The Equity Cushion Analysis in Bankruptcy

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NOTES

THE EQUITY CUSHION ANALYSIS IN BANKRUPTCY

I. INTRODUCTION

Since the enactment of the Bankruptcy Reform Act of 1978, some courts have given the concept of debtor's equity in collateral undue significance in determining whether to grant a secured creditor relief from the automatic stay in a Chapter 11 bankruptcy proceeding. This represents an unwarranted departure from the approach developed under the reorganization chapters of the Bankruptcy Act. In questioning the wisdom of this departure, this note will first discuss the approach developed by the courts under the Bankruptcy Act to determine whether to grant a secured creditor relief from the stay. A discussion of the factors which evolved under the Act necessarily involves consideration of the issue of valuation which is inextricably involved in determining the extent of the debtor's equity in the collateral. Following this discussion, this note will address the automatic stay and the concept of adequate protection under the new Bankruptcy Code and will examine the current tendency of the courts to interpret adequate protection in terms of


The Code is a federal law promulgated under article I, section 8, clause 4 of the U.S. Constitution as a uniform law on the subject of bankruptcies. As a law of the United States, it is the supreme law of the land. U.S. CONST. art. VI. Thus, where the new law is applicable, it supersedes inconsistent state laws.

The new bankruptcy law is commonly referred to as the Bankruptcy Code or the Code and will be referred to as such in this article.


an equity cushion. Lastly, a discussion of the infirmities inherent in
the equity cushion analysis will be undertaken which suggests that
the courts should revert to the balancing approach developed under
the Act, using the equity cushion as only one factor among several in
determining whether to grant relief from the automatic stay.

II. Overview

A business seeking refuge in the reorganization provisions of
Chapter 11 invariably is financially distressed. "It has suffered busi-
ness reverses of any one and probably several basic types. It has lost
money gradually or suddenly . . ., [and] experiences a chronic
shortage of cash and credit making it impossible to carry on the bus-
iness in a normal fashion and to pay debts as they mature."4

The scenario further unfolds as incessant creditors begin to cor-
ner the debtor. The debtor is delinquent with virtually all its trade
creditors and many have stopped deliveries or require that they be on
a C.O.D. basis. The debtor's financial plight may be slowing its col-
clections. Suits are threatened or are already instituted while diligent
creditors may in fact be endeavoring to execute on judgments. "Un-
secured creditors are demanding security. Secured creditors are de-
manding more if, indeed, they are not already pursuing non-judicial
remedies against such assets as may be available to them."5 In short,
the debtor is suffering grave financial difficulties and seeks asylum in
Chapter 11.

The filing of a bankruptcy petition for relief under Chapter 11
of the Code, as was true under the relief chapters of the Act, not
only commences a case,6 but also operates ipso facto as a stay of
certain judicial proceedings and acts.7 The filing of the petition con-
stitutes an automatic stay of all litigation against the debtor and
most actions against the debtor's property,8 with certain exceptions.9

4. Festersen, Equitable Powers in Bankruptcy Rehabilitation: Protection of the Debtor
5. Festersen, supra note 4, at 312.
6. 11 U.S.C. § 301. The analogous provisions applicable to the Bankruptcy Act are
found in the Rules of Bankruptcy Procedure according to the particular chapter proceeding.
See Bankruptcy Rules 8-1 to 13-901, 11 U.S.C. app. t.is. II-VII (1976) [hereinafter cited
as Bankr. Rules]. For a discussion of the Rules of Bankruptcy Procedure and their relation-
ship to the Bankruptcy Act and the new bankruptcy law, see infra notes 102-11 and accompa-
nying text.
7. 11 U.S.C. § 362. For the stay provisions under the Bankruptcy Act, see Bankruptcy
Act §§ 11(a), 113, 116(4), 148, 314, 414, 428, 614; Bankr. Rules, supra note 6, 401, 601, 8-
"The automatic stay is one of the fundamental debtor protections provided by the bankruptcy laws." It affords the debtor desperately needed protection by giving him a breathing spell from his creditors.

The raison d'être for the stay of acts and actions to enforce liens against the debtor's property is the need to protect the estate against dismemberment and disappearance at the instance of more aggressive creditors. The comprehensive stay effects this purpose by stopping "all collection efforts, all harassment, and all foreclosure actions." It is virtually impossible to imagine a successful rehabilitation proceeding in which creditors were not restrained from foreclosing on major assets of the debtor. Preserving the status quo of the debtor subserves the rehabilitative purpose of a Chapter 11 proceeding by affording the debtor a respite and an opportunity to develop a viable plan of reorganization.

The debtor, taking comfort behind the protective shield of section 362(a), ostensibly secure from the onslaught of creditors, has in reality set the stage for the conflict between the estate of the debtor and secured creditors. A creditor, desiring to protect itself against adverse contingencies that may befall the debtor, often seeks to have the debtor's obligations secured by an interest in the debtor's real or personal property. The creditor assumes that if the debtor

13. A simple example will serve to illustrate this point. Where a tree cutter is in possession of certain equipment necessary to carry on his trade, and this equipment is subject to a security interest, foreclosure by the secured creditor would make rehabilitation impossible. The tree cutter would not be able to afford substitute equipment and it is obviously impossible for him to continue working without the equipment.
14. 11 U.S.C. § 362(a). Thus, allowing foreclosure by the creditor thwarts any possibility of successful reorganization. This situation is even more significant where the debtor is in possession of millions of dollars of industrial equipment subject to security interests in favor of various creditors.
15. Article Nine of the Uniform Commercial Code provides a simple means of creating and perfecting security interests. See U.C.C. §§ 9-201, -203, -302 to -305 (1972). A security interest is defined as "an interest in personal property or fixtures which secures payment or performance of an obligation." Id. § 1-207(37). A secured party is defined as "a lender, seller or other person in whose favor there is a security interest including a person to whom accounts, contract rights or chattel paper have been sold." Id. § 9-105(1)(m)(i).

Article Nine of the U.C.C. has been adopted in every state except Louisiana. Thirty-three
fails to honor the obligations, the security will guarantee satisfaction of the debt. Much to his consternation, however, the secured creditor may find that the debtor has filed a Chapter 11 petition invoking the automatic stay of foreclosure proceedings.

This turn of events seriously threatens the secured creditor’s property rights. The debtor in possession of the collateral is using it in his business; the collateral is subject to depreciation and dissipation in the debtor’s hands while the secured creditor is kept in abeyance. The oversecured creditor will fear that his equity cushion—the amount by which the value of his collateral exceeds his claim—will vanish because of continued depreciation and accruing interest. The undersecured creditor runs the risk that the collateral will depreciate until it is valueless, leaving him with only a general and unsecured claim should the reorganization fail and liquidation result.

The drafters of the Code were not insensitive to the secured creditor confronted with this predicament; a source of relief was provided in section 362(d). Section 362(d)(1) provides that upon the

jurisdictions have adopted the 1972 revisions of article nine while sixteen remain governed by the 1962 version. UNIF. COMMERCIAL CODE U.L.A. 1, 2 (1981).


17. It has long been recognized that the secured creditor has a property interest in its collateral protected by the fifth amendment to the Constitution. Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555 (1935); In re Penn Central Transp. Co., 454 F.2d 9, 13 n.10 (3d Cir. 1972); see Wright v. Union Cent. Life Ins. Co., 311 U.S. 273, 278 (1940).

18. An oversecured creditor is one whose collateral exceeds in value the claim that it secures. The Bankruptcy Code, however, speaks in terms of secured and unsecured claims. Section 506(a) provides that “[a]n allowed claim of a creditor secured by a lien on property in which the estate has an interest . . . is a secured claim to the extent of the value of such creditor’s interest in the estate’s interest in such property.” 11 U.S.C. § 506(a).

19. If a creditor has a security interest in property of the debtor, and that property has a lower value than the amount of the creditor’s claim against the debtor, the creditor is undersecured.

20. An undersecured creditor under the Code has his claim divided into two parts. The claim is secured to the extent of the value of the collateral; any claim in excess of the value of the collateral is a separate and unsecured claim. 11 U.S.C. § 506(a).

21. 11 U.S.C. § 362(d). This article will not address subparagraph (2) of section 362(d). This ground for relief from the stay of an act against the property of the debtor has two elements: (1) The debtor has no equity in the property and (2) the property is not necessary to an effective reorganization. 11 U.S.C. § 362(d)(2). This section is designed to obviate the problem of real property mortgage foreclosures of property where the bankruptcy petition is filed on the eve of foreclosure. [This] section is not intended to apply if the business of the debtor is managing or leasing real property, such as a hotel operation, even though the debtor has no equity if the property is necessary to an effective reorganization of the debtor.
request of a party in interest, the court will grant relief from the stay by terminating, annulling, modifying, or conditioning it "for cause, including the lack of adequate protection of an interest in property of such party in interest." The Bankruptcy Act, pursuant to the 

rules of Bankruptcy Procedure, provided that relief from an automatic stay could be sought by filing a complaint with the bankruptcy court, which commenced an adversary proceeding. The court could, for cause, then terminate, annul, modify, or condition the stay.

Although a grant of relief from the stay under the Act was within the discretion of the bankruptcy court, courts generally considered four issues to be relevant to an application for such relief: the debtor's equity in the collateral, the likelihood of material harm to the secured creditor, the likelihood of rehabilitation, and the property's importance to the debtor's operations. Under the Code, the concept of adequate protection, though left undefined by the drafters, has generally been interpreted in terms of an "equity cush-

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The Senate Report states that "this exception is [designed] to reach the single-asset apartment type cases which involve primarily tax-shelter investments and for which the bankruptcy laws have provided a too facile method [sic] to relax conditions, but not the operating shopping center and hotel cases where attempts at reorganization should be permitted." S. Rep., supra note 10, at 53, reprinted in 1978 U.S. Code Cong. & Ad. News at 5839.


24. Bankr. Rules, supra note 6, 701(6); see id. 10-601(c), 11-44(d), 12-43(d). In extraordinary circumstances, temporary ex parte relief was available under Rules 10-601(d), 11-44(e), and 12-43(e). See id. 10-601(d), 11-44(e), 12-43(e).

25. Id. 703.

26. Id. 10-601(c), 11-44(d), 12-43(d).

27. In re Laufier, 230 F.2d 866, 868 (2d Cir. 1956); In re Murel Holding Corp., 75 F.2d 941, 942 (2d Cir. 1935); In re Tracy, 194 F. Supp. 293, 295 (N.D. Cal. 1961).


the difference between the outstanding debt and the value of the collateral. Where the value of the collateral substantially exceeds the value of the outstanding debt, a cushion is said to exist, adequately protecting the creditor. Where the cushion is slight and likely to be dissipated, or is absent altogether, the courts are inclined to find that the creditor is not adequately protected and may lift the stay, allowing foreclosure upon property which may be vital to a successful reorganization.

Application of an equity cushion analysis in determining whether to grant relief from the stay is an unwarranted departure from the approach developed under the Bankruptcy Act. The equity cushion analysis has no basis in the historical development of stay litigation, is inconsistent with the congressional intent that each case be judged on its own facts, and has the effect of working arbitrary and unjust results. The similarity in language and purpose of the stay provisions under the Bankruptcy Act and the new Code is evident, and there seems to be no sound basis for deviating from the flexible and equitable approach developed under the Act.

III. RELIEF CHAPTERS X AND XI UNDER THE ACT, CHAPTER 11 UNDER THE CODE, AND THE RULES OF BANKRUPTCY PROCEDURE

The relief chapters of the bankruptcy laws serve to rehabilitate debtors for continued and more value-productive participation in the open credit economy—to provide debtors a meaningful fresh start.


33. See infra notes 273-318 and accompanying text.


The term 'open credit economy' refers to the role of private credit generally in the economy...and involves] a complex of highly organized processes. They are commonly identifiable as the producers of transactions in which financial institutions extend credit according to contractual terms binding future payment. [These processes] may be distinguished according to the different [although overlapping] creditors, debtors, and intermediaries who participate; the different objectives of credit extension; the different institutional arrangements in which the transactions arise; and the different methods and procedures of contractual creation, perform-
The policy favoring debtor rehabilitation encourages distressed businesses to restructure finances so that they may continue to operate, provide jobs, pay creditors, and produce a return for investors and owners. The premise of a business reorganization is that assets that are used for production in the industry for which they were designed are more valuable than those same assets liquidated at forced sale prices. "As a principle of national economy, preservation of a business is preferred to its liquidation."

The Bankruptcy Reform Act of 1978 is an attempt by Congress to adapt the law of bankruptcy to the realities of the credit economy. Chapter 11, "which deals with the reorganization of a financially distressed business enterprise, providing for its rehabilitation by adjustment of its debt obligations and equity interests," replaces the business rehabilitation Chapters X, XI, and XII of the Bankruptcy Act of 1898. The goal of these provisions is to rehabilitate the debtor's finances and avoid liquidation of assets. Chapter 11 of the Code synthesizes Chapters X, XI, and XII of the Bankruptcy Act.
ruptcy Act and greatly improves the chances for successful and efficient reorganizations by providing a flexible scheme that can be tailored to fit the needs and circumstances of each debtor.

A. Chapters X and XI Under the Act

Chapter X

The procedure under the Bankruptcy Act was relatively simple and the basic principles were the same for all rehabilitation chapters. When a petition was filed with the court all creditor actions against the debtor were stayed. The stay gave the debtor the opportunity to bring all of its creditors together for discussion, explanation of the debtor's financial problems, and negotiation. Creditors were prevented from unilaterally acting to gain an advantage over other creditors or to pressure the debtor into action.

Chapter X was essentially a remedial statute, designed to effect the rehabilitation of corporate debtors. It attempted to conserve the going-concern values of property, avoid foreclosures and forced sales, and enable the debtor to continue operations.

The reorganization proceeding's purpose was to formulate and confirm a plan of reorganization. The plan would determine how much creditors would be paid and whether such payment would be made in cash, property, or securities; what interest, if any, stockholders would retain in the company; and what structure the business would maintain in continuing operations.

A salient and principal feature of a Chapter X reorganization was that both secured and unsecured debt, as well as the interests of stockholders, could be adjusted or modified. The reorganization machinery was set in motion by the filing of a petition, either by

44. Bankr. Rules, supra note 6, 10-601(a), 11-44(a), 12-43(a).
46. Fidelity Assurance Assoc. v. Sims., 318 U.S. 608, 622 (1943); see Oglesby & Simpson Supply Co. v. Duggan, 174 F.2d 904, 906 (8th Cir. 1949).
50. Bankruptcy Act § 126; Bankr. Rules 10-101. See 6 COLIER ON BANKRUPTCY ¶
the debtor or by three or more creditors holding claims of a specified nature and amount. Chapter X was primarily for the reorganization of large publicly held corporations, particularly those needing a readjustment of their secured debts.

Chapter X prescribed that certain requisites be contained in the petition filed with the court. In addition, all petitions were subject to dismissal if not filed in "good faith." The court in which a voluntary petition for reorganization was filed would enter an order approving the petition, if satisfied that it complied with the requirements of the chapter and that it was filed in good faith. Once the petition was approved, the court was required to appoint one or more disinterested trustees if the indebtedness, liquidated as to amount and not contingent as to liability, exceeded $250,000. If the indebtedness was less than $250,000, the court could appoint trustees or allow the debtor to remain in possession of the business and continue operations.

Once the reorganization process commenced, the disinterested trustee became the key figure. Because rehabilitation of the debtor was envisioned, the trustee was granted rights and powers enabling him to act on the premises, and was generally authorized to oper-

4.03 (14th ed. 1978).
52. Bankruptcy Act § 126; Bankr. Rules, supra note 6, 10-101, -105; see 6 COLLIER ON BANKRUPTCY ¶¶ 4.03, -05-07 (14th ed. 1978).
53. See SEC v. American Trailer Rentals Co., 379 U.S. 594 (1965); 6 COLLIER ON BANKRUPTCY ¶ 0.12[1] (14th ed. 1978). Small corporations could be reorganized under Chapter X if a readjustment of secured debt was necessary. Id.
55. Bankruptcy Act §§ 141, 146; Bankr. Rules, supra note 6, 10-113 (a), (b). For a discussion of the good faith requirement of petitions, see 6 COLLIER ON BANKRUPTCY ¶¶ 6.07-.08 (14th ed. 1978).
56. Bankruptcy Act § 141; Bankr. Rules, supra note 6, 10-113. Under Rule 10-113(a), if the court was not satisfied that the petition complied with the requirements of the chapter and good faith it "shall enter an order permitting the petition to be amended or dismissing the case." Id. 10-113(a). For a general discussion of the approval or dismissal of a debtor's petition under § 141 and Rule 10-113, see 6 COLLIER ON BANKRUPTCY ¶ 6.02 (14th ed. 1978).
57. Bankruptcy Act § 158; Bankr. Rules, supra note 6, 10-202(c)(2); see 6 COLLIER ON BANKRUPTCY ¶ 7.08 (14th ed. 1978).
58. Bankruptcy Act § 156; Bankr. Rules, supra note 6, 10-202(a); see 6 COLLIER ON BANKRUPTCY ¶ 7.02 (14th ed. 1978).
59. Bankruptcy Act § 156; Bankr. Rules, supra note 6, 10-202(a).
60. Bankruptcy Act §§ 186-187; see 6 COLLIER ON BANKRUPTCY ¶ 8.02-09 (14th ed.
ate the debtor's business. It was, in addition, incumbent upon the trustee to perform the important task of assembling and formulating a plan of reorganization for submission to the court. In circumstances where a trustee was not appointed and the debtor continued in possession of the business, Chapter X granted the debtor the rights and powers of a trustee and permitted either the debtor or any creditor to submit a plan.

Chapter X prescribed provisions required of every reorganization plan, as well as certain optional provisions which a plan could contain if desirable in a particular case. This provided needed flexibility while simultaneously insuring that every plan would meet a minimum standard. Within these bounds, the actual terms of a plan would respond to the specific circumstances of the debtor and the financial difficulties to be overcome.

In order for a plan to be approved, the court had to conclude that the statutory requisites of the Act had been complied with and that the plan was "fair and equitable, and feasible." After approval, the court would submit the plan to creditors and stockholders for acceptance or rejection. Once the plan was accepted by or on behalf of creditors holding two-thirds in amount of claims of each class affected by the plan and similarly accepted by a majority of each remaining class affected, the plan became subject to confirmation by the court.

The court would confirm the plan if satisfied that the proposal

1978).

61. Bankruptcy Act § 189; Bankr. Rules, supra note 6, 10-207; see 6 Collier on Bankruptcy ¶ 8.12 (14th ed. 1978).
62. Bankruptcy Act §§ 167, 169; Bankr. Rules, supra note 6, 10-301(c)(1); see 6 Collier on Bankruptcy ¶ 7.31 (14th ed. 1978).
63. Bankruptcy Act § 188; Bankr. Rules, supra note 6, 10-207, 10-208(b); see 6 Collier on Bankruptcy ¶ 8.10, 8.12 (14th ed. 1978).
64. Bankruptcy Act § 170; Bankr. Rules, supra note 6, 10-301(c)(2); see 6 Collier on Bankruptcy ¶ 7.34 (14th ed. 1978).
65. Bankruptcy Act § 216(1), (3), (5)-(8), (10)-(12); see 6A Collier on Bankruptcy ¶ 10.03, 10.05, 10.09-12, 10.19-21 (14th ed. 1977).
66. Bankruptcy Act § 216(2), (4), (9), (13), (14); see 6A Collier on Bankruptcy ¶ 10.04, 10.08, 10.18, 10.22-23 (14th ed. 1977).
68. Bankruptcy Act § 174; Bankr. Rules, supra note 6, 10-303(d).
69. Bankruptcy Act § 179; see Bankr. Rules, supra note 6, 10-303(d), 10-305. For an in-depth discussion of proof and allowance of claims and interests in reorganization cases, see 6 Collier on Bankruptcy ¶ 9.02-.09 (14th ed. 1978). For a discussion of the court's classification of claims and interests, see 6 Collier on Bankruptcy ¶ 9.10-.15 (14th ed. 1978).
and acceptance were in good faith, that the plan was "fair and equitable, and feasible," and otherwise complied with the statutory requirements.\textsuperscript{70} Following confirmation, the steps specified in Chapter X for consummation of the plan and distribution thereunder would commence.\textsuperscript{71} Upon consummation the court would enter a decree closing the estate.\textsuperscript{72}

\textit{Chapter XI}

Chapter X was intended for the reorganization of corporations with public debt or with security holders whose rights would be adversely affected by the proposed reorganization plan.\textsuperscript{73} Chapter XI, on the other hand, was designed to permit an individual, a partnership, or a corporate debtor to negotiate a common law extension or composition plan with unsecured creditors.\textsuperscript{74} Only the debtor had the right to file for relief under Chapter XI,\textsuperscript{75} and the debtor also had the exclusive right to file a plan.\textsuperscript{76}

Unlike Chapter X, the rights of equity interests and secured creditors could not be affected under a Chapter XI plan without their consent.\textsuperscript{77} Chapter XI, however, offered simplicity and greater flexibility and eliminated the complex procedural elements intended to protect the interests of public creditors and security holders in a reorganization case.\textsuperscript{78} A trustee was appointed in very limited circumstances, and the debtor generally remained in possession of the collateral and operated the business under court supervision.\textsuperscript{79} In

\textsuperscript{70} Bankruptcy Act § 221. For an extended discussion regarding confirmation of a plan, see 6A COLLIER ON BANKRUPTCY ¶¶ 11.02-10 (14th ed. 1977).

\textsuperscript{71} Bankruptcy Act §§ 224(3), (4), 227; BANKR. RULES, supra note 6, 10-309(a), 10-405. For a discussion of the effect and consequences of confirmation, see 6A COLLIER ON BANKRUPTCY ¶¶ 11.13-16 (14th ed. 1977).

\textsuperscript{72} Bankruptcy Act § 228; BANKR. RULES, supra note 6, 10-309(b). For a discussion of the final decree, see 6A COLLIER ON BANKRUPTCY ¶¶ 11.17-21 (14th ed. 1977).

\textsuperscript{73} SEC v. United States Realty & Improvement Co., 310 U.S. 434, 447 (1940); see SEC v. American Trailer Rentals Co., 379 U.S. 594 (1965); In re Continental Inv. Corp., 586 F.2d 241 (5th Cir. 1978).

\textsuperscript{74} See supra note 73; Commission Report I, supra note 34, at 240. Composition or extension plans were called general plans of arrangement; arrangement was defined in Chapter XI as "any plan of a debtor for the settlement, satisfaction, or extension of the time of payment of his unsecured debts, upon any terms." Bankruptcy Act § 306(1).

\textsuperscript{75} Bankruptcy Act § 306(5).

\textsuperscript{76} Bankruptcy Act § 306(1).


\textsuperscript{78} See supra note 73.

\textsuperscript{79} Bankruptcy Act § 342.
short, formulation of the reorganization plan and "indeed the entire Chapter XI proceeding, for all practical purposes [was] in the hands of the debtor, subject only to the requisite consent of a majority in number and amount of unsecured creditors . . . and the ultimate finding by the court that the plan [was] . . . 'for the best interests of the creditors.'" 80

B. Chapter 11 Under The Bankruptcy Code

With the enactment of the new Bankruptcy Code, the business reorganization chapters under the Bankruptcy Act have been consolidated into one new chapter—Chapter 11. Chapter 11 under the Code combines the need for expeditious, effective reorganization found in Chapter XI of the Act with many of the protections for public investors contained in Chapter X of the Act. 81

A Chapter 11 case is commenced either by a voluntary petition filed by the debtor 82 or an involuntary petition filed by a certain number of creditors with a specified amount of claims 83. The commencement of a voluntary case constitutes an automatic order for relief, 84 and appropriate notice of such an order is required. 85 Chapter 11 embodies a policy that a debtor will be permitted to operate its business as a debtor in possession 86 after entry of an order for relief, unless it can be established that cause exists for the appointment of a trustee. 87 The debtor in possession has the exclusive right to negotiate a plan of reorganization with creditors and equity interests for 120 days after the filing of the petition or for such period as the court deems appropriate. 88 Thereafter, the debtor no longer retains this exclusive franchise unless the requisite acceptances of the


For a historical perspective of Chapters X and XI, their origin, and their basic differences, see Commission Report I, supra note 34, at 237-48.

81. For a discussion of some of the basic differences and similarities between Chapter 11 of the 1978 Code and Chapters X and XI of the Act, see King, Chapter 11 of the 1978 Bankruptcy Code, 53 AM. BANKR. L.J. 107 (1979).

82. 11 U.S.C. § 301.


84. 11 U.S.C. § 301.


86. 11 U.S.C. § 1101(1)(definition of debtor in possession under Chapter 11).

87. See 11 U.S.C. §§ 1104(a)(1), 1107-1108; 5 COLIER ON BANKRUPTCY §§ 1108.01-.03 (15th ed. 1981); see also 11 U.S.C. § 1104(a)(2) (trustee shall be appointed "if such appointment is in the interests of creditors, any equity security holders, and other interests of the estate").

88. 11 U.S.C. § 1121(b), (d).
A Chapter 11 plan may modify the rights of any class of creditors or equity security holders and may be confirmed notwithstanding the opposition of one or more classes of creditors or equity interests. This is not to say that the Code places no restrictions on the treatment of creditors and stockholders or leaves them unprotected. If the holder of a claim or interest has not accepted the plan the court cannot confirm it, unless the plan provides that such holder will receive or retain at least what would have been received if the debtor was liquidated under Chapter 7 of the Code. In addition, a plan cannot be confirmed if the court determines that the plan is likely to be followed by liquidation or the need for further financial reorganization, unless liquidation or further reorganization is contemplated by the terms of the plan.

The Bankruptcy Code provides that classes of creditors whose claims are not impaired by the plan are deemed to accept the plan.

A claim is considered impaired by a plan if it does not provide for full payment in cash on the consummation date or does not provide for payment according to the original terms of the contract.

Where the plan impairs a class of claims the proponent of the plan must procure acceptances from two-thirds in amount and more than one-half in number of such class. Where a class of equity interests are impaired, acceptances are required from two-thirds in amount of the class. If the proponent acquires the requisite acceptances and complies with the other enumerated requirements, the

89. 11 U.S.C. § 1121(c), (d).
90. See 11 U.S.C. §§ 1123, 1129, 1141; 5 COLLIER ON BANKRUPTCY ¶¶ 1123.01[1]-[3], 1123.02[1], 1129.03 (15th ed. 1981).
94. 11 U.S.C. § 1126(f). Any class denied participation under a plan in the sense that the plan does not provide for any distribution to that class is deemed to have rejected the plan. 11 U.S.C. § 1126(g).
96. 11 U.S.C. § 1126(c).
97. 11 U.S.C. § 1126(d).
court will confirm the plan.\textsuperscript{98} Upon confirmation virtually all claims against a Chapter 11 debtor are discharged.\textsuperscript{99}

The provisions of Chapter 11 may at times assist a debtor in avoiding a Chapter 11 proceeding. Dissident unsecured creditors should be aware that their rights may be modified under a plan if the required majority approves it. Intransigent secured creditors involved in out-of-court negotiations should be aware that the amount of their secured claim will be determined on the basis of the court's assessment of the value of the collateral.\textsuperscript{100} Moreover, the secured creditor should also be cognizant of the fact that a plan of reorganization can be confirmed notwithstanding objection if the plan provides for deferred payment of the present value of the creditor's claim.\textsuperscript{101}

C. Rules of Bankruptcy Procedure

In 1964 the Supreme Court was granted the authority to promulgate rules of practice and procedure for cases under the Bankruptcy Act,\textsuperscript{102} comparable to the existing rulemaking power in the areas of civil, criminal, and admiralty practice.\textsuperscript{103} This grant of authority was a response to Congress' inattentiveness to bankruptcy administration.\textsuperscript{104} The Bankruptcy Act contained numerous procedural provisions and as court practice evolved, Congress did not amend the law to keep pace with this evolution. Instead, Congress entrusted the modernization of bankruptcy procedure to the Supreme Court.

The Rules of Bankruptcy Procedure, designed to govern all procedural aspects of a bankruptcy case,\textsuperscript{105} were first promulgated in 1973 and were completed for all chapters of the Act in 1976.\textsuperscript{106} The Rules, if not expressly rejected by Congress prior to their effective date, supercede all conflicting statutory provisions, subject only to

\textsuperscript{100} See supra note 91.
\textsuperscript{101} See supra note 91.
\textsuperscript{103} See 1 \textsc{Collier on Bankruptcy} 5 (14th ed. 1973).

the limitation that they neither abridge, enlarge, nor modify any substantive right.\textsuperscript{107} It is entirely possible, and in many instances likely, that the adoption of a rule may not modify the language of a statutory provision, but the statute's application thereafter may be affected to some degree.\textsuperscript{108} It is therefore necessary to read the Rules in conjunction with the concomitant statutory provision in order to understand the relationship of the rule to the statute and to determine the extent to which that provision has been affected.

The advent of the Bankruptcy Code substantially affects the role of the Supreme Court. The Court retains rulemaking authority so that it may continue to promulgate rules of practice and procedure for bankruptcy cases; the new law, however, repeals the provision that permits rules to annul statutory law with which they conflict.\textsuperscript{109} The new law contains a minimum of procedural matter, thus affording the Court great flexibility in promulgating rules of practice since there are few statutory provisions with which such rules could conflict.\textsuperscript{110} Until the Court promulgates new rules, the existing ones remain applicable to the extent they are not inconsistent with the new law.\textsuperscript{111}

IV. RELIEF FROM THE STAY IN PROCEEDINGS UNDER THE ACT

It is well recognized that the bankruptcy court is a court of equity and that bankruptcy proceedings are essentially equitable in nature.\textsuperscript{112} Moreover, it is accepted that the application of a secured creditor for permission to reclaim its collateral raises an issue touching upon the discretion of the court\textsuperscript{113} and that in the exercise of this


\textsuperscript{108} 1 COLLIER ON BANKRUPTCY 11 (14th ed. 1973).


\textsuperscript{111} Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 405(d), 92 Stat. 2549, 2685 (1978). Pursuant to 405(d), the rules in effect on September 30, 1979 continue to apply, unless inconsistent with the new law, until repealed or superceded by new rules. Id.


\textsuperscript{113} Continental Ill. Nat'l Bank & Trust Co. v. Chicago, Rock Island & Pac. Ry. Co., 294 U.S. 648, 677 (1935); In re Laufer, 230 F.2d 866, 868 (2d Cir. 1956); In re Murel Holding Corp., 75 F.2d 941, 942 (2d Cir. 1935).
discretion the court is to be guided by equitable considerations.  

Case law concerning the restraint of creditors in bankruptcy proceedings has been shaped by controversies where the property rights of the creditor are pitted against human concerns such as a continuation of business, loss of employment, and the impact on the local economy. The court must attempt to foster rehabilitation without inequitably depriving the secured creditor of his right to repayment. Courts, mindful of debtors' and creditors' competing interests "are conscious of the deep concern of the... secured creditors lest their security depreciate beyond adequate salvage, but... must balance that with the Congressional mandate to encourage attempts at corporate reorganization where there is a reasonable possibility of success." Implicitly described in this statement is the balancing process used to weigh the "need to rehabilitate debtors against the need both to preserve the integrity of previous transactions between the debtor and his creditors and to determine the extent to which creditors should be forced to surrender their rights to assist the debtor in the process of rehabilitation."  

The fate of debtors under the relief chapters of the Act was often determined by decisions as to which party would have control or use of the collateral during the proceeding. The continued use of the assets subject to the creditors' security interests was usually necessary if the debtor was to remain in operation long enough after the petition had been filed to reorganize or propose a plan of arrangement.  

The discretionary decisions regarding control of collateral which a court could interpose between a debtor and a secured creditor


The question of restraining secured creditors presupposes, of course, that the security interest is valid. It is also axiomatic that the secured creditor's interest is, generally, in reclaiming its collateral as soon as possible, unless circumstances permit maximization of recovery by assisting in rehabilitation. For instance, secured creditors with a lower priority than other secured creditors may have an interest which coincides with the debtor's, if their only hope for recovery is debtor rehabilitation facilitated by the use of the collateral. See Note, Use of Secured Creditors' Collateral in Chapter X Reorganizations: A Proposed Modification of the Commission's and Judges' Bills, 1 J. CORP. L., 555, 569 (1976).  

arose primarily from the automatic stay provisions. These provisions were vague as to how the court’s power was to be exercised. The stay rules initially placed the burden on the creditor to seek and show cause for relief, which could take the form of termination, annulment, modification, or conditioning of the stay. Once the creditor had shown cause, the burden shifted to the debtor to show that he was entitled to continuation of the stay.

In determining whether to grant relief from the stay, the courts overcame the vagueness of the Rules and generally considered four issues relevant to an application for relief: the likelihood of a successful reorganization, the property’s importance to the debtor’s operations, the likelihood of material harm to the secured creditor, and the debtor’s equity in the collateral. These four considerations were given varying degrees of significance in the balancing process according to the particular facts and circumstances of the case. A balancing process, by nature, does not require the finding of a predetermined level for each factor considered. A court, therefore, could accord each consideration a specific quantum of significance when assessing the aggregate of considerations. While there were no standardized criteria for the exercise of a judgment by a court, the basis of the judgment was expected to bear a rational relationship to the point of the proceedings, the nature of the interests to be protected, and the overall salutary purpose of the relief

119. Bankr. Rules, supra note 6, 10-601(c), 11-44(d), 12-43(d); see Kennedy, supra note 28, at 226-27. “[T]he secured creditor’s complaint [had to] frame the issues applicable in the case and establish all essential elements of a claim for relief from an automatic stay.” Peitzman and Smith, supra note 6, at 1225.

The bankruptcy rules concerning ex parte relief were slightly more illuminating, providing the creditor relief from the stay if he could present specific facts showing that he would suffer immediate and irreparable injury, loss, or damage. Bankr. Rules, supra note 6, 10-601(d), 11-44(e), 12-43(e).
121. See infra notes 129-43 and accompanying text.
122. See infra notes 144-49 and accompanying text.
123. See infra notes 150-60 and accompanying text.
124. See infra notes 161-212 and accompanying text.
125. Kennedy, supra note 28, at 239; see, e.g., In re Georgetown on Del., Inc., 466 F.2d 80 (3d Cir. 1972); see Peitzman and Smith, supra note 16, at 1225-26, 1230; Webster, supra note 117, at 222-23.
126. Webster, supra note 117, at 222-23.
127. Id.
chapters.  

A. Likelihood of a Successful Rehabilitation

In order to approve a petition filed under Chapter X of the Act, the court must find that the petition was filed in good faith. A petition is not filed in good faith if “it is unreasonable to expect that a plan of reorganization can be effected.” Before an approved plan of reorganization can be confirmed under Chapter X, the court must find it to be feasible. The standard of feasibility is generally viewed by the courts as equivalent to the likelihood of successful reorganization. Moreover, the court must be satisfied at the time of confirmation that “the proposal of the plan and its acceptance are in good faith.” A plan proffered without any realistic hope for success would not be proposed in good faith. Accordingly, a court considering the likelihood of a successful reorganization must not assist a debtor, by giving him control of the collateral to the detriment of the secured creditor, if the debtor is undoubtedly going to be liquidated.

The degree of likelihood of a successful rehabilitation required to justify continuation of a stay during a bankruptcy proceeding has been variously articulated. The typical formulation in a case denying relief from a stay is that reorganization appears to be a “reasonable possibility.” Bankruptcy Judge Babitt of the Southern District of New York, in a recent Chapter XII case, denied relief from a stay in view of evidence that “it is as reasonably likely that the debtor will

129. Bankruptcy Act § 141 (voluntary petition), § 142 (involuntary petition); BANKR. RULES, supra note 6, 10-113(a), (b).
130. Bankruptcy Act § 146(3).
131. Bankruptcy Act § 221(2).
132. See 6A COLLIER ON BANKRUPTCY ¶ 11.07, at 235-42 (14th ed. 1977); King, Feasibility in Chapter X Reorganizations, 49 AM. BANKR. L.J. 323, 325-26 (1975). King states that feasibility requires the court to be “assured that there is reasonable potential for success.” Id. at 326.
133. Bankruptcy Act § 221(3).
134. See 6A COLLIER ON BANKRUPTCY ¶ 11.08 (14th ed. 1977).
136. BVA Credit Corp. v. Consolidated Motor Inns (In re Consolidated Motor Inns), 6 COLLIER BANKR. CAS. (MB) 18, 31 (Bankr. N.D. Ga. Oct. 6, 1975); cf. In re Empire Steel Co., 228 F. Supp. 316, 319 (D. Utah 1964) (where stay granted under Bankruptcy Act § 314 was directed to be terminated unless incident to a “plan susceptible of reasonably prompt processing.”).
successfully rehabilitate as not.” The typical rationale when relief from a stay is granted is that reorganization is not a “realistic expectation.”

Any assessment of the likelihood of a successful reorganization requires the court to speculate on the probable outcome of a complicated and uncertain process. A stark appraisal of relevant experience probably warrants adoption by the courts of a strong presumption against the likelihood of success of any reorganization. “Notwithstanding the burden of justification imposed on the party seeking continuation of the stay, the bankruptcy courts have understandably been reluctant to terminate a stay at an early stage of the reorganization process solely on a finding that reorganization is . . . unlikely.” Especially in Chapter X cases, where the original petition must be filed in “good faith” and is subject to dismissal if “it is unreasonable to expect that a plan of reorganization can be effected,” courts are hesitant to conclude at the outset that the proceedings are destined to fail. The courts will usually give the debtor a reasonable time to work out an eligible rehabilitative plan before determining that the proceedings are not likely to succeed.

137. C.I. Mortgage Group v. Nevada Assocs. (In re Nevada Towers Assocs.), 14 COLLIER BANKR. CAS. (MB) 146, 151 (Bankr. S.D.N.Y. Aug. 10, 1977). The court also noted that at an early stage in the proceedings, “it is not necessary that the debtor prove to a high degree of certainty that it will successfully rehabilitate itself.” Id.


141. See supra note 55.

142. Bankruptcy Act § 146(3).

143. The range of time between the debtor’s filing of a petition and the bankruptcy court’s order allowing relief from the stay is quite varied. See, e.g., Lance, Inc. v. Dewco Servs. Inc., 422 F.2d 778 (9th Cir. 1970) (five months); First Fed. Sav. and Loan Ass’n v. Holiday
This judicial reluctance, however, affords little consolation to a lienor whose security suffers continuing deterioration during the pendency of the stay. In most cases, disposition of a complaint seeking relief from the stay will require a consideration of other issues.

B. Essentiality of the Encumbered Property

It has been suggested that a bankruptcy court in rehabilitation proceedings will exercise its equitable powers in favor of debtors in order to promote the desired end of rehabilitation. The courts, however, are not so slanted and are both sensitive and responsive to the respective interests involved. Courts have often relieved secured creditors of the burden of a stay where it appeared that the encumbered property was not essential to rehabilitation of the debtor's business.

Essentiality may be found not only when the property is indispensable to the reorganized enterprise but also when it is required to enable the debtor to operate its business during the pendency of the case in the bankruptcy court. "In the absence of a demon-
strated need of the property for the purposes of the reorganization or rehabilitation, the proponent of the . . . stay cannot sustain the burden of justifying interference with the lienor's right to enforce his lien." Moreover, when hope of rehabilitation is dismal or the stay threatens injury to the lienor's security, indispensability of the property to the debtor's survival and a mere hope of rehabilitation are not enough to justify continuation of the stay.

It is not often that a court must decide whether the essentiality requirement applies to the debtor's business. In most rehabilitation proceedings the two are synonymous. The essentiality requirement is almost always satisfied. Presumably, this is because the debtor would probably not litigate the issue if he did not believe control of the collateral was essential to a successful rehabilitation. Hence, the court may look to other considerations in determining whether to grant relief from the stay.

C. Potential Injury To The Secured Creditor

The question of whether continuation of the stay will cause undue harm to the secured creditor is so closely related to the issue of debtor equity in the collateral that the two are often collapsed into one. Courts often assume that where there is excess collateral for a secured debt, the creditor cannot complain of a stay of foreclosure; and, on the contrary, where the secured debt exceeds the value of the collateral, the secured creditor will always be harmed by the stay. Neither assumption is always justified. Even where there is substantial value in the collateral in excess of the secured debt, the creditor suffers harm if the interest on the debt accrues or the collat-

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148. Kennedy, supra note 28, at 244-45.


150. See infra notes 161-81 and accompanying text.


152. In re DLB Dev. Corp., 1 BANKR. CT. DEC. (CRR) 1463, 1466-67 (Bankr. S.D. Cal. 1975); see Silver Gate Sav. and Loan Ass'n v. Carlson (In re Victor Builders, Inc.), 418 F.2d 880, 882 (9th Cir. 1969).
eral depreciates, thereby dissipating the equity cushion. In addition, the secured creditor is deprived of the use of money, and this may in turn result in impairment of the creditor's own standing with financial institutions.

A secured creditor whose debt exceeds the value of the collateral might not suffer from a stay if the collateral does not depreciate while in use by the debtor during chapter proceedings. Similarly, a secured creditor's position would not be jeopardized if the debtor were able to make payments equal to the amount of depreciation and accruing interest or to give the secured creditor a lien on additional property. Also, suppose that at the time a debtor files the petition the collateral of a creditor consists mainly of raw materials and work in progress with negligible liquidation value. The undersecured creditor might indeed benefit if, during the proceedings, the collateral were to be converted into finished inventory.

A court, in assaying a petition for relief, must concurrently consider the rights of the secured creditor and the interests of the debtor and general creditors. It is essential that the court be sensitive to and continually aware of the rehabilitative purpose of the pro-

153. See supra notes 18, 19 and accompanying text.
154. E.g., In re DLB Dev. Corp., 1 BANKR. CT. DEC. (CRR) 1463, 1466 (Bankr. S.D. Cal. Oct. 9, 1975) (secured creditor forced to borrow funds at higher interest rate than that required on its loan to debtor).
155. These methods of adequate protection were expressly incorporated into the new bankruptcy law, along with the third method of providing the secured creditor with the indubitable equivalent of its interest in the collateral. 11 U.S.C. § 361; see infra notes 204-08 and 252-61 and accompanying text.
156. See, e.g., Reconstruction Fin. Corp. v. Kaplan (In re Waltham Watch Co.), 185 F.2d 791 (1st Cir. 1950) (permitting debtor to assemble inventory into finished goods and to complete work in progress strengthened net position of secured creditor); C.I. Mortgage Group v. Nevada Associs. (In re Nevada Towers Associs.), 14 COLLIER BANKR. CAS. (MB) 146, 155 (Bankr. S.D.N.Y. Aug. 10, 1977) (secured creditor argued that stay threatened to add $780,000 to its deficiency claim, but court anticipated that property could be improved sufficiently during stay to permit full payment of secured debt, whereas termination of stay would force secured creditor to take property with no prospect for return on its investment).
157. At some point, continuation of the automatic stay may cross the line between mere postponement of a secured creditor's remedies and erosion of security which amounts to a taking of property in violation of the fifth amendment. In re Empire Steel Co., 228 F. Supp. 316, 319 (D. Utah 1964) ("[t]he 'status' of secured creditors then unavoidably would be affected [by prolonged continuation of the stay], for status depends not only upon assurance of eventual payment but the right to payment or enforcement in point of time bearing some relationship to the conditions of the security instruments"). Compare In re Chicago, Rock Island & Pac. Ry. Co., 545 F.2d 1087, 1090 (7th Cir. 1976) ("[t]he due process clause of the fifth amendment is not violated by anything less than actual impairment of a creditor's security") with In re Penn Cent. Transp. Co., 494 F.2d 270 (3d Cir.) (requiring high degree of likelihood of reorganization within reasonable time), cert. denied, 419 U.S. 883 (1974).
ceeding. The court must balance the harm that the secured creditor may suffer as a result of the stay against the hardship that the debtor and general creditors may suffer as a result of foreclosure. 158

This balancing test, traditionally used by equity courts in ruling on requests for injunctive relief, 159 is appropriate for evaluating continuation of the stay because the stay is in the nature of a temporary injunction designed to maintain the status quo. 160 Implicit in this balancing process is the consideration of equity in the collateral, an issue which is often given critical significance in determining whether to grant relief from the stay.

D. The Debtor's Equity in the Collateral

Most litigation regarding injunctions and stays of lien enforcement stems from creditors' concern that the stay will injure their secured position. Determination of that issue as a practical matter, entails a preliminary determination of the value of the collateral. When the debtor has substantial equity so that the value of the property substantially exceeds the amount of the debt, some courts have refused to grant relief from the stay on the theory that the creditor's position is secure. 161 A stay of enforcement of a lien, where substantial equity is present, is not likely to jeopardize the position of the secured creditor. Conversely, when the value of the security is less than the amount of the debt, some courts have vacated the stay, 162 the absence of equity rendering the issue moot. 163 The absence of value in the property in excess of the secured debt will make it difficult for the debtor to convince the court that a stay of enforcement will not injure the secured creditor, 164 unless the debtor can provide

158. See supra note 125.
161. See supra note 151 and accompanying text.
162. In re DLB Dev. Corp., 1 BANKR. CT. DEC. (CRR) 1463, 1467 (Bankr. S.D. Cal. Oct. 9, 1975); see Silver Gate Sav. and Loan Ass'n v. Carlson (In re Victor Builders, Inc.), 418 F.2d 880, 882 (9th Cir. 1969).
163. In re DLB Corp., 1 BANKR. CT. DEC. (CRR) 1463, 1467 (Bankr. S.D. Cal. Oct. 9, 1975). One court has suggested that it was required to protect a secured creditor where the debtor's alleged equity in the security was not sufficiently large. See In re Georgetown on Del., Inc., 466 F.2d 80 (3d Cir. 1972). The Chapter X trustee asserted that the debtor's book-value equity in certain realty was $19,974.50. The court, however, did not find this amount to be "meaningful" where the debtor's current and long-term liabilities exceeded alleged total assets by $206,346. Id. at 82-83.
164. See supra note 163. But see supra note 156.
The property, unless it is land, is almost certain to depreciate during the pendency of the stay, and if the property is used by the debtor during the term of the stay, the rate of depreciation may be so high as practically to destroy the value of the collateral.

(i) Valuation of the Equity in the Collateral

The standard of valuation presents a subsidiary issue that may assume critical importance in a determination of the presence or absence of equity and the adequacy of protection for the secured creditor subject to the stay. Bankruptcy law envisions at least two standards of valuation: liquidation value, which is the amount realized on a forced sale of the collateral;\(^\text{166}\) and, reorganization value, which is the amount realizable through a sale in the normal course of business.\(^\text{167}\) The difference between these two values accounts for the emphasis in bankruptcy law on reorganization and on continuation of a debtor's business. The assumption is that liquidation should be avoided if there is any reasonable likelihood that going-concern value can be preserved.\(^\text{168}\)

A secured creditor, in seeking relief from the stay, is likely to support his argument by attempting to show the inadequacy of the collateral to cover his debt and prejudice likely to accrue from a postponement of foreclosure. The argument may well be predicated on a valuation of the property at liquidation value rather than on going-concern value.\(^\text{168}\) Since the significant difference between an unsecured and secured creditor is the latter's ability to realize on certain property made specifically available for payment of its

\(^{165}\) See supra notes 155, 156; infra notes 204-08, 252-61 and accompanying text.

\(^{166}\) Peitzman and Smith, supra note 16, at 1237. For the purpose of this article, the terms forced sale value and liquidation value will be used interchangeably.

\(^{167}\) See Consolidated Rock Prods. Co. v. Du Bois, 312 U.S. 510, 525-26 (1941); Reliance Standard Life Ins. Co. v. Pembroke Manor Apartments (In re Pembroke Manor Apartments), 547 F.2d 805, 807-08 (4th Cir. 1977); In re Creed Bros. Inc., 14 COLLIER BANKR. CAS. (MB) 426, 431 (Bankr. S.D.N.Y. Aug. 26, 1977). For the purposes of this article, the terms fair market value and going concern value will be used interchangeably.


EQUITY CUSHION ANALYSIS

If there is a substantial difference between the forced sale value and the going-concern value of property subject to a lien, and if the question of value must be determined at the threshold of the case or if a successful reorganization appears to be a reasonable prospect, then the court wisely is likely to avoid reliance on liquidation value. It is important to remember that the court possesses great discretion and wide latitude in determining value and that any determination should be based on “equitable considerations arising from the facts of the case.”

Certain types of collateral may militate for or against a particular standard of valuation. “[T]he nature of the debtor’s business, the prospects for rehabilitation, and the nature of the collateral” should all be considered when determining the valuation standard to be applied. There is no hard and fast rule that will apply in every case. The infinite number of variations possible in debtor-creditor dealings, the continuing developments in the law, and the changing


A determination and use of liquidation value is inappropriate, in the first instance, because a rehabilitation proceeding is itself premised on the debtor's continuing operations and not its liquidation; secondly, use of liquidation value reflects the minimum equity the debtor has in the property and, concomitantly, the least protection afforded the secured creditor. Such a finding may impel the court to vacate the stay at an early stage and thwart the purpose of a reorganization proceeding where use of a different valuation standard would reflect a greater equity and, in turn, more protection for the secured creditor.

174. See Peitzman and Smith, supra note 16, at 1239.
modes of financing all point to flexibility in choosing a valuation standard.\textsuperscript{176} Use of liquidation value should almost always be avoided.\textsuperscript{177} Use of a standard based on what might be obtained upon a sale in the ordinary course of business might also be unadvisable at times.\textsuperscript{178} The court's approach should be responsive to the rehabilitative purpose of the proceeding and sensitive to the respective interests involved. The standard of valuation, therefore, should be determined on an ad hoc, case by case, basis so that the courts may value the collateral as the facts and circumstances of a particular situation warrant.

Finally, it should be kept in mind that in determining the date on which valuation is to occur, the secured creditor is entitled to no less than the value of its collateral as of the date of the petition.\textsuperscript{179} The bankruptcy court must protect the secured creditor against diminution in value of the collateral during the course of the proceeding\textsuperscript{180} when the collateral was retained at the debtor's behest. It is generally conceded that the value of property subject to a lien may change during the course of a case, and thus a finding of a particular value at one stage or for one purpose ought not to preclude a reexamination of the question when circumstances change.\textsuperscript{181}

\begin{itemize}
\item[(ii)] \textbf{Significance of Equity in the Collateral}
\end{itemize}

The absence of equity in the collateral has usually been viewed as critically significant in a Chapter XI case.\textsuperscript{182} This conception has often been predicated on the bankruptcy court's lack of power to affect the rights of secured creditors without their consent in a plan


\textsuperscript{177} See supra note 172 and accompanying text.

\textsuperscript{178} See supra note 174.

\textsuperscript{179} See \textit{In re} New York, New Haven & Hartford Ry. Co., 147 F.2d 40, 47-48 (2d Cir.), \textit{cert. denied}, 325 U.S. 884 (1945); see also supra note 157.

\textsuperscript{180} See \textit{In re} Chicago, Rock Island & Pac. Ry. Co., 545 F.2d 1087 (7th Cir. 1976); \textit{In re} Third Ave. Transit Corp., 198 F.2d 703 (2d Cir. 1952); see also supra note 17.

\textsuperscript{181} See Peitzman and Smith, supra note 16, at 1240. The authors note that "[w]here the creditor has sought relief from [the] stay, an increase in collateral value from the date of the petition to the date of trial would, of course, enlarge the debtor's equity cushion and perhaps make relief from the stay less likely." \textit{Id.}

\textsuperscript{182} See, e.g., Silver Gate Sav. and Loan Ass'n v. Carlson (\textit{In re} Victor Builders, Inc.), 418 F.2d 880, 882 (9th Cir. 1969). The \textit{Silver Gate} court upheld remand of the case to the referee to determine whether there was equity in the property. The court stated that the presence of equity would warrant permanent injunction of mortgage foreclosure until a final decree; the absence of equity would require termination of a temporary restraining order under § 314. \textit{Id.}
confirmed under Chapter XI. The existence of an equity cushion, however, is not, and should not be, indispensable to the continuation of a stay. Bankruptcy courts were explicitly authorized by Congress to enjoin lien enforcement when appropriate to further the objective of rehabilitation under Chapter XI. Where a secured creditor is adequately protected from injury resulting from the stay, the collateral is essential to rehabilitation, and a reorganization is a realistic possibility, the absence of an equity cushion should be immaterial. One commentator has even suggested that equity becomes an issue only if withdrawal of the property from the debtor will affect the prospects of an arrangement or reorganization that has a reasonable chance of succeeding.

In Chapter X and XII cases under the Bankruptcy Act, a debtor could adjust or modify a secured creditor's interest and staying foreclosure was not dependent upon the debtor having substantial equity. One illustrative Chapter X case is Fruehauf Corp. v. Yale Express Sys., Inc., which was the last in a series of three cases dealing with a secured creditor seeking to reclaim trucks subject to a security interest. The court in Yale Express affirmed the district court's denial of the creditor's reclamation petition because

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184. See In re Bolton Hall Nursing Home, 14 COLLIER BANKR. CAS. (MB) 90, 92 (Bankr. D. Mass. May 20, 1977) (court observed that Chapters XI and XII were intended for use of debtors without equity in property); Festersen, supra note 4, at 333; Webster, supra note 117, at 231-32; see infra notes 213-15, 274-318 and accompanying text.

185. See Bankruptcy Act §§ 2a(15), 11a, 314; BANKR. RULES, supra note 6, 10-601(a).

186. See Festersen, supra note 4, at 333. But see Seidman, supra note 28, at 347.

187. Seidman, supra note 28, at 347.


190. (In re Yale Express Sys., Inc.), 384 F.2d 990 (2d Cir. 1967).

"it [was] clear beyond cavil that the prospects of reorganization would be frustrated if the reclamation petition were granted."\textsuperscript{192} The debtor has little or no equity in the trucks which were depreciating steadily.\textsuperscript{193} The court of appeals in the second Yale Express case suggested rental payments to compensate the secured creditor for depreciation,\textsuperscript{194} but in reviewing the district court's denial of reclamation on remand, the court of appeals found that this would hamper the reorganization as much as reclamation.\textsuperscript{195} The only protection afforded the secured creditor was a promise from the court that it would be given "equitable consideration" in the plan for any loss occasioned by the depreciation of its collateral.\textsuperscript{196}

The justification given in Yale Express for the treatment of the secured creditor was the broad purpose of a reorganization proceeding. The court focused on the essentiality of the collateral to the debtor's business and the likelihood of successful reorganization "in light of the fundamental purpose of reorganization proceedings to enable the debtor to continue operations."\textsuperscript{197} That there was little or no equity in the collateral was virtually of no significance.

In In re Bermec Corp.,\textsuperscript{198} a case decided four years after Yale Express, the Second Circuit was a bit more vigilant of the secured creditors' interests. The debtor was in the business of leasing trucks and tractor-trailers throughout the United States and Canada. As was the case in Yale Express, a large part of the equipment owned by Bermec was subject to security interests in favor of various creditors.\textsuperscript{199} Bermec Corp. filed a petition under Chapter XI of the Bankruptcy Act and then filed an amended petition under Chapter X.\textsuperscript{200} The secured creditors opposed the latter petition as not being filed in good faith because it was "unreasonable to expect that a plan of reorganization [could] be effected" within the meaning of section 146(3) of the Act.\textsuperscript{201} The referee in bankruptcy found that it was not unreasonable to expect that a plan of reorganization would be ef-

\textsuperscript{192} 384 F.2d at 991.
\textsuperscript{193} See id. at 992.
\textsuperscript{194} Id. at 439.
\textsuperscript{195} 384 F.2d at 992.
\textsuperscript{196} Id.
\textsuperscript{197} Id. at 991.
\textsuperscript{198} 445 F.2d 367 (2d Cir. 1971).
\textsuperscript{199} Id. at 368.
\textsuperscript{200} Id. at 367.
\textsuperscript{201} Id.
ected and, accordingly, the district judge approved thepetition.\textsuperscript{202} This determination was upheld on appeal to the Second Circuit.\textsuperscript{203}

The secured creditors, in opposing approval of the petition, raised the issue of depreciation and the need for quick enforcement of their liens in order to protect their interests.\textsuperscript{204} In \textit{Bermec}, however, the trustee deviated from the approach taken in \textit{Yale Express} and offered to pay to the secured creditors an amount equal to the economic depreciation of the encumbered equipment "so as to approximately preserve their status quo."\textsuperscript{205} The appellate court did not explicitly rule on this approach, although it did uphold the finding below that the trustee would be able to make such payments.\textsuperscript{206} Subsequently, the referee, in an unpublished opinion,\textsuperscript{207} again found that "payment to secured creditors of the amount of the economic depreciation of the equipment securing their claims was 'a fair and equitable method of protecting the interests of the secured creditors.'"\textsuperscript{208}

\textit{Yale Express} and \textit{Bermec} both illustrate the extent of protection and encouragement a court will afford a debtor in a reorganization proceeding so that the salutary purposes of rehabilitation can be effectuated. The decision in \textit{Yale} undoubtedly represented the most liberal application of the court's power to permit the continued use of collateral by the debtor where loss to the secured creditor was a near certainty.\textsuperscript{209}

The \textit{Bermec} decision is significant for its recognition of the pro-

\textsuperscript{202} \textit{Id.} at 368. The referee, appointed as a special master by the district court judge to hear and report on the approval of the petition, found that despite present losses of $500,000 each month, certain affirmative steps with regard to the operations of the business could be taken which could result in a profitable or at least a break-even operation. \textit{Id.}

\textsuperscript{203} \textit{Id.} at 369.

\textsuperscript{204} \textit{Id.} at 368.

\textsuperscript{205} \textit{Id.} at 369.

\textsuperscript{206} \textit{See id.}

\textsuperscript{207} \textit{In re Bermec Corp., BANKR. L. REP. (CCH) ¶ 64,065} (Bankr. S.D.N.Y. July 15, 1971)(summary of opinion of Referee Herzog).

\textsuperscript{208} Murphy, \textit{supra} note 28, at 35 (footnote omitted) (citing to the unpublished opinion of Referee Herzog); \textit{cf.} Crystal v. Green Point Sav. Bank (\textit{In re Franklin Garden Apartments}), 124 F.2d 451, 453-54 (2d Cir. 1941)(Chapter X proceeding where court allowed turnover from mortgagee to trustee of apartment building although debtor had a negligible equity; debtor's use of rents from building restricted to operating costs and expenses, and remainder required to be paid over to mortgagee, except to extent that mortgaged property received benefit through the proceeding or mortgagee's rights were fully secured).

\textsuperscript{209} It has been suggested that \textit{Yale Express} has little support in prior bankruptcy case law and constitutes a violation of the fifth amendment rights of the secured creditor. Murphy, \textit{supra} note 28, at 34.
propriety of reimbursing the secured creditor for depreciation in the economic or real value of its collateral. It is also noteworthy that Bermec supports the implication that, absent such reimbursement, foreclosure might be permitted. The concept of interim compensation as a means of avoiding harm to the secured creditor was expressly incorporated into the adequate protection provisions of the Bankruptcy Code and, consequently, will be a significant factor in the courts' evaluation of a complaint for relief from the automatic stay.

(iii) Undue Significance Accorded the Equity Consideration

The foregoing analysis of the issues that bankruptcy courts addressed under the Act in determining whether to grant relief from a stay in a bankruptcy proceeding reveals that the courts accord each component varying degrees of weight according to the facts and circumstances of the case and the nature of the proceeding. At times the balancing process obfuscates the determinative issue and leaves one with the sense that the aggregate of circumstances impelled the court to propound a decision it felt to be proper. Many times, however, often because of the particular chapter proceeding, the bankruptcy courts have attached undue significance to the amount of equity in the collateral.

There are . . . considerations which may amount to red herrings of a sort. One of these is the oft mentioned concern as to how much equity the debtor has in property sought by a secured creditor. . . . [I]f a debtor badly needs the property and its vital signs are strong, the size of its equity shouldn't have much bearing on the situation, although a large equity does make a decision favorable to the debtor more palatable for all concerned.

Equity is, indeed, a red herring and the use of the equity analysis as the sole determinative component in assessing an application

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210. The court of appeals in Bermec did not explicitly require the making of interim payments but did uphold the concept. See 445 F.2d at 369.
213. See Festersen, supra note 4, at 317. The author states that "courts will find the power and forge the weapons to achieve the result considered to be desirable." Id.
214. See supra notes 182, 183 and accompanying text.
215. Festersen, supra note 4, at 333.
for relief from a stay would be Procrustean. Equity in the collateral indicates that the security can depreciate in value while the debtor uses it without affecting the secured creditor's interest. It is not a talisman, the presence of which magically empowers a court to make decisions it would not make in the absence of equity. Equity is simply one means of protecting the creditor's interest in the collateral.

Some courts under the Bankruptcy Code have extolled the concept of equity and have mechanically applied an equity cushion analysis when interpreting adequate protection in assessing a petition for relief from the automatic stay.216 The following sections will discuss the mechanics of the automatic stay and the concept of adequate protection under the Code and, thereafter, the defects inherent in a stringent application of the equity cushion analysis.

V. Adequate Protection And The Equity Cushion Under The Code

In Mueller v. Nugent,217 decided shortly after the enactment of the Bankruptcy Act of 1898, the United States Supreme Court declared that a petition in bankruptcy is "a caveat to all the world, and in effect an attachment and injunction."218 This judicial gloss indicates an early recognition that a stay of creditors from collecting their claims against the debtor and his property is indispensable to bankruptcy administration. The fresh start sought by the debtor in invoking the bankruptcy laws is likely to be compromised by permitting the continuation of actions against him. Upon the filing of a bankruptcy petition under the new law, all the debtor's property becomes property of the estate and is brought into the custody of the bankruptcy court;219 no interference with that custody can be countenanced without the court's permission.220 The bankruptcy court's control has been buttressed with statutory power, in addition to its inherent power as a court of equity, to enjoin litigation and acts of creditors and others insofar as necessary to effectuate the bank-

216. See supra note 30; infra notes 274-318 and accompanying text.
217. 184 U.S. 1 (1902).
218. Id. at 14.
ruptcy objectives. In addition, with the passage of the new Bankruptcy Code, Congress has conferred statutory status on the automatic stay for all classes of cases commenced under the new Code.

A. Mechanics of the Automatic Stay

A petition filed under the new Chapter 11 triggers an automatic stay, as did the filing of a petition pursuant to the Rules of Bankruptcy Procedure. As under prior law, the stay becomes operative immediately whether the petition is voluntary or involuntary. The new bankruptcy law, unlike prior law, does not recognize or permit any different effect to be given the stay because of the chapter under which the case was commenced. Chapter 11 of the Code synthesizes Chapters X, XI, and XII of the old Act. By combining the business rehabilitation chapters, the courts will now be able to assess a petition for relief from the stay without concern for the particular relief chapter involved and the ability of the court to affect secured creditors without consent.

The automatic stay is applicable to all entities, including a creditor holding a secured claim, and operates against the following: the commencement or continuation of any judicial, administrative, or other kind of proceeding to enforce any claim against the debtor; "any act to obtain possession of property of the estate or of property from the estate;" "any act to create, perfect, or enforce any lien against property of the estate" or property of the

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222. 11 U.S.C. §§ 362, 922, 1301. This article deals only with section 362.
224. Bankr. Rules, supra note 6, 10-601(a), 11-44(a), 12-43(a).
226. See 11 U.S.C. §§ 103, 362. Under the Bankruptcy Act, courts would inevitably give consideration to the particular chapter proceeding in which the stay arose. This was because in a Chapter XI case a debtor could only alter or modify the rights of unsecured creditors whereas in Chapter X a secured creditor could be affected. See SEC v. American Trailer Rentals Co., 379 U.S. 594 (1965); see also supra notes 49, 77 and accompanying text.
228. 11 U.S.C. § 362(a). The Bankruptcy Code defines "entity" to include a person, estate, trust, or governmental unit. 11 U.S.C. § 101(14). "Person" is defined to include an individual, partnership, or corporation, but it does not include a governmental unit. 11 U.S.C. § 101(30).
debtor;\textsuperscript{232} any act to collect a claim against the debtor arising before the commencement of the case;\textsuperscript{233} and the setoff on any debt owing to the debtor that arose before the commencement of the case.\textsuperscript{234} In short, the stay provision is comprehensive and almost all-inclusive,\textsuperscript{235} though it is not the exclusive remedy available to the bankruptcy court to restrain entities from interfering with the case. The bankruptcy court also has the power to issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of the Code;\textsuperscript{236} the power of a court of law, equity, and admiralty;\textsuperscript{237} and the power to issue writs under the all writs statute.\textsuperscript{238}

As was previously discussed, the filing of a Chapter 11 business reorganization petition exposes the secured creditor to a serious risk of diminution in value of his collateral because of depreciation as the debtor continues to use the property in its business.\textsuperscript{239} The debtor in possession\textsuperscript{240} in a Chapter 11 case is expected to continue business operations\textsuperscript{241} and may in the ordinary course of business, use, lease, or sell any of the assets of the estate without authorization of the court.\textsuperscript{242} The property, however, will undoubtedly remain in the

\textsuperscript{232} 11 U.S.C. § 362(a)(5). This paragraph differs from 11 U.S.C. § 362(a)(4) in that it also stays any act to enforce a lien arising prior to the filing of the petition against property acquired by the debtor after the commencement of the case or property which is exempt under 11 U.S.C. § 522. See Kennedy, supra note 11, at 19-21.

\textsuperscript{233} 11 U.S.C. § 362(a)(6). This paragraph prevents efforts by creditors to collect pre-petition debts by telephone calls or other informal means of coercion. See Kennedy, supra note 11, at 21-22.

\textsuperscript{234} 11 U.S.C. § 362(a)(7). Although the right to set off pre-petition debts is stayed by the filing of a petition, the right of setoff is not abrogated. See 11 U.S.C. § 553.

\textsuperscript{235} 11 U.S.C. § 362(b)(1)-(8). Section 362(b) of the Code contains eight explicit limitations on the operation of the stay provided for in subsection (a). For a discussion of these exceptions, see Kennedy, supra note 11, at 24-37.


\textsuperscript{239} See supra text accompanying notes 17-20.

\textsuperscript{240} 11 U.S.C. § 1101(1).

\textsuperscript{241} See 11 U.S.C. § 1104 (procedure governing appointment of trustee), § 1107 (debtor in possession has virtually all rights and duties of trustee), § 1108 (trustee may operate business without court authorization).

\textsuperscript{242} 11 U.S.C. § 363(c)(1). Cash collateral is the only exception to this grant of power. 11 U.S.C. § 363(c)(2). The debtor must apply for permission to use a bank account or cash that is subject to security agreements, and the court cannot grant such permission until secured creditors have been given notice and an opportunity for a hearing. 11 U.S.C. § 363(c)(2). It should also be noted that "after notice and a hearing" means after such notice and hearing "as [are] appropriate in the particular circumstances"; notice alone will suffice if the court determines that "there is insufficient time for a hearing to be commenced" before an
debtor's hands if its use is essential to the debtor's business. Both the oversecured creditor, fearing diminution of its equity cushion, and the undersecured creditor, running the risk that its collateral will depreciate until it is valueless, will seek additional protection or relief from the stay.

The last four subsections of section 362 govern relief from the automatic stay. Subsection (d)(1)\(^\text{243}\) follows the basic pattern of the comparable subdivision of the automatic stay rules.\(^\text{244}\) Specifically, section 362(d)(1) empowers the court to terminate, annul, modify, or condition the stay of a party in interest for cause, including the lack of adequate protection of such party.\(^\text{245}\)

The hearing requirements for a section 362(d) request to alter a stay are stringent.\(^\text{246}\) If the court does not order a final hearing or a continuance of the stay within thirty days of the request by a party in interest, the stay terminates automatically.\(^\text{247}\) The court may continue the stay only if there is a reasonable likelihood that the party opposed to the request for relief will prevail and if the final hearing is commenced within thirty days of the preliminary hearing.\(^\text{248}\) Thus, a final hearing must be commenced within sixty days of the request. The party making the request (the secured creditor) must prove only that the debtor has no equity in the property;\(^\text{249}\) the burden of proof on all other issues is upon the party opposing the request.\(^\text{250}\) Furthermore, the court is empowered to grant relief from the stay without a hearing, if an entity with an interest in the property affected will suffer irreparable damage.\(^\text{251}\)

\(^\text{243}\) 11 U.S.C. § 362(d) provides:

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

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

\(^\text{Id.}\)

\(^\text{244}\) Bankr. Rules, supra note 6, 10-601(c), 11-44(d), 12-43(d).

\(^\text{245}\) See supra note 243.

\(^\text{246}\) See supra note 243.

\(^\text{247}\) See supra note 243.

\(^\text{248}\) See supra note 243.

\(^\text{249}\) See supra note 243.

\(^\text{250}\) See supra note 243.

\(^\text{251}\) See supra note 243.
B. Grounds for Relief From the Stay Under the Code

When the holder of a claim secured by a lien on property of the estate or property of the debtor requests relief from the automatic stay, the holder of the secured claim is entitled to "adequate protection" of his interest in the property.252 "[A]dequate protection" has been established in the Code as the touchstone against which complaints to dissolve or modify the stay must be tested.253 This standard, as mandated by the Code, is applied as a matter of right and not as a matter of discretion.254 "Adequate protection must be applied in light of the peculiar facts of each case and upon the equitable considerations arising therefrom."255

Adequate protection is a concept which Congress intentionally left undefined.256 Instead, section 361 of the Code enumerates three nonexclusive methods of providing adequate protection to an entity with an interest in property of the debtor.257 If the value of the secured creditor's collateral will decrease during the proceedings, the trustee may be required to make periodic cash payments to the secured creditor.258 Alternatively, the holder of the secured claim may be granted an additional or replacement lien on other property of the estate.259 In addition, the court may approve other forms of relief which will protect the interest of the secured creditor.260 These ex-
amples are not intended to be exclusive or exhaustive, but are rather to illustrate means whereby adequate protection may be provided and to define the contours of the concept itself. Moreover, it is not for the court to devise the method of providing adequate protection; rather, it is incumbent upon the debtor to propose the method to be used. If the party that is affected by the action objects to the proposed method, a bankruptcy court may determine whether the form of protection proffered reflects the spirit and intent of section 361.

It is apparent that the policy of adequate protection under the Code is drawn from cases decided under the Bankruptcy Act. The Bankruptcy Rules, which allowed relief from the stay for cause shown, were interpreted to require consideration of a number of factors, including the presence of equity, the likelihood of harm to the creditor, prospects for reorganization, and the essentiality of the property to the successful rehabilitation of the debtor. Similarly, section 362(d)(1) of the Code provides that the court shall grant relief for cause. Despite this apparent similarity in language and purpose between the relief provisions of the Rules, as applied to the Act, and the Code, many courts have abandoned the guidance of the case law under the Act and have applied an equity cushion analysis in determining whether to grant relief from the stay.

C. The Equity Cushion Analysis and Its Infirmities

Deciding whether to continue or vacate the stay solely on the
ground of the debtor's equity in the property is an unwarranted departure from practice under the Act and may produce unjust results, such as where the encumbered property is so vital to the operation of the debtor's business that foreclosure would prove ruinous, not only to the debtor, but to other creditors as well. For the very reason that section 361 is based on the concept of adequate protection as it developed in stay litigation under the Bankruptcy Act, the courts should look to the standards which evolved thereunder to formulate guidelines for determining whether a creditor would be adequately protected during the continuation of the automatic stay.

An example of the unjust result which may occur because of undue reliance on the debtor's equity in the property should prove illustrative. Suppose a land developer takes a $500,000 bank loan to finance construction of an apartment complex. The bank's appraisal shows that the undeveloped property securing the loan is worth $1,000,000. "The developer . . . incurs cost overruns and construction delays which render it impossible to complete the project for occupancy before the loan is in default." A Chapter 11 petition is filed by the developer. Further hardship befalls the developer as the state and federal governments pass environmental protection legislation that makes construction more costly, "and the developer's permit from the county government approaches expiration at a time when local opposition is mobilized against the project." When the bank seeks relief from the automatic stay, it prepares a new appraisal showing that the value of the property now equals the amount of the secured debt. A court confronted with these circumstances may find that the developer no longer has any equity in the real estate and that the project is accruing unpaid taxes and interest to the detriment of the secured creditor. On the other hand, the developer may be able to salvage the project in time and produce substantial equity for itself and all creditors.

273. See supra notes 269 & 271.
274. See supra notes 28 & 266.
275. This example is found in Peitzman and Smith, supra note 16, at 1227.
276. Id.
277. Id.
278. Id. at 1227-28; cf. C.I. Mortgage Group v. Nevada Assocs. (In re Nevada Towers Assocs.), 14 COLLIER BANKR. CAS. (MB) 146 (Bankr. S.D.N.Y. Aug. 10, 1977)(despite mortgagee's request for relief from stay, Chapter XII debtor with no equity in uncompleted apartment building permitted to remain in possession and complete building because court found purpose of Chapter XII to be rehabilitation and completed building would be more valuable to both debtor and mortgagee).
A court cannot resolve this problem by mechanically invoking an equity cushion analysis. The presence or absence of equity in the property does not, in and of itself, militate for or against the continuance or vacation of the stay. The court must also consider whether the property's value may continue to decrease, resulting in harm to the secured creditor; whether the debtor has a reasonable prospect of rehabilitation; and whether the property is vital to the operation of the debtor's business. Only then can the court make an informed judgment.

In *Diversified Mortgage Investors v. Lake Tahoe Land Co.*, the holder of a first deed of trust on vacant land, part of which was forest land and part of which had been subdivided into parcels for condominiums, sought to vacate the automatic stay imposed by virtue of a Chapter 11 petition. The court, after grappling with the valuation issue, which is ultimately involved in the process of making an equity determination, found that there was insufficient land value to adequately protect the debt due the creditor. The court also found that termination of the stay was appropriate for causes independent of the adequate protection issue. It is noteworthy, however, that the court observed in dictum that a 40 to 50 percent cushion for lenders on partly developed raw land would be necessary to afford adequate protection.

In another recent case, *City National Bank v. San Clemente Estates*, the court stated that the equity cushion method has been widely adopted in decisions interpreting section 361 of the Code, and held that a 65 percent cushion for a first lienholder on land securing a construction loan was adequate protection. The court noted, however, that if development projections were not met and the land had to be marketed in its present undeveloped condition, a new

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279. Peitzman and Smith, *supra* note 16, at 1228; *see supra* note 266.
281. *See supra* notes 166-81 and accompanying text.
282. 5 Bankr. at 36. The property was found to have a value of $1,856,960 while the debt due the plaintiff exceeded two million dollars, leaving the creditor underscured. *Id.*
283. *Id.* at 36-37. The plaintiff's debt had been due and payable for four years, there were tax delinquencies and a staggering amount of unpaid interest, and certain acts of the debtor had been in violation of the security contract to the detriment of the creditor. *Id.*
286. *Id.* at 609.
287. *Id.* at 610.
valuation of the property would be required, resulting in an approximately 6 percent cushion, which would be "precariously close to being inadequate."288

The court more importantly observed, in obeisance to the drafters of the Code, that "this quantitative approach may have the salutary effect of giving precise guidance as to the standard to be used, but it does seem to be inconsistent with the congressional intent that each case is to be judged on its own facts."289 This precise guidance, which results from the use of the equity cushion analysis, is, indeed, inconsistent with the congressional intent and also with the historical development of stay litigation. The language and purpose of the stay provisions under the Act and the Code are quite similar and there seems to be no sound basis for deviation from the approach developed under the Act in assessing a petition for relief from the stay under the Code.

The court in Midlantic National Bank v. Anchorage Boat Sales, Inc.,290 also acknowledged this similarity between the Act and the Rules, and the Code.291 A secured creditor that provided the debtor, a retailer of new and used pleasure boats, with floor plan financing, filed a complaint seeking relief from the automatic stay in a Chapter 11 proceeding.292 Having concluded that the undersecured creditor was entitled to relief under section 362(d)(2),293 the court analyzed the complaint for relief under section 362(d)(1) in light of the law as it existed under the Bankruptcy Act and Rules. It supported the granting of relief under this section as well, finding that the debtor had no reasonable possibility of reorganization and no equity in the collateral.294

The result in Anchorage was a foregone conclusion in that there was absolutely no possibility that the debtor could reorganize itself. It is refreshing, however, that the court acknowledged the consensus doctrine that had developed under previous law that four factors were relevant, not just the extent of equity, in determining whether a

288. Id. at 611. This 6% figure includes costs associated with the sale of the property in bulk that could amount to as much as 12% of the sales price. Id.
289. Id. at 610 (citing H.R. REP., supra note 11, at 339, reprinted in 1978 U.S. CODE CONG. & AD. NEWS at 6295).
291. Id. at 641-42.
292. Id. at 636.
293. Id. at 641. For a discussion of section 362(d)(2), see Kennedy, supra note 11, at 44-45; supra note 21.
294. 4 Bankr. at 642.
The court continued by stating that it is "apparent that the policy of adequate protection is drawn from cases decided under the Bankruptcy Act" and that because adequate protection under the Code is "based on the concept of adequate protection as it developed in stay litigation under the Bankruptcy Act, the Court should look to these cases to formulate standards for determining whether a creditor would be adequately protected during the continuation of the automatic stay." These factors, as the Anchorage court indicated, should be balanced in evaluating a petition for relief from the stay, and should supplant the equity cushion analysis currently applied by some bankruptcy courts.

The court in Ingersoll-Rand Financial Corp. v. 5-Leaf Clover Corp., conscious of the flexibility of bankruptcy courts "to fashion . . . relief in light of the facts of each case and general equitable principles," found that the small equity cushion present in mining equipment owned by the debtors would be maintained by their making regular payments at least equal to the combined depreciation and interest on the debt. In this manner, the equity ratio, found by the court to be so important, would be maintained at the appropriate level. Were the debtors unable to make these payments, the stay would be lifted and the mining equipment so vital to the debtors' operations would be repossessed by the secured creditor.

The court, after acknowledging that reorganization would be unlikely without the use of the mining equipment, never gave any consideration to the likelihood of a successful reorganization. Instead, the court ordered the debtors to make a payment of $35,000 to the secured creditor within fifteen days, even though there existed an equity cushion of approximately twice the amount of the payment. This payment undoubtedly impaired the chances of the debtors' reorganization. If the court had addressed the issue of likeli-
hood of a successful reorganization, it might have found that there was a reasonable likelihood of success. It then could have eliminated this prohibitive payment and allowed the debtors to provide in their plan of reorganization for payments over time to the secured creditor, with appropriate interest. These payments would be fully compensatory. Such a plan would have truly manifested the flexibility of bankruptcy courts and their equitable powers in a rehabilitation proceeding. It does not seem unreasonable to ask for the assistance of a secured creditor in the financing of a debtor's reorganization where the creditor will be fully compensated in deferred payments and there is a high likelihood of a successful reorganization. In order to confirm an arrangement of this nature, however, the court must first, of course, determine the likelihood of a successful reorganization.

The question of whether an equity cushion is necessary to provide adequate protection under section 362(d)(1) was recently raised in Bankers Life Insurance Co. of Nebraska v. Alyucan Interstate Corp. The debtor, a construction and real estate development firm, filed a Chapter 11 petition, and the secured creditor, holder of a trust deed on realty, sought relief from the automatic stay under section 362(d)(1). The court, in a well-reasoned decision, determined that under section 362(d) several issues must be addressed: First, what is the interest in property being protected; second, what as-

304. The court, in order to confirm such a plan, would have to find that the secured creditor would receive at least what it would have received under a Chapter 7 liquidation. 11 U.S.C. § 1129(a)(7). Also, if the class of secured claims of which the creditor is a member does not accept the plan, the court still can confirm the plan if the payments are made in cash and the creditor retains its lien securing such claim. 11 U.S.C. § 1129(b)(1), (2). See Klee, supra note 91, at 133.

305. If the court does not find that there is a reasonable likelihood of a successful reorganization, then the plan cannot be confirmed because it would not be feasible under section 1129(a)(11) and would possibly be in violation of the good faith requirement contained in section 1129(a)(3). 11 U.S.C. § 1129(a)(3), (11); see 5 COLLIER ON BANKRUPTCY ¶ 1129.02[3], [11] (15th ed. 1981).

The fact that the Code contains this feasibility requirement for a Chapter 11 plan is evidence that the Code contemplates the court's consideration of the likelihood of a successful reorganization. "Section 1129(a)(11) requires the court to carefully scrutinize the plan to determine whether it offers a reasonable prospect of success and is workable." 5 COLLIER ON BANKRUPTCY ¶ 1129.02[11], at 1129-33 (15th ed. 1981).

308. 12 Bankr. at 806-07. The court found this factor important because the protection afforded a secured party may depend upon the particular interest and property involved. Id. The interest in property involved in the proceeding was the creditor's lien on the realty of the debtor. Id. at 809.
pects of the interest in property require protection; third, from what is the interest in property being protected; and fourth, what is the method of protection? The court concluded that since the collateral, and therefore the lien, were neither declining nor subject to sudden depreciation in value, the creditor suffered no harm cognizable under section 362 as a result of the stay. Accordingly, the court denied relief from the stay.

In a trenchant analysis, the court, in dictum, rejected the current trend in case law toward defining adequate protection in terms of an equity cushion. The analysis was predicated upon four grounds, one of which was the fact that the cushion analysis has no basis in the historical development of stay litigation.

309. 12 Bankr. at 807-08. The court noted that “[a]dequate protection is concerned with the value of the interest in property.” Id. at 807. Therefore, “the ‘interest in property’ entitled to protection is not measured by the amount of the debt but by the value of the [allowed secured claim].” Id. at 808. This is important because accruing interest and taxes may be immaterial if they do not affect the value of the collateral, while fluctuations in the market affecting the value of the collateral may be highly relevant to adequate protection. Id. The collateral in Alyucan was of sufficient value to protect the creditor. Id. at 809.

310. The court tersely asserted that the interest in property was being protected “from any impairment in value attributable to the stay.” Id. at 808. It continued by stating that only declines in value of the collateral that are direct results of the stay must be recompensed. Id. at 808-09. In relation to the proceeding, this factor had no relevance in that the collateral was not declining or subject to sudden depreciation in value. Id. at 809.

311. This factor is necessarily involved in any proceeding for relief from the stay. The court essentially noted that the method of protection will vary with the interest in property being protected and that the debtor need only adequately protect the interest in the collateral to the extent of any decline in value caused by the stay. Id. There was no need to consider this factor in the proceeding because the creditor was suffering no harm as a result of the stay and thus required no protection. Id.

312. Id.

313. Id.

314. See id. at 809-13.

315. Id. at 810-12. The court noted three other grounds upon which it rejected the equity cushion analysis: “(1) It is inconsistent with the purpose of adequate protection. (2) It is inconsistent with the illustrations of adequate protection found in Section 361. (3) It is inconsistent with the statutory scheme of Section 362(d).” Id. at 810.

The court stated that equity cushion analysis is inconsistent with the statutory scheme in that “[u]nder 362(d)(2) a lack of equity, absent a further showing that the property is unnecessary to an effective reorganization, does not warrant relief from the stay.” Id. at 811. Semantically, this is correct. The court proceeded and reflected on this language stating that [t]his statutory provision expresses a legislative judgment, first, that it is the absence of equity rather than any particular cushion which is the criterion for relief from [the] stay, and second, that the absence of equity is not alone dispositive—the court must still weigh the necessity of the property to an effective reorganization. The cushion analysis in inconsistent with this judgment.

Id. at 811 (emphasis in original).

Though section 362(d) is phrased in the disjunctive, see 11 U.S.C. § 362(d), and section
visions under the Bankruptcy Act allowed relief for cause shown, which “was interpreted to require consideration of a number of factors, including the presence of equity, the likelihood of harm to the creditor, prospects for reorganization, and essentiality of the property in the operation of the estate.”

The Alyucan court has identified the proper judicial methodology in determining whether to grant relief from a stay because of lack of adequate protection. The court, in rejecting the equity cushion analysis, evinces a sensitive awareness of the objectives of Chapter 11 and rehabilitation. Adherence to the cushion analysis can, indeed, work unjust results and its rigidity is contrary to the equitable powers reposed in the bankruptcy court. Bankruptcy courts should follow the lead of Alyucan and put the presence or absence of equity in its proper perspective. The lack of equity in the collateral should not sound the death knell for the debtor where a consideration of the other factors warrants continuation of the stay.

VI. CONCLUSION

The bankruptcy courts’ recent tendency under the Bankruptcy Code to predicate determinations of whether relief from the automatic stay should be granted on an equity cushion analysis constitutes an unwarranted and undesirable departure from the analysis employed under the Bankruptcy Act. The balancing process utilized under the Act, employing equity as one variable among many, allowed the courts to accord each component appropriate weight depending on the circumstances of each case so that the rehabilitative objectives of Chapter 11 would be effectuated.

Although the equity cushion analysis enjoys ease of application and practical appeal, it is contrary to the legislative directive that the facts in each case be considered to determine whether relief is appropriate. The approach developed under the stay provisions of the Act, however, is responsive to this command. It affords the court the necessary flexibility in addressing the unique factual configuration that confronts the court in each reorganization case. Therefore,

362(d)(2) was designed to obviate a very specific abuse of the bankruptcy system, an act against property, id. § 362(d)(2), the court’s analysis in Alyucan is a compelling one, and indicates the proper role equity should play in determining whether to grant relief from the stay. For a discussion of the derivation and purpose of section 362(d)(2), see supra note 21.

316. 12 Bankr. at 811-12.
317. Id. at 810.
the courts, under the Code, should revert to the balancing approach developed under the Act and use the equity cushion as only one factor in determining whether to grant relief from the automatic stay.

Lawrence J. Dash