision, this is not an unintended result.133 Neither party wishes to engage in a showdown in the bankruptcy court if compromise is at all possible. Thus, a secured creditor must be aware of both the positive and negative effects of these provisions on his position, as they will affect his negotiating posture with the debtor.

The initial burden of proof at a confirmation hearing under section 1141 is upon the debtor. The objecting secured creditor must be prepared to rebut a prima facie case made by the debtor at such hearing.

Finally, confirmation does not divest the bankruptcy court of continuing jurisdiction to supervise both the plan and any distribution to creditors under the plan, or to make whatever additional orders are necessary until issuance of a final decree and closing of the case.134 The case may be reopened and possibly dismissed or converted for grounds including failure or inability to comply with the plan,135 or a change in the debtor's financial circumstances. The order of confirmation may also be revoked if procured by fraud.136 At the same time, the Code provides for postconfirmation

131. Broude, supra note 110, at 448.
132. Klee, supra note 123, at 133.
133. Id. at 134.
135. 11 U.S.C. § 1112(b)(7)-(8).
136. Id. § 1144.
modification of the plan after notice and a hearing.137

VII. CONCLUSION

The initial response of a secured creditor unfamiliar with the Code's provisions for protection of its interest may be one of despair. The creditor is typically used to thinking of bankruptcy in terms of liquidation. Even when the creditor comprehends the distinction between liquidation and reorganization, it usually faces delays in realization upon its collateral or the obligation which it secures. The prospect for a restructuring of its claim also looms along with a delay in the use of its money, a delay possibly without interest compensation. Even after confirmation, in the majority of cases it is by no means certain that the debtor will be able to adhere to the terms of its plan without some modification to deal with unforeseen circumstances such as a change in the business climate.

Secured parties must realize, however, that in many ways the Code affords them the tools to protect their interests, whether by seeking return of the collateral under a motion for relief from stay, or by exerting pressure upon the debtor in a variety of ways in order to ultimately reach an acceptable negotiated treatment of its claim. Furthermore, the Code affords a creditor a measure of accountability and control through court supervision over use and disposition of collateral which might otherwise be lacking. It also provides immediate access to a forum equipped to deal with creditor-debtor issues in an efficient manner, under a mandate to make expeditious determinations. In fact, the creditor must acknowledge that the ultimate outcome of the reorganization proceedings may be beneficial to its interests. This is particularly true when the creditor is undersecured and elects to be treated as a fully secured creditor, receiving payment of its claim in full even though were the debtor to liquidate it would receive only the lesser value of its collateral.

Thus the secured creditor may determine that it is not necessarily opposed to the debtor's rehabilitation. The seemingly insurmountable obstacles posed by the imposition

137. See id. at § 1127(b).
of the automatic stay and the likely impending delay during the course of the reorganization are not inconquerable. In many ways, they may work in favor of the creditor. Assuming that it has a perfected lien, the creditor's interests are not seriously jeopardized as long as it remains constantly vigilant for signs of depletion or dissipation of its collateral. Thus the creditor must be cautious and on its guard, immediately affecting an aggressive stance in negotiations with the debtor, and exerting leverage and pressure wherever appropriate to obtain a beneficial result, while being careful not to breach the stay.

In effect, the creditor must force the debtor to buy its cooperation. Such cooperation may be necessary at almost every stage of the reorganization proceedings, not only in matters directly involving the parties, such as motions for relief from stay and provision of "adequate protection," but also when the debtor seeks cooperation of its creditors to obtain, for example, permission to use, sell or lease collateral, extension of time or permission to obtain new credit. Ultimately, the creditor must seek to obtain the best treatment of its interest under a plan as is reasonably possible, or if necessary, to recover some or all of its collateral. Thus the creditor must monitor the proceedings for failure by the debtor in possession to take all steps necessary under the Code, and for continued losses or depletion of the collateral and business failure.

If the steps suggested in this article are taken by the creditor, it may emerge from the reorganization proceedings in a strong, if not stronger, position than when it entered them, as the debtor in possession, freed from the burden of excessive debt, successfully reorganizes and continues doing business with the creditor and others in the future. Such is the hope of the drafters of the Code. The intended result, preservation of a viable economic entity which can contribute to the nation's economy and provide a potential continued source of employment, is surely in the interest of all concerned.