

When Is a Secured Creditor Entitled to Adequate Protection?

An Emerging Trend

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There has been extensive decisional law¹ on the issue of whether to grant a secured party adequate protection² of its interest in collateral as of (1) the petition date, (2) the date when the secured party makes a demand to the debtor for adequate protection, (3) the date of a motion to lift stay or for adequate protection, or (4) the date of a hearing with respect to a motion to lift stay or for adequate protection.³ The courts generally choose between either the petition date or the date of the motion.⁴ Courts that have chosen to grant adequate protection as of the petition date, when they offer any reason, seem to rely on a constitutional reasoning. As one bankruptcy court reasoned:

The very heart of the concept of adequate protection is to assure the secured creditor that as the bankruptcy procedures unfold he will not be faced with a decrease in the value of his collateral. The problem thus presented rises to the level of a constitutional issue that is whether the stay of the creditor's ability to exercise his contractual rights deprives him of a property right without due process of law.⁶



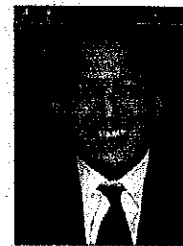
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Those courts that take the view that adequate protection should start only after the secured creditor demands it stand on more practical grounds: If secured creditors are always entitled to adequate protection as of the petition date, what's to stop them from waiting until the eve of confirmation of a proposed plan to step forward with a big adequate protection bill that may jeopardize the debtor's chances of reorganizing?⁷ Interestingly, the one circuit court to consider the issue took an entirely different course by adding another hurdle for the secured creditor. The Eighth Circuit Court of Appeals held that the secured creditor is only entitled to adequate protection from the hypothetical date that it would have been able to execute on the collateral had the debtor never filed its bankruptcy petition.⁸

The courts in *Haiflich* and *Best Products* essentially reason that the Bankruptcy Code confers no special right on the secured creditor insofar as adequate protection is concerned. Indeed, those courts point out that the Code expects the secured creditor to fend for itself insofar as procuring adequate protection.⁹ These courts generally use the date of the motion to either lift stay or seek

adequate protection as the date from which the debtor must provide adequate protection payments.¹⁰

This position does not necessarily conflict with the reasoning of the courts that have held that secured creditors are entitled to adequate protection from the petition date regardless of when the secured creditor formally demands it.¹¹ As Bankruptcy Judge Sledge noted in *In re Cason*: "Certainly, property rights protected by the Fifth Amendment can be waived."¹²



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The cases holding that adequate protection can accrue, if at all, only after the secured creditor demands it represent the trend. Whereas practically all courts that use the petition date (or some other pre-motion date) as the starting point for adequate protection benefits issued their decisions during the 1980s, courts that have considered the issue in the 1990s have tended to implicitly, if not explicitly, follow *Haiflich*. These cases coincide with the increasing adoption by the courts of the concept of multiple valuations. That is, collateral should generally be valued as of the confirmation date for purposes of whether to confirm a plan, but should be

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² Unfortunately, the Supreme Court did not reach this issue in *U.S. Savings Ass'n v. Timbers of Inwood Forest Assoc. Ltd.*, 481 U.S. 385, 108 S.Ct. 626, 98 L.Ed.2d 740 (1988). "A question left open in *Timbers*, and on which bankruptcy cases are split, is from what point in time are secured creditors owed adequate protection. (This issue is often presented as what is the appropriate valuation date for the collateral subject to the adequate protection motion: the petition date, motion date, confirmation or some other date)." *In re Continental Airlines Inc.*, 146 B.R. 536, 539 (Bankr. D. Del. 1992).

³ "Adequate-protection payments are designated to compensate a holder of a secured claim for any decline in the value of its collateral post-petition and pre-confirmation. To prove a decline in value, the movant must complete two steps. First, it must establish value at a beginning point, which is the benchmark. Second, it must show a decrease in that value. This may be accomplished by a comparison with a second value at the end of the protected period, by a previous decline from an earlier date, i.e., filing date, which is expected to continue by a straight-line depreciation, etc. The period protected by adequate-protection payments ends with the earlier of confirmation or termination of the automatic stay." *In re Cason*, 190 B.R. 917, 928 (Bankr. N.D. Ala. 1995), citing Thomas, Karlin L., "Valuation of Assets in Bankruptcy Proceedings: Emerging Issues," 51 Mont. L. Rev. 126 (1990). Establishing value involves an entirely different set of issues that are not the subject of the present article.

⁴ It is worth mentioning that the actual issue concerns the date by which a secured creditor is entitled to accrue adequate protection payments. As one court noted, even if one finds that adequate protection should be awarded only after the secured party demands it, "this does not contradict the principle that the claim subject to adequate protection is the value as of filing; it merely sets the point at which payments for a decline from that value should commence." *In re Addison Properties Limited Partnership*, 185 B.R. 766, 780 n. 15 (Bankr. N.D. Ill. 1995). Furthermore, as discussed in this article, adequate-protection payments will accrue prior to the date the debtor or trustee actually makes payment.

⁵ Commentators have also differed over this issue. Compare Blensstock, M.J., *Bankruptcy Reorganization*, pp. 174-175, n. 32 (1987) (adequate protection accrues as of demand or motion date) with Carlson, David O., "Time, Value and the Rights of Secured Creditors in Bankruptcy, or When Does Adequate Protection Begin?," *J. Bankr. Law & Practice*, Feb. 1992 (February 1992) (adequate protection payments accrue as of the petition date). See, also, Leung, Stephen P., "Tribling is Biverting: Determining the Date for Valuing Collateral," 17 Am. Bankr. Inst. J. 34 (July/August 1998) (that valuation "scheme that provides that collateral be valued (a) as of the filing date of the bankruptcy petition with respect to whether a creditor's interest has been adequately protected and (b) as of the confirmation date for purposes of plan confirmation").

⁶ *In re Born*, 10 B.R. 43, 48 (Bankr. S.D. Tex. 1981).

⁷ *In re Best Products Co. Inc.*, 138 B.R. 155 (Bankr. S.D.N.Y. 1992), *aff'd*, 149 B.R. 346 (S.D.N.Y. 1992); *In re Haiflich*, 63 B.R. 314 (Bankr. N.D. Ind. 1986).

⁸ *In re Ahlers*, 794 P.2d 388 (8th Cir. 1986), *reversed on other grounds*, 483 U.S. 197 (1988) (measure adequate protection as of the date when the creditor, absent filing of bankruptcy petition, could have taken possession of the collateral under state law and could have sold it to a third party, the amount that could have been realized and the creditor's expected return on reinvestment). See, also, *In re Ashby*, 66 B.R. 894 (Bankr. D. N.D. 1986); *In re Blackford Farms Inc.*, 68 B.R. 639 (Bankr. N.D. Iowa 1986); *In re Five Star Partners L.P.*, 193 B.R. 603, 615 (Bankr. N.D. Ok. 1996); *In re Glinz*, 69 B.R. 916 (Bankr. D. N.D. 1987).

⁹ See §363(e). The case is otherwise with regard to providing adequate protection for the use of cash collateral, in which case the Code requires that the debtor seek authority to use cash collateral and to provide adequate protection for its use. In such cases, adequate protection is generally provided from the date of the petition filing. See, e.g., *In re Johnson*, 47 B.R. 204 (Bankr. W.D. Wis. 1985).

¹⁰ *In re Dynaco Corp.*, 162 B.R. 389, 25 Bankr. Dec. 159 (Bankr. D. N.H. 1993); *In re Best Products Co. Inc.*, 138 B.R. 155 (Bankr. S.D.N.Y. 1992), *aff'd*, 149 B.R. 346 (S.D.N.Y. 1992); *In re Metromedia Fiber Network Inc.*, 290 B.R. 487 (Bankr. S.D.N.Y. 2003); *Matter of Continental Airlines Inc.*, 146 B.R. 536 (Bankr. D. Del. 1992); *Matter of Continental Airlines Inc.*, 154 B.R. 176 (Bankr. D. Del. 1993); *In re Waverly Textile Processing Inc.*, 214 B.R. 476, 10 Fourth Cir. and D.C. Bankr. 102 (Bankr. E.D. Va. 1997); *In re Barrett*, 149 B.R. 494 (Bankr. M.D. Ohio 1993); *In re Kain*, 86 B.R. 506 (Bankr. W.D. Mich. 1988); *In re Walter*, 199 B.R. 390, Collier Bankr. Cases 2d 1049 (Bankr. C.D. Ill. 1996); *In re Haiflich*, 63 B.R. 314 (Bankr. N.D. Ind. 1986); *Matter of Wilson*, 70 B.R. 46 (Bankr. M.D. Ind. 1987); *In re Hinkleley*, 40 B.R. 679 (Bankr. D. Utah 1984) (court in chapter 13 case measured adequate protection as of date creditor demanded adequate protection, i.e., at §341 meeting, rather than later date of creditor's motion); *In re Adams*, 2 B.R. 313 (Bankr. M.D. Fla. 1980); and *In re Cason*, 190 B.R. 917, 34 Collier Bankr. Cases 2d 1476 (Bankr. N.D. Ala. 1995).

¹¹ *In re Southfield Estates Inc.*, 48 B.R. 910 (Bankr. D. R.I. 1985); *In re Aegion Parc Inc.*, 34 B.R. 965 (Bankr. D. Mass. 1983); *In re Ritz Carlton Inc.*, 98 B.R. 170 (S.D.N.Y. 1989); *MerLife Insurance Co. v. Manrow*, 17 B.R. 934 (D. Del. 1982); *In re Dival Manor Associates*, 191 B.R. 622 (Bankr. D.D. Pa. 1996); *In re Kennedy Mortgage Co.*, 23 B.R. 466 (Bankr. D. N.J. 1982); *In re Born*, 10 B.R. 43 (Bankr. S.D. Tex. 1981); *In re Dattar System Corp.*, 42 B.R. 241 (Bankr. N.D. Ill. 1983); *In re Addison Properties Limited Partnership*, 185 B.R. 766 (Bankr. N.D. Ill. 1995); *In re Weyland*, 63 B.R. 854 (Bankr. E.D. Wis. 1986); *In re Johnson*, 47 B.R. 204 (Bankr. W.D. Wis. 1985); *In re Ausherman*, 34 B.R. 393 (Bankr. N.D. Ill. 1983); *In re Marion Street Partnership*, 168 B.R. 218 (Bankr. D. Minn. 1989); *In re Sun Valley Ranches Inc.*, 38 B.R. 595 (Bankr. D. Idaho 1984); *Lafolla Mortgage Fund v. Rancho El Cajon Association*, 18 B.R. 283 (Bankr. S.D. Cal. 1982); *In re Reddington Sun Acres Limited Partnership*, 119 B.R. 809 (Bankr. D. N.H. 1990); *In re African Interstate Corp.*, 12 B.R. 803 (Bankr. D. Utah 1981); *In re Homestead Partners Ltd.*, 200 B.R. 274, 29 Bankr. Ct. Dec. 924 (Bankr. N.D. Ga. 1996); *In re Barkley-Coyll Enterprises Inc.*, 13 B.R. 86 (Bankr. N.D. Ga. 1981), *aff'd*, 677 F.2d 112 (5th Cir. 1982); see, also, *In re Delta Resources*, 54 F.3d 722, 729 (11th Cir. 1995) (court stated in dictum "The matter of adequate protection is determined at or near the inception of a bankruptcy case").

valued at a different date for purposes of determining an adequate protection motion.¹³

The Eighth Circuit's Approach

The Eighth Circuit in the *Ahlers*¹⁴ case is consistent with the trend of cases in that it uses the demand date as a starting point for determining the secured creditor's right to accrue adequate protection. However, the Eighth Circuit probably goes too far in assuming that the Code provides no rights to the secured creditor who is seeking adequate protection. In this case, the Eighth Circuit used a "but for" analysis to determine at which point adequate protection benefits start to accrue. Using the date the secured creditor demanded adequate protection as its benchmark, the Eighth Circuit reasoned that under Minnesota law, the secured creditor must give six weeks published notice for foreclosure sale and must wait until the 12-month redemption period following the sale of land had run. Therefore, the Eighth Circuit reasoned that "if no foreclosure proceedings were commenced before the filing of the bankruptcy proceeding, the adequate-protection payments would begin one year and six weeks after the adequate-

¹³ See, e.g., *In re Casari*, 190 B.R. 917, 924 (Bankr. N.D. Ala. 1995); see, also, *Leana*, Stephen P., "Timing Is Everything: Determining the Date for Valuing Collateral," 17 *Am. Bankr. Inst. J.* 14 (July/August 1998).

¹⁴ 794 F.2d 388 (8th Cir. 1986), reversed on other grounds, 485 U.S. 197 (1988).

protection motion was filed by the creditor."¹⁵ This holding conflicts with the protections provided by the Code. The secured creditor can get relief from the automatic stay pursuant to §362 if the secured creditor can show that it is not receiving adequate protection.¹⁶

Taken at face value, *Ahlers* effectively removes this as a ground for relief from the automatic stay for secured creditors since secured creditors would be denied from using that argument for at least 14 1/2 months—at least in Minnesota—from the date it began foreclosure proceedings or moved to lift the automatic stay. Yet Congress clearly contemplated the balancing of interests between secured creditors and debtors in drafting §§362 and 363. Just as the Code confers special rights and privileges on debtors, it balances those rights, e.g., the automatic stay, etc., with rights of the secured creditor, e.g., adequate protection that is due during the pendency of the bankruptcy case, not after a hypothetical period from which the secured creditor would have executed against the collateral absent the filing of a bankruptcy petition. So, as in the use of cash collateral under §363, if a debtor wishes to use the property subject to the secured creditor's interest, it must

¹⁵ 794 F.2d 388, 396 (8th Cir. 1986).

¹⁶ Section 362(d)(1); see, also, 362(d)(3).

provide adequate protection under §362 to protect the secured creditor's interest in that property. Such a *quid pro quo* seems apparent from the statutes.

But When Does the Secured Creditor Actually Get Adequate Protection Payments?

An interesting side issue arises as to when the trustee should actually pay adequate protection, which is something different than the question of when adequate protection should start to accrue. In the chapter 13 context, courts have split on whether the trustee should pay adequate protection pre-confirmation, e.g., *In re Hagle*, 91 B.R. 27 (Bankr. E.D. Mich. 1988) (yes); *In re Cason*, 190 B.R. 917 (Bankr. N.D. Ala. 1995) (no). As the *Cason* court pointed out, "any order directing a payment by the standing trustee involves a \$1326 payment from the debtor."¹⁷ Since the chapter 13 debtor provides the funds that the chapter 13 trustee uses to fund the chapter 13 plan, \$1326 implies that adequate-protection payments must be made only after confirmation of the plan. Hence, although the secured creditor has accrued adequate-

¹⁷ *Id.* at 932.

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protection benefits from the date of its motion for adequate protection or to lift stay, it does not get paid those accrued adequate-protection benefits until plan confirmation. While the law regarding this issue continues to be unsettled in the context of a chapter 13 case,¹⁸ such reasoning does not apply to a chapter 11 case, which has no §1326 counterpart, and where the secured creditor may look directly to the debtor or the operating trustee for adequate protection payments.

Conclusion

Although some courts may still use the petition date automatically for purposes of granting adequate protection, prudent secured creditors should be prepared to demand adequate protection from the debtor immediately upon the filing of the bankruptcy petition, and they should be prepared to follow up with an appropriate motion in order to secure their rights to adequate protection. ■

¹⁸ Current bill S. 236 pending before Congress would overturn the *Cason* court's ruling and require pre-confirmation payments to secured creditors.