REAL ESTATE BANKRUPTCIES FOR DUMMIES:

A Bankruptcy Law Primer on Special Considerations in Real Estate Bankruptcies, Including Partnership, Single Asset, Environmental, and Valuation Issues

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I. INTRODUCTION

This article is not intended to be a comprehensive guide or outline covering all aspects of bankruptcy where real estate is involved. Rather, as the title suggests, it is intended to give the reader a general understanding of some of the issues that, more often than not, surface in bankruptcy cases involving real property. Specifically, many partnerships are formed for the specific purpose of purchasing, developing, owning, and/or managing real property. As such, it is important for the practioner to be familiar with some fundamental issues regarding partnership bankruptcies. Moreover, many of the partnerships who file a petition for relief under Title 11, do so with only one asset, a particular piece of real property. Accordingly, this paper is intended to highlight the significant issues in a Single Asset Real Estate bankruptcy case. Further, many time real estate assets in bankruptcy have been, or are being, encumbered with environmental problems. This paper provides an overview of how bankruptcy courts deal with federal and state environmental claims that arise both before and after the debtor files for relief. Finally, this paper provides an overview of how bankruptcy courts assign a value to real property in a debtor s bankruptcy estate.

II PARTNERSHIP ISSUES

A. Eligibility of Partnerships for Bankruptcy

1. Partnerships are Generally Eligible for Bankruptcy

In most respects, the Title 11 (11 U.S.C. § 101 *et. seq.*; the Bankruptcy Code) does not distinguish partnerships or limited liability companies from other business organizations. *See* T. Randall Wright, Bankruptcy Issues in Partnership and Limited Liability Company Cases, SF77 ALI-ABA 169, 172. Rather, the focus of the Bankruptcy Code is on giving the debtor entity the statutory tools it needs to recover financially, or to allow it to end its business in a way that benefits its creditors. *Id.* There are however, some provisions of the Bankruptcy Code dealing with specific partnership issues.

Generally, partnerships are eligible for relief under the Bankruptcy Code. A general or limited partnership, with some exceptions, that is domiciled in, has its place of business in or has property in the United States (and that is not otherwise ineligible) may be a debtor under Chapter 7, 11, or 12 of the Bankruptcy Code. *See* Bankruptcy Code §§ 101(41) (definition of person includes partnership); 109(a), (b), (d) & (f) (who may be a debtor); Aboussie Bros. Constr. Co. v. United Mo. Banke (In re Aboussie Bros. Constr. Co.), 8 B.R. 302, 303 (E.D. Mo 1981) (for bankruptcy purposes, a partnership is a separate and distinct entity from its partners...[and] may be adjudged bankrupt irrespective of the bankruptcy of the individual partners.). Upon the filing of a petition, a bankruptcy estate is born, consisting of all the equitable and legal interests the debtor has or can claim, including property rights, contractual rights, and causes of action including certain special cause of action which the Bankruptcy Code gives the estate in order to help out to recover assets. *See* Bankruptcy Code § 541. Because of Congress s desire to create a

central forum for fair distribution of assets, both the Bankruptcy Code and the cases are far-reaching in characterizing assets as part of the estate.

2. Does a Partnership Exist? State Law Governs

State law governs whether a partnership exists. *See* E.A. Martin Mach Co. v. Williams (In re Newman), 875 F.2d 668, 670 (8th Cir. 1989). The Revised Uniform Partnership Act (as enacted in Texas) (Revised Partnership Act) has applied to all Texas partnerships since at least January 1, 1999. *See* Tex. Rev. Civ. Stat. Ann. art. 6132b-1.01 *et seq.*, Michelle E. Shriro, Partnership Issues in Bankruptcy, presented to Dallas Bankruptcy Bar, April 2000. Under the Revised Partnership Act, a person may become a partner only with the consent of all partners. *Id.*, Tex. Rev. Civ. Stat. Ann. Art 132b.4.01(g). A transfer of a partnership interest confers a right to distributions but does not entitle the transferee to participate in the management of the partnership. Shriro at 2; Tex. Rev. Civ. Stat. Ann. Art 6132b-5.03(a). Withdrawal by a partner does not cause dissolution of the partnership as it did under the Uniform Partnership Act (UPA). *See* Unif. Partnership Act §§29, 31 (*repealed* by Revised Uniform Partnership Act, Tex. Civ. Stat. Ann. Art. 6132b-1.01 *et seq.*), 6 Uniform Laws Annotated at 752, 771. Rather, the partnership continues to exist and the remaining partners may buy out the departing member s interest. Tex. Rev. Civ. Stat. Ann. Art. 6132b-7.01. Under the Revised Partnership Act, the bankruptcy of a partner constitutes an act of withdrawal, but does not constitute an event requiring winding up of the partnership, unless the partnership agreement so provides. *See* Tex. Rev. Civ. Stat. Ann. Arts. 6132b-6.01(b)(6), 6132b-8.01(c) (contrast Unif. Partnership Act § 29, 31, 6 Uniform Laws Ann. at 752, 771, under which the bankruptcy of a partner resulted in dissolution); Shriro, at 4 (Many partnership agreements specify the bankruptcy of a general partner as an event requiring a winding up of the partnership, or in the case of partnership agreements drafted before the enactment of the Revised Partnership Act, as an event of dissolution). Under the Revised Partnership Act, a person ceases to be a general partner upon filing of a bankruptcy petition. *See* Tex. Rev. Civ. Stat. Ann. art 6132a-1 § 4.02. Moreover, withdrawal of a general partner causes dissolution of the partnership unless there remains at least one non-debtor general partner and the partnership agreement provides for continued existence. *See* Tex. Rev. Civ. Stat. Ann. art 6132a-1 § 8.01.

3. Partnership by Estoppel

A partnership by estoppel is probably not eligible for relief under the Bankruptcy Code. In other words, while parties may be acting as a partnership and a court might find that those parties would be estopped from claiming a partnership did not exist, this judicially created partnership by estoppel will not be considered a separate entity eligible for bankruptcy relief under the Bankruptcy Code. Despite the fact that the entity will not be eligible for bankruptcy relief, if a partnership by estoppel is found, the individual partners will not be able to claim partnership assets as part of their individual bankruptcy estates. In In re Indvik, 118 B.R. 993, 1003 (Bankr. N.D. Iowa 1990), the court held that even if no partnership exists, the individual debtor were estopped from denying the existence of a partnership and could not claim partnership assets as exempt in their Chapter 7 cases. *See* Larsen v. Consolidated Pet Foods, Inc. (In re S&D Foods, Inc.), 144

B.R. 121, 158-59 (Bankr. D. Colo. 1992) (Court found relationship of debtor and another to be de facto partnership or certainly one by estoppel). Thus, while creditors outside the bankruptcy setting would be able to pursue assets of people holding themselves out as a partnership, this de facto partnership or partnership for estoppel is not an entity eligible for bankruptcy relief and individuals in a de facto partnership, however, will not be able to claim the de facto partnership assets as individual assets in their individual bankruptcy cases.

4. Eligibility of Partnership in Dissolution

A partnership in dissolution is eligible for Chapter 7 relief. In In re Donald Verona & Bernard Green, 126 B.R. 113, 115-16 (Bankr. M.D. Fla. 1991), the court held that a partnership which was dissolved by the death of a partner (*see* UPA § 31(4), note under Revised Partnership Act as enacted in Texas, the death of a partner is not necessarily a event requiring dissolution) continues its legal existence until its affairs are wound up, and is eligible for chapter 7 relief. *See* In re Pallett Reefer Co., 233 B.R. 687, 691 (Bankr. E.D. La. 1999) (joint venture partnership which was terminated by agreement on the date of arbitrator s award, was only dissolved, and a partnership in dissolution is eligible for bankruptcy relief); Waldschmidt v. Dudley (In re Henderson), 127 B.R. 168, 171-74 (M.D. Tenn. 1991) (where partnership was dissolved by transfer of one partner s interest to the other in violation of state bulk sales law, partnership creditors retained their standing as such, with rights in the partnership assets senior to those of the trustee of the debtor partner). *But see* Petralex Stainless, Ltd. v. Christiana Metals (In re Petralex Stainless, Ltd.), 78 B.R. 738, 741-42 (Bankr. E.D. Pa. 1987) (suggesting that court lacked jurisdiction of involuntary petition by joint venturer against joint venture if it caused dissolution, but concluding that dissolution did not occur).

However in C-TC 9th Avenue Partnership v. Norton Co. (In re C-TC 9th Avenue Partnership), 113 F.3d 1304, 1307-09 (2d Cir. 1997), the Second Circuit opined, that a partnership in dissolution because of the withdrawal of one of its two partners is not eligible to be a Chapter 11 debtor under Bankruptcy Code § 109(d). In so holding, the court focused on a state law limitation on the activities of a dissolved partnership (i.e., that it can only complete transactions unfinished at dissolution) and contrasted them with the ability of a dissolved corporation to be reinstated. The court considered these limitations on a dissolved partnership to be tantamount to liquidation under Chapter 7 of the Bankruptcy Code, and thus inconsistent with the primary purpose of Chapter 11: to reorganize and emerge from bankruptcy as an operating enterprise. Thus, even though liquidation is permitted in Chapter 11 and a Chapter 11 petition may be filed in order to liquidate, the court held that there is no reason a debtor should be permitted to enter these proceedings without a possibility or reorganization. *See* In re C-TC Avenue Partnership, 113 F.3d at 1307-09. On this basis, the court determined that a partnership in dissolution (as contrasted with a partnership) is not a person under Bankruptcy Code § 109(d) and cannot be a Chapter 11 debtor. *Id.*

In the course of its analysis, the Second Circuit in C-TC distinguished the United States Supreme Court s opinion in Toibb v. Radloff, 501 U.S. 157, 111 S. Ct. 2197 (1991), where the Supreme Court held that an individual who is not engaged in an ongoing business is nonetheless

eligible for Chapter 11 relief. The C-TC court stated, [i]n Toibb, the Court was determining whether being an ongoing business was a requirement for eligibility for Chapter 11 relief. Here, we are determining whether the term person encompasses a partnership in dissolution. *See* C-TC, 113 F.3d at 1308, n.2. In C-TC, the Second Circuit relied heavily on the reasoning in In re Fitzgerald Group, 38 B.R. 16 (Bankr. S.D.N.Y. 1983). In that case, the court abstained from the Chapter 11 case, under Bankruptcy Code § 305(a), for a partnership which had been dissolved pre-petition by the death of one of its two general partners. The partnership estate had only one asset, a typewriter worth $2,500, and nine creditors with claims totaling approximately $23,000, which the court felt did not justify expensive federal intervention in the partnership s liquidation. 38 B.R. at 18. Further, the court stated that [l]iquidation is not the proper function of...a Chapter 11 reorganization proceeding. *Id.*

If a partnership in dissolution is not a person under the Bankruptcy Code, as the court held in C-TC, there may be unanticipated implications for the effect on such partnerships of any provision of the Code applicable to persons. For example, a partnership in dissolution may not be eligible for relief under any chapter of the Bankruptcy Code. Nevertheless, in In re Hagerstown Fiber Limited Partnership, 226 B.R. 353, 359 (Bankr. S.D.N.Y. 1998), the court indicated that Chapter 7 is the only bankruptcy alternative for a dissolved partnership. In that case, a Chapter 11 case for a dissolved partnership which owned and operated a paper mill, the court interpreted C-TC to establish a bright line test that a dissolved partnership is not eligible for relief in Chapter 11, without regard to whether it seeks to rehabilitate or liquidate. This is because a Chapter 11 debtor must have the legal option to continue in business. 226 B.R. at 358.

In Contrast, the court in In re Shea & Gould, 214 B.R. 739 (Bankr. S.D.N.Y. 1977), refused to read C-TC to require dismissal of the Chapter 11 case for a law partnership in dissolution. It characterized as dictum the Second Circuit s holding that a partnership is not a person under the Bankruptcy Code. It also distinguished Shea & Gould as a case with substantial creditors and assets (i.e., different from a classic single asset real estate case), which was filed for the purpose of liquidation (not reorganization), an objective consistent with state law limitations on the activities of dissolved partnerships. *Id.* at 745-48. Moreover, In In re Foxridge Limited Partnership, 238 B.R. 810, 812, 815-16 (Bankr. W.D. Mo. 1999), the court stated that the debtor partnership in dissolution was an entity eligible for relief under Chapter 11, even when the partnership was to be re-formed and continued through a plan. The court in In re Foxridge Limited Partnership, however, did not mention C-TC. Finally, a different approach was taken by the court in In re Middletown Metro Associates, 225 B.R. 281 (Bankr. D. Conn. 1998). In that case, the court held that a partnership, which had been dissolved when both general partners became Chapter 7 debtors, was reconstituted as a new partnership after the Chapter 7 trustees abandoned the partner debtors partnership interests to them and they continued to operate the business, a shopping center. Therefore, the partnership was not in dissolution, and was a person eligible for Chapter 11 relief. The court distinguished C-TC as involving the withdrawal of one of two partners, so the business could not be reconstituted as a partnership and had to be dissolved.

B. Voluntary Petitions

Bankruptcy Rule 1004(a) provides that to be eligible for relief under Title 11, all general partners in a partnership must at least consent to a voluntary petition by a Partnership. *See* Bankruptcy Rule 1004(a) (a voluntary petition may be filed on behalf of a partnership by one or more general partners if all general partners consent to the petition.); *see also* Goldberg v. Rose (In re Cloverleaf Properties), 78 B.R. 242, 245 (Bankr. 9th Cir. 1987) (court held that bankruptcy petition filed by one of three general partners without knowledge of the others must be dismissed, citing In re Seychelles, 30 B.R. 72 (Bankr. N.D. Tex. 1982), and distinguishing In re R.S. Pinellas Motel Partnership, 5 B.R. 269 (Bankr. M.D. Fla. 1980), where the non-consenting partner was estopped from objecting to jurisdiction because it was fully aware fo the pendency of the case and failed to take prompt action to seek dismissal); In re Memphis-Friday s Assocs., 88 B.R. 821 (Bankr. W.D. Tenn. 1988) (where voluntary petition of general partnership was filed by one of two general partners without the consent of the other, it would be treated as a de facto involuntary petition; court declined to dismiss the case, distinguishing In re Cloverleaf Properties); In re SWG Assocs., 199 B.R. 557, 559-562 (Bankr. W.D. Pa. 1996) (authorization in partnership agreement for a majority of managing partners...to determine all questions relating to the conduct and management of the partnership business was insufficient, as a matter of state law, to empower the majority to file a voluntary Chapter 11 petition, given the limitations in the UPA on the power of less than all of the general partners to bind a partnership; court nonetheless treated the petition as involuntary and, likening the case to In re Memphis-Friday s Assocs., 88 B.R. 821 (Bankr. W.D. Tenn. 1988), refused to dismiss because the court had not yet taken any substantive action regarding the affairs of the partnership debtor); In re Channel 64 Joint Venture, 61 B.R. 255 (Bankr. S.D. Ohio 1986) (where joint venture agreement provided that management committee could authorize filing of bankruptcy by majority vote, minority consented to filing); *see also* In re Bel Air Assocs., Ltd., 4 B.R. 168, 171 (Bankr. W.D. Okla. 1980) (the general partner may file a petition on behalf of a limited partnership even though a limited partner objects).

C. Involuntary Petitions

If a partnership is eligible for involuntary relief under Bankruptcy Code § 303(a) (involuntary case may be commenced against a person, except a farmer, family farmer, or a corporation that is not moneyed, business, or commercial corporation, that may be a debtor under the Chapter under which such case is commenced) an involuntary petition may be filed by:

1. The requisite number and amount of partnership creditors, as specified in Bankruptcy Code § 303 (b)(1) & (2).

Bankruptcy Code § 303(b)(1) provides that an involuntary petition may be filed by three or more entities, each of which is either a holder of a claim against such person that is not contingent as to liability or the subject of a bona fide dispute, or an indenture trustee representing such a holder, if such claims aggregate at least $10,775.00 more than the value of any lien on property of the debtor partnership securing such claims held by the holders of such claims. *See*

Bankruptcy Code § 303(b)(1). Bankruptcy Code 303(b)(2) provides that an involuntary petition may filed, if there are fewer than 12 holders described in Section 303(b)(1), excluding any employee or insider of such person and any transferee of a transfer that is voidable, by one or more such holders that hold in aggregate at least $10,775.00 of such claims.

Individual creditors of a partner do not qualify as petitioning creditors, and therefore, do not qualify as a holer of a claim under Bankruptcy Code § 303(b)(1) or (2), since they do not have direct claims against the partnership. It appears, however, that a general partner or a limited partner that holds a separate creditor s claim against the partnership, may be petitioning creditor under §303(b)(1). Moreover, it appears that a limited partner that is not an employee, an insider of the recipient of a voidable transfer and that is the holder of a separate creditor s claim against the partnership may be petitioning creditor under Bankruptcy Code § 303(b)(2). Correspondingly, In re Taylor & Associates, L.P., the court held that limited partners were proper involuntary petitioners against the partnership under Bankruptcy Code § 303(b)(1) where they had been induced...to invest in a limited partnership expecting high returns on purchases of bonds, stocks, and stock options, [t]he proposed investments were never made, and [the sole general partner] had converted the creditor s funds. 193 B.R. 465, 472 (Bankr. E.D. Tenn. 1996) *rev d on other grounds* 294 B.R. 474. Under these circumstances, the court held that the limited partners were creditors that had tort or contract claims against the limited partnership and were proper involuntary petitioners. *Id.*

Contrastingly, the court in In re Cold Harbor Associates, L.P., 204 B.R. 904, 913-19 (Bankr. E.D. Va. 1997) re-characterized the limited partners/involuntary petitioners claims as equity debts evidenced by promissory notes and held that the limited partners were not holders of claims for purposes of Bankruptcy Code §303(b). Moreover, in In re Beacon Reef Ltd. Partnership, 43 B.R. 644 (Bankr. S. D. Fla. 1984), the court abstained from an involuntary case against a limited partnership which was instituted by a disgruntled limited partner because the case involved primarily a dispute between two general partners and the limited partner, there were a small number of partnership creditors and adequate relief could be afforded in state court. *See* In re A&T Partnership, 192 B.R. 900 (Bankr. S.D. Ohio 1996) (dismissed involuntary petition filed by one of two general partners because it was just a continuation of a dispute between the partners regarding the meaning of the partnership agreement which had been litigated for almost five years in state courts; there has been no indication that there is any creditor interest in the dispute); In re ABQ-MCB Joint Venture, 153 B.R. 338 (Bankr. D.N.M. 1993) (dismissed involuntary petition filed by one of two general partners because it appears that MCB is using the bankruptcy process solely for the purpose of moving state litigation against the other general partner and the secured creditor to this forum.)

2. As few as one but less than all of the general partners in partnership. Bankruptcy Code § 303(b)(3)(A).

In In re Pallet Reefer Co., 233 B.R. 687, 692-93 (Bankr. E.D. La. 1999), the court held that a general partner of a dissolved partnership, even if it has lost the right to manage the partnership because of a default, has standing to file and involuntary petition under Bankruptcy

Code § 303(b)(3)(A), citing In re BC&K Cattle Co., 84 B.R. 69, 70 (Bankr. N.D. Tex. 1988). The bankruptcy court also refused to abstain from the involuntary case, which the non-petitioning general partner argued was essentially a two-party dispute that could go forward in state court. The court held that, even thought the partnership in dissolution was solvent, it was in the best interest of the debtor to be liquidated as soon as possible. Since there were competing state court liquidation actions and competing state injunctions; the bankruptcy court which has expertise in liquidation would be able to accomplish the liquidation more expeditiously then either of the competing state courts. Further liquidation in bankruptcy would not interfere with other pending state court disputes between the parties. Moreover, in In re Monterey Equities-Hillside, 73 B.R. 749 (Bankr. N.D. Cal. 1987), the court held that a receiver for a limited partnership, which was appointed by an ex parte order of a state court obtained by 5 of 34 limited partners, could file an involuntary petition against the limited partnership where the state court had authorized him to do so. In addition, courts may view voluntary petition filed without the consent of all the general partners as involuntary petitions. In In re Memphis-Friday s Assocs., 88 B.R. 821 (Bankr. W.D. Tenn. 1988), the court treated a voluntary petition for general partnership filed by one of two general partners without the consent of the other as a de facto involuntary petition.

Despite the ability of fewer than all the general partners to file an involuntary petition, there will be no standing to bring an involuntary petition if the petitioner is the recipient of a transfer of a general partner s interest in the partnership. In In re Tip O Texas RV Village, 87 B.R. 195 (Bankr. M.D. Fla. 1988), Comer, a general partner in a limited partnership, assigned his interest to a wholly-owned corporation, and thereafter, Comer and the corporation filed an involuntary petition against the limited partnership. The court held that neither had standing to do so, citing Florida law (RULPA § 702) which provides that the assignee of a general partner s interest in a limited partnership is not entitled to exercise the rights of a partner and that the assignor ceases to be a partner and to have any powers or rights of a general partner. *See* In re Lehal Realty Assocs., 101 B.R. 418 (Bankr. S.D.N.Y. 1989) (transfer of partnership interest by one of two general partners to a third party does not make third party a general partner with standing to file an involuntary petition; however, when other general partner later agreed to transfer part of his partnership interest to a third party, he acknowledged third party as a general partner with him, so third party had standing as general partner to file involuntary against partnership).

3. A general partner, the trustee of a general partner or a partnership creditor, if Title 11 relief has been ordered against all of the general partners. Bankruptcy Code §303 (b)(3)(B). *See* In re Farmer s Mkt., 3 B.R. 223, 224 (Bankr. C.D. Cal. 1980) (limited partner was permitted to file an involuntary petition against partnership under §303(b)(3)(B) where sole general partner had filed under Bankruptcy Act.).

4. A foreign representative of the estate of the partnership. §303(b)(4).

D. Petitions Under Title 11 Against Partners

A voluntary petition by or an involuntary petition against a partner may be filed without regard to whether a petition has been filed against the partnership of which he/she/it is a member

An otherwise qualified partnership creditor is probably an eligible involuntary petitioner against a general partner. In re Elsub Corp., 66 B.R. 172 (Bankr. D. N.J. 1986) (partnership creditors counted as creditors of the general partner involuntary debtor for purposes of determining whether partner had more than twelve creditors); In re Lamb, 40 B.R. 689, 692-93 (Bankr. E.D. Tenn. 1984) (bankruptcy trustee of partnership holding Bankruptcy Code § 723(a) judgement against general partner was eligible petitioning creditor against general partner); *but see* Norman v. Norman (In re Norman), 32 B.R. 562, 565 (Bankr. W.D. Mo. 1983) (since under state law a partnership creditor must satisfy itself first from partnership assets, debtor general partner s liability for such debts is contingent and need not be considered in determining debtor s eligibility for chapter 13 relief).

In In re Equidyne Properties, Inc., 60 B.R. 245 (Bankr. S.D.N.Y. 1986), the court held that limited partners were not proper involuntary petitioners against general partner based on obligations of the general partner under the limited partnership agreements to contribute to limited partnerships under certain circumstances. These are partnership claims, which may be pursued only by the partnerships or their representatives. To the extent they are individual claims for damage or injury to the value of their partnership interest caused by Properties alleged failure to make the requisite payments to the Partnerships, the are both contingent and highly speculative and are subject to a bona fide dispute.

The failure of a general partner to pay undisputed partnership debts is probably grounds for involuntary relief against the partner. *See* § 303(h)(1).

E. Limitations on Conversion of Bankruptcy Cases involving Partnership

There are no special Code provisions regarding conversion or dismissal of partnership or partner cases. In In re Seychelles, 30 B.R. 72, 74 (Bankr. N.D. Tex. 1982), the court held that a partnership Chapter 7 case could not be automatically converted to Chapter 11 under Bankruptcy Code §706(a) without the consent of all general partners. Conversion sought by less than all of the general partners was subject to the notice and hearing requirements of Bankruptcy Code §706(b) (stating that a request by a party in interest to convert a Chapter 7 case to a Chapter 11 case requires notice and hearing). In addition, a limited partner, as opposed to a general partner, is a party in interest eligible to seek conversion of a partnership case from Chapter 7 to Chapter 11, but must comply with the notice and hearing requirements of Bankruptcy Code §706(b). *See* In re Brookhollow Assocs., 575 F.2d 1003, 1007 (1st Cir. 1978).

Despite the ability of the general partners (or any party in interest if notice and hearing requirements are met) to convert a Chapter 7 case to Chapter 11, such a request for conversion may not provide the partnership with the ability to regain possession of the partnership property.

In In re Alpine Lumber & Nursery, 13 B.R. 977, 979 (Bankr. S.D. Cal. 1981), after the filing of an involuntary Chapter 7 petition, an interim trustee was appointed. Prior to trial, the general partners filed a conversion of involuntary proceeding to Chapter 11" and the debtor (partnership) sought possession of its property from the interim trustee under Bankruptcy Code §348(e) (upon conversion, the trustee of case prior to conversion, is terminated). The court held that a voluntary request for entry of an order for relief in a Chapter 11 is not a conversion of a case under 11 U.S.C. §706 and therefore §348(e) does not remove the interim trustee from possession of the debtor s estate. To remove the interim trustee from possession, the debtor has to post a bond under §303(g) (authorizing the debtors regaining of property if posts sufficient bond) or convince the court that the causes which led to the appointment in the first place are no longer present. 13 B.R. at 979.

F. Property of a Partnership Estate

Under Bankruptcy Code § 541(a), the estate of a partnership debtor includes all legal or equitable interests of the debtor in property as of the commencement of the case, subject to the exclusions in Bankruptcy Code § 541(b) (including powers exercisable solely for the benefit of another and interests as lessee of nonresidential property terminated through expiration of the lease term) and (c)(2) (beneficial interests in spendthrift trusts). *See* Offical Comm. Of Unsecured Creditors v. Ashdale (In re Labrum & Doak, LLP), 227 B.R. 391, 404-12 (Bankr. E.D. Pa. 1998), appeal dismissed 1999 WL 667280, 667284, 667285 (E.D. Pa. Aug. 26, 1999) (estate of dissolved law partnership includes share of income earned by debtor s former partners after dissolution in matter originating during their tenure with firm and billed on hourly, non-contingent fee basis because, under Pennsylvania version of UPA, absent contrary agreement, partners of dissolved partnership owe fiduciary duty to wind up firm s unfinished business without additional compensation).

1. Contribution Obligations Of Partners as Property of the Partnership Estate.

All assets of the partnership are included in the partnership debtor s estate, including any contributions from the partners necessary for the payment of the partnership liabilities. In Litchfield Co. of South Carolina Ltd. Partnership v. Anchor Bank (In re Litchfield Co. of South Carolina Ltd. Partnership), 135 B.R. 797, 803-04 (W.D.N.C. 1992), the court held that the assets of the partnership include contributions of the partners necessary for the payment of all liabilities in any Title 11 case (not just Chapter 7 cases, where Bankruptcy Code § 723 applies) (Bankruptcy Code § 723 allows the trustee to assert certain claims against a general partner in Chapter 7 cases). The court based this conclusion on UPA § 18(a) (each partner must contribute towards the losses...sustained according to his share of the profits), § 40(d) ([t]he partners shall contribute, as provided in section 18(a) the amount necessary to satisfy the [partnership] liabilities). Citing In re Litchfield, the court in Madison Assocs. v. Baldante (In re Madison Assocs.), 183 B.R. 206, 215 n.11 (Bankr. C.D. Cal. 1995), stated that the applicability of Bankruptcy Code § 723(a) only to Chapter 7 cases does not preclude a Chapter 11 trustee from proceeding under Bankruptcy Code § 544 (trustee s powers to avoid certain transfers or obligations of the debtor) to recover from general partners the deficiency of the property of the

estate to pay the partnership debtor s creditors. Similarly, in Official Committee of Unsecured Creditors v. Bechtle (In re Labrum & Doak, LLP), 236 B.R. 275, 292-93 (Bankr. E.D. Pa. 1999), a liquidating Chapter 11 case for a law partnership, the court adopted the reasoning of the Litchfield case that, even though Bankruptcy Code § 723 is inapplicable, the Chapter 11 estate under Bankruptcy Code § 541(a) (describing property of the estate) nevertheless includes causes of action against partners for required contributions under Pennsylvania s version of the UPA. Further, the court stated that Bankruptcy Code § 723 is merely a codification of the application of existing state law, and concepts developed in [Bankruptcy Code] § 723 cases can be applied in Chapter 11 deficiency cases as well. *Id.* Contrarily, in In re Mesa Business Park Partnership, 127 B.R. 144, 149 (Bankr. W.D. Tex. 1991), the court declined to value real property under Bankruptcy Code § 506(a) (providing for the valuation of property of the estate secured by a lien of a secured creditor) for the sake of valuation alone in part because the Chapter 11 partnership cannot compel partners to make contributions, so their financial wherewithal does not figure into the estate s financial future, even it reorganization were in prospect. *Id.*; In re 1441 Veteran Street Co., 144 F.3d 1288, 1290 (9th Cir. 1998) (Bankruptcy Code § 506(a) operated to bifurcate a secured creditor s allowed claim into secured and unsecured interests based upon the bankruptcy court s valuation of the secured property); *but see* MBank Corpus Christi v. Seikel (In re I-37 Gulf Ltd. Partnership), 48 B.R. 647 (Bankr. S.D. Tex. 1985) (UPA § 40 does not define the assets of the partnership but applies to the settling of accounts between partners).

2. Recoveries From Avoiding Powers.

Under Bankruptcy Code § 541(a)(3), the estate of a partnership debtor includes any interest in property recovered under Bankruptcy Code § 550, which authorizes recovery of property or the value of property to the extent that a transfer is avoided under Bankruptcy Code § 544 (trustee as lien creditor and as successor to certain creditors and purchasers), § 545 (statutory liens), § 547 (preferences), § 548 (fraudulent transfers and obligations), § 549 (post-petition transactions), § 553 (setoff), or § 723 (rights of partnership trustee against general partner). Moreover, Bankruptcy Code § 548(b) contains a special fraudulent transfer provision applicable only in partnership cases. It authorizes the trustee of a partnership debtor to avoid any transfer of the debtor s property, or obligation incurred by the debtor, to a general partner, if the transfer was made or the obligation incurred within one year before the petition date and if the debtor was insolvent or thereby rendered insolvent. *See* Berisford, Inc. v. Stroock & Lavan (In re 1634 Assocs.), 157 B.R. 231, 233-34 (Bankr. S.D.N.Y. 1993) (Bankruptcy Code § 548(b) is not limited only to transfer made directly to a general partner; it applies to any transfer, direct or indirect which benefits the general partner).

In addition, Bankruptcy Code § 544(b) gives a trustee whatever avoiding powers an existing unsecured creditor might have under applicable non-bankruptcy law. Bankruptcy Code § 544(b) permits a partnership trustee to utilize Uniform Fraudulent Conveyance Act (UFCA) § 8, which renders voidable by partnership creditors every transfer of partnership property, and every partnership obligation incurred, to a partner, when the partnership is insolvent or thereby rendered insolvent. Moreover, the Bankruptcy code provides a special definition of insolvency for partnership. Under Bankruptcy Code § 101(32)(B), a partnership is insolvent for all purposes

under the Bankruptcy Code when the sum of its debts is greater than the fair market value of the aggregate of (i) the partnership s property (with certain exceptions) and (ii) the sum of the excess of each general partners non-partnership property (with certain exceptions) over such partner s non-partnership debts. *Id., See also* First Nat l Bank v. Minnesota Util. Contracting, Inc. (In re Minnesota Util. Contracting, Inc.), 101 B.R. 72, 83-84 (Bankr. D. Minn. 1989) (applying definition to find debtor insolvent). In Union Meeting Partners v. Lincoln Life Insurance Co.(In re Union Meeting Partners), 163 B.R. 229 (Bankr. E.D. Pa. 1994), the issue was whether the general partners net non-partnership assets should be added to the difference between the debtor partnership s assets and liabilities for purposes of determining insolvency in a preference case where the defendant had a nonrecourse debt. The debtor/plaintiff argued that they should not be included in the calculation because the defendant would not have had access to the general partners assets to ensure payment of his debt. The court found the debtor s argument not without logical and equitable appeal, but nonetheless rejected it. *Id.* Invoking the plain meaning rule, the court found Bankruptcy Code § 101(32)(B) unambiguous and lacking in any qualifiers or conditions which would support the debtor s interpretation. *Id.; See also* Venice-Oxford Assocs. Ltd. Partnership v. Multifamily Mortgage Trust 1996-1 (In re Venice-Oxford Assocs. Ltd. Partnership), 236 B.R. 820, 828-30 (Bankr. M.D. Fla. 1999) (under plain meaning rule, even though preference defendant has nonrecourse debt against debtor partnership, solvency is to be determined under Bankruptcy Code § 101(32)(B) by adding net non-partnership assets of each general partner to the difference between the partnership s debts and assets; the definition of insolvency set forth in §101(32) and applied in §574(b)...does not address the enforcement rights of any specific creditor).

III. THE AUTOMATIC STAY

A. Generally

Once a bankruptcy petition is filed, and for the duration of the case, creditors are prohibited from taking action against the debtor or its assets to collect debts, enforce liens, obtain collateral, or otherwise improve their per-petition position, unless the bankruptcy court gives it permission to lift the stay after notice and hearing. *See* Bankruptcy Code § 362. The automatic stay has been characterized as one of the most powerful weapons know to the law. In re Penz, 121 B.R. 602, 694 (Bankr. E.D. Okl 1990). The automatic stay provides virtually any person with the power to invoke the broad injunctive power of the bankruptcy court without any of the showings normally required to obtain an injunction such as likelihood of success, irreparable harm, or the posting of a bond merely by filing a bankruptcy petition and paying the filing fee. In creating the automatic stay, Congress recognized that the automatic stay, by its nature, seriously affects the rights of all the debtor s creditors. Congress therefore created exceptions to the application of the automatic stay. *See* Bankruptcy Code § 362(d). Specifically, on request of a party in interest after notice and hearing, the court will grant relief from the stay for cause, including adequate protection of an interest in property. *See* Bankruptcy Code § 362(d)(1). Additionally, the court may grant relief from the automatic stay if the debtor does not have adequate equity in the property and such property is not necessary for an effective reorganization. *See* Bankruptcy Code § 362(d)(1) & (2). In re Villamont-Oxford Assocs. Ltd. Partnership, 230

B.R. 457 (Bnakr. M.D. Fla. 1998) (to determine that collateral is necessary to effective reorganization so as to preclude relief from stay based on debtor s lack of equity, court need not find that debtor s plan ultimately will be confirmed, rather court must find only reasonable possibility that debtor can reorganize and court may consider any and all viable and effective methods of reorganization). Finally, the Bankruptcy Code provides special considerations for lifting the automatic stay in single asset real estate cases, as discussed in detail below.

B. Scope of the Automatic Stay

Bankruptcy Code § 362(a) enumerates, in eight subsections, the actions which are subject to the automatic stay. The stay applies to all entities, as defined in Bankruptcy Code § 101(15) of the Bankruptcy Code, including individuals, partnerships, corporations, estates, trusts and governmental units. *See* Lincoln Savings Bank, FSB v. Suffolk County Treasurer (In re Parr Meadows Racing Assoc.), 880 F.2d 1540, 1545 (2d Cir. 1989); In re Carter, 131 B.R. 4 (Bankr. D. Conn. 1991) (automatic stay applicable to state court); In re Eisenberg, 7 B.R. 683 (Bankr. E.D.N.Y. 1980). There are, however, certain exceptions to the automatic stay set forth below.

The following is a list of the eight prohibited actions:

1. The commencement or continuation of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced pre-petition, or to recover a claim against the debtor which arose before the commencement of a case. Bankruptcy Code § 362(a)(1). (Note that typically, only actions against the debtor are stayed. The stay does not apply to proceedings initiated by the debtor. See, e.g., Brown v. Armstrong, 949 F.2d 1007 (8th Cir. 1991); Martin-Trigona v. Champion Fed. Sav. & Loan Ass n, 892 F.2d 575 (7th Cir. 1989). Circuit courts are divided on whether a debtor can pursue an appeal after filing bankruptcy. See Farley v. Henson, 2 F.3d 273 (8th Cir. 1993) (automatic stay barred debtor s appeal of judgment against him; court held that a debtor-defendant s appeal is a continuation of a proceeding against the debtor under section 362(a)(1)); But see Chaussee v. Lyngholm, (In re Lyngholm), 24 F. 3d 89 (10th Cir. 1994) (bankruptcy court properly relied on order of appellate court obtained by debtor post-petition in determining creditor s claim amount). Compare Parker v. Bain, 68 F. 3d 1131 (9th Cir. 1995) (bankruptcy stays all proceedings originally brought against the debtor irrespective of who is appellant in appeal)).

2. The enforcement of a pre-petition judgment against the debtor or its property. Bankruptcy Code § 362(a)(2). (The rights of a creditor in this instance are to timely file a proof of claim).

3. Any act to obtain possession of property of or from the estate or to exercise control over property of the estate. Bankruptcy Code § 362(a)(3).

(The legislative history indicates that the purpose Bankruptcy Code § 362(a)(3) is to prevent the estate from being dissipated. House Report No. 595, 95th Cong., 1st Sess. 341 (1977). This prohibition has been applied in some broad contexts. See e.g. Official Committee of Unsecured Creditors v. P.S.S. Steamship Co., Inc.), (In re Prudential Lines. Inc.), 114 B.R. 27 (Bankr. S.D.N.Y. 1991). (the claiming of a worthless stock deduction by the debtor s 100% shareholder parent company (a nondebtor) was held to be a violation of the stay, pursuant to section 362(a)(3); the claiming of such a deduction would destroy the debtor s net operating loss carryovers which are property of the estate, amounting to the exercise of control over property of the estate); In re Phar-Mor. Inc., 152 B.R. 924 (Bankr. N.D. Ohio 1993) (debtor was prohibited from selling its stock where to do so would cause a change of ownership in the bankrupt entity, which in turn would cause the debtor to lose the benefits of its $300 million NOL); Pan Am Corp. v. All Unsecured Creditors et al., (In re Pan Am. Corp.), Adv. No. 91-6175A (CB) (Bankr. S.D.N.Y. Oct. 3, 1991) (court enjoined all trading of claims, pursuant to sections 105 and 362, on grounds that NOL s of debtor might be reduced by claims trading); In re Winer, 149 B.R. 539 (Bankr. N.D. III. 1993) (an individual debtor s state law rights to wind up the affairs of the corporation in which he was the sole shareholder were property of the estate, thus a lawsuit commenced in district court against the corporation for specific performance of an agreement was in violation of the automatic stay); In re Eastmare Development Corp., 150 B.R. 495 (Bankr. D. Mass. 1993) (debtor s estate included equitable ownership of property held by a nominee trust of which the debtor is the beneficiary); Edisto Resources Corp. v. McConkey, (In re Edisto Resources Corp.), 158 B.R. 954 (Bankr. D. Del. 1993). In In re Edisto, the debtor was a majority shareholder in a corporation in which the other shareholders had instituted a state receivership action. The court held the state court action constituted a violation of the automatic stay because the debtor s right, as a majority shareholder, to control the corporation was property of the estate. The shareholders also attempted to bar the debtor s ability to share in the proceeds of the derivative suit. But see In re Calvert, 135 B.R. 398 (Bankr. S.D. Cal. 1991) (the automatic stay arising from a debtor-50% shareholder s bankruptcy petition did not preclude the board of directors of the corporation from exchanging equity for debt with the other 50% shareholder, and thereby giving the nondebtor shareholder a majority interest in the corporation; court concluded that the intangible rights and obligations of stock ownership, which were estate property, were not sufficiently broad to keep the board from taking actions that would affect the value of the stock); In re Germansen Decorating, Inc., 149 B.R. 517 (Bankr. N.D. III. 1992) (debtor gave creditor post-dated checks prepetition, which creditor cashed postpetition; creditor s acts held to violate section 362(a)(3) as an act to obtain possession or control of

property of the estate) (A creditor s postpetition acceptance of debtor s voluntary payments of a pre-petition debt may be a violation of the automatic stay); *see also* In re Calstar, Inc., 159 B.R. 247 (Bankr. D. Minn. 1993) (postpetition chargebacks against debtor s credit card sales by credit card company violated automatic stay).

4. Any act to create, perfect, or enforce any lien against property of the estate. Bankruptcy Code § (a)(4). (In most jurisdictions, the automatic stay does not prevent actions to extend, continue or renew valid statutory liens. See Morton v. National Bank of N.Y. (In re Morton), 866 F.2d 561 (2d Cir. 1989); In re Burke, 5 B.R. 368 (Bankr. E.D. Pa. 1980) court held mere retention of automobile by garageman asserting garageman s lien did not violate the automatic stay)).

5. Any act to create, perfect or enforce any lien against the property of the debtor to the extent that the lien secures a claim that arose before the case was filed. Bankruptcy Code § 362(a)(5). (Generally, this section prevents secured creditors from acquiring a lien interest in after-acquired property of the debtor, abandoned property, property that is exempt under section 522 of the Bankruptcy Code and property that does not become part of the estate to secure prepetition claims.

6. Any act to collect, assess or recover a claim against the debtor which arose before the commencement of the case. Bankruptcy Code § 362(a)(6). (This subsection prevents actions by a creditor to collect a pre-petition debt even if the action is not related to a proceeding as required by section 362(a)(l). For example, demand letters, phone calls, and other creditor behavior aimed at coercing repayment would be prohibited. In Gordon v. Hines (In re Hines), 147 F.3d 1185 (9th Cir. 1998), however, the court held that collection of post-petition attorney s fees, performed pursuant to pre-petition contract, was not violation of automatic stay, based on quantum meruit).

7. Any setoff of any debt owing to the debtor which arose before the commencement of the case against any claim against the debtor. Bankruptcy Code § 362(a)(7). (The Code provides an orderly method of setoff under section 553. Parties who fail to follow the requirements of setoff set forth in section 553 may be held in violation of the stay. In In re Operation City, Inc., 148 B.R. 184 (Bankr. S.D.N.Y. 1992), the State of New York setoff the amount it owed the debtor against the amount the debtor owed the state on previous contracts. The court held the state violated the automatic stay and also waived sovereign immunity pursuant to section 106(a) of the Code by taking this action to collect its debt, and thus, the court could sanction the state based on the impropriety of its

actions. (Note, later opinions have questioned the constitutionality of section 106(a) of the Code). The Supreme Court concluded in Citizens Bank v. Strumpf, 116 S. Ct. 286 (1995) that a bank s temporary administrative freeze of a debtor s account, while the bank sought to enforce its right to a setoff under section 553, did not violate the automatic stay. But see Holden v. I.R.S. (In re Holden), 236 B.R. 156 (Bankr. D. Vt. 1999) (administrative freeze by IRS on tax refund violated section 362 (a)(3)). In New York State Electrical and Gas Corp. v. McMahon (In re McMahon), 129 F.3d 127 (2d Cir. 1997), the court held that a utilities postpetion application of a prepetition security deposit was not an offset, but recoupment which did not require relief from stay)

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8. The commencement or any continuation of a proceeding before the Tax Court. Bankruptcy Code § 362(a)(8). (In Bigelow v. C.I.R., 65 F. 3d 127 (9th Cir. 1995), the court held that fact debtor initiated Tax Court proceedings did not preclude a finding that proceedings violated automatic stay.)

C. Effect of the Stay on Third-Party Non-Debtors

1. General non-applicability of Bankruptcy Code § 362 in relation to third parties

Bankruptcy Code § 362 has generally been held not to stay actions against non-debtors since a proceeding against a non-debtor is not an action against the debtor or the debtor s property. In re Keyco. Inc., 49 B.R. 507 (Bankr. ED.N.Y. 1985); In re MacKay Co., 50 B.R. 756 (D. Utah 1985). In MacKay, the court held that the stay protected a non-bankrupt co-debtor only in extraordinary circumstances, refusing to confirm a plan which protected a non-debtor. See also All Seasons Resorts, Inc. v. Milner (In re All Seasons Resorts, Inc.), 79 B.R. 901 (Bankr. C.D. Cal. 1987) where the court stated that extension of the automatic stay occurs only in special situations and requires filing of an adversary proceeding. Croyden Assocs. v. Alieco, Inc., 969 F.2d 675, 677 (8th Cir. 1992) (in suit against issuer of debentures (debtor) and party which was to assume issuer s obligations under the debentures (non-debtor), automatic stay was applicable only to claims against the debtor and not the co-defendants -- even if they are in a similar legal or factual nexus with the debtor; court said that the only exception to this rule is in the case of unusual circumstances, citing A.H. Robins Co. v. Piccinin, 788 F.2d 994 (4th Cir.1986)); Saratoga Group, Ltd. v. Peoples Nat l Bank (In re Gerist), 973 F.2d 318, 321 (4th Cir. 1992) (secured creditor would not violate the stay, pursuant to section 362(a)(6) or otherwise, by foreclosing on collateral owned by corporate non-debtor, even though the debtor individual had guaranteed or served as a co-maker on the debt to the secured creditor); In re Veeco Inv. Co., L.P., 157 B.R. 452 (Bankr. E.D. Mo. 1993) (automatic stay did not bar creditor from executing judgment against non-debtor guarantors who were making financial contributions to debtor s plan).

The court found unusual circumstances existed to warrant enjoining a foreclosure action against the debtor s principals residence in In re F.T.L., Inc., 152 B.R. 61 (Bankr. E.D. Va. 1993). The court based its finding on the facts that the defendant was a secured creditor of the debtor, was receiving adequate protection payments, the principals were committing the equity in their residence to the plan, and confirmation of a plan was highly unlikely over the objection of the defendant. See also Litchfield Co. of South Carolina, L.P. v. Anchor Bank (In re Litchfield Co. of South Carolina L.P.), 135 B.R. 797 (W.D.N.C. 1992) (automatic stay was violated by a creditor s state court collection efforts against a Chapter 11 debtor-limited partnership s partners; the debtor had the right under South Carolina law to compel contributions from its general partners, that right was estate property, and the creditor s prosecution of its complaint against the partners for its own benefit interfered with that right); In re Third Eighty-Ninth Assocs., 138 B.R. 144 (S.D.N.Y. 1992) (bankruptcy court had authority under section 105 to enjoin debtor from pursuing an action on guaranty against guarantor who played a key role in reorganization, but not two other guarantors who played no such key role); In re Pioneer Valley Indoor Tennis Center, Inc., 20 B.R. 884 (Bankr. D. Mass. 1982) (the court held that Bankruptcy Code § 362(a)(6) prevented a creditor of the debtor from taking action against a third party which had posted collateral for the debtor s obligation; the court reasoned that the action against the third party was an act to recover a claim against the debtor -- even though no action was taken against the debtor -- within the meaning of Bankruptcy Code § 362(a)(6), and therefore, was stayed). The Bankruptcy Appellate Panel for the Ninth Circuit reached a conclusion opposite to Pioneer in Advanced Ribbons and Office Products, Inc. v. U.S. Interstate Distribution, Inc.(In re Advanced Ribbons and Office Products. Inc.), 125 B.R. 259 (Bankr. 9th Cir. 1991) (creditor s post-petition foreclosure on stock of debtor, owned and pledged as collateral by nondebtor, did not violate stay).

The court in the case of Federal Life v. First Financial Group of Texas, Inc., 3 B.R. 375 (S.D. Tex. 1980), held that the automatic stay applied to judicial proceedings against the debtor and its co-defendants when the allegations against them arose from the same factual and legal basis. In Federal Life, the district court refused to order severance of the proceedings against the co-defendants. But see In re Hillsborough Holdings Corp., 130 B.R. 603 (Bankr. M.D. Fla. 1991) (automatic stay did not shield debtor (much less non-debtors) from discovery in pending civil suit in which debtor was a co-defendant with non-debtor; the co-defendant sought relief from the stay to depose debtor s employees and the court granted such relief despite debtor s arguments that it would place a strain on the debtor); In the Matter of Mahurkar Double Lumen Hemodialysis Catheter Patent Litigation, 140 B.R. 969 (N.D. Ill. 1992) (although patent infringement claims brought against the Chapter 11 debtor were barred by the automatic stay, discovery in the multi-district patent case was not barred to the extent discovery was calculated to lead to evidence admissible against the debtor s non-debtor co-defendant). See also United States v. Dos Cabezas Corp., 995 F.2d 1486 (9th Cir.1993) (automatic stay in corporate debtor s case did not toll limitations period for the government s cause of action against six individual co-debtor defendants); Credit Alliance Corp. v. Williams, 851 F.2d 119 (4th Cir. 1988) (a post-petition default judgment entered in a suit against one debtor and two non-debtor guarantors was valid and enforceable against the non-debtors); Cornick v. Hi Grade Cleaners, Inc., 595 F. Supp. 718 (N.D. III. 1984) (automatic stay does not protect debtor s non-bankruptcy co-defendants against

suits); Southside Lawn & Garden/Suffolk Yard Guard v. Wetsel Seed Co., Inc. (In re Southside Lawn & Garden/Suffolk Yard Guard), 115 B.R. 79 (Bankr. S.D. Va. 1990) (court refused to extend automatic stay to non-debtor guarantors who were general partners and managers of the debtor; court noted that the Robins case -- which is probably the most well-known bankruptcy decision involving extension of the stay to non-debtors (cited below), was quite limited in its application and there were no unusual circumstances present in the case at bar which would justify the court using its injunctive powers under section 105); In re Provincetown Boston Airline, Inc., 52 B.R. 620 (Bankr. M.D. Fla. 1985) (the automatic stay did not extend to protect non-debtors (with possible exception of airline president) who were defendants along with airline/debtor in two class action suits); In re Pizza of Hawaii, Inc., 761 F.2d 374 (9th Cir. 1985) (suit against principals of debtor corporation); Royal Truck & Trailer. Inc. v. Armadora Maritima Salvadorena, S.A. de C.V. & Uiterwvk Corp., 10 B.R. 488 (N.D. Ill. 1981). But see S.I. Acquisition, Inc. v. Eastway Delivery Service, Inc. (In re S.I. Acquisition, Inc.), 817 F. 2d 1142 (5th Cir. 1987) (prosecution of alter ego claims against non-debtor is violation of automatic stay because such claims were property of the estate under section 541).

In Clark Oil & Refining Corp. v. Chicago Pipe Line Co. (In re APEX Oil Co.), 91 B.R. 865 (Bankr. S.D. Mo. 1988), the court held that the automatic stay did not prevent the note-holders of a pipeline corporation (non-debtor) that was partly owned by the debtor from accelerating their notes, pursuant to an agreement which provided that the filing of bankruptcy by any shareholder of the pipeline corporation was an event of default. The court also declined to use its general injunctive powers under Bankruptcy Code § 105 to prevent the note-holders from accelerating (a general discussion of a bankruptcy court s general injunctive powers under section 105 is contained below).

If the debtor is shown to be a real party in interest either by way of indemnification or other operation of law, an action against his co-participant may be stayed. See A. H. Robins Co. v. Piccinin, 788 F.2d 994 (4th Cir. 1986), where the court applied the automatic stay to a debtor s insurers, officers and employees because of the effect indemnification suits could have on the debtor. The court s decision was based in part on the broad reading the court gave to the section 362 stay by its ruling that insurance coverage itself was property of the estate. See also Homsy v. Floyd (In re Vitek, Inc.), 51 F. 3d 530 (5th Cir. 1995) (recognizing the ruling in Robins, that the automatic stay applies where the insurance proceeds are property of the estate). But see Veliotis v. General Dynamics Corp. (In re Veliotis), 79 B.R. 846 (Bankr. S.D. Mo. 1987), where the court refused to stay an action against General Dynamics in an alleged kickback scheme because General Dynamics failed to show that debtor was the real party in interest. Likewise, the automatic stay did not prevent litigation involving officer s and director s liability policy issued to Chapter 11 debtor, as opposed to indemnification policy, because it was not property of debtor s estate. Pintlar Corp. v. Fidelity and Caus. Co. (In re Pintlar Corp.), 124 F. 3d 1310 (9th Cir. 1997). Additionally, neither the automatic stay, nor the court s general injunctive powers, could be invoked to restrain the IRS from collecting individual debtor s unpaid taxes from the debtor s spouse who chose not to file for bankruptcy. Harrison v. I.R.S (In re Harrison), 82 B.R. 557 (Bankr. D. Colo. 1987). But see In re Reiter, 126 B.R. 961 (Bankr. W.D. Tex. 1991) (IRS violated stay by levying upon non-debtor spouse s wages; spouse s wages were property of the

estate in this Chapter 13 case and were protected by the stay).

2. Court s general injunctive powers under Bankruptcy Code § 105.

Although section 362 generally does not stay actions against non-debtor third parties who may be guarantors, co-debtors, or co-defendants with the debtor, a bankruptcy court may enjoin an action against a guarantor or other non-debtor third party, who is not protected within the scope of section 362, under the bankruptcy court s general power to protect its jurisdiction -- if the creditor s action constitutes harassment or jeopardizes the success of a rehabilitation proceeding. Section 105 of the Bankruptcy Code provides that the bankruptcy court may issue any order, process or judgment that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code]. Consequently, the bankruptcy court is authorized to issue injunctions to protect its jurisdiction and to carry out the provisions of the Code. Celotex Corp. v. Edwards, 514 U.S. 300, 131 L.Ed.2d 403, 115 S. Ct. 1493 (1995). See e.g. Obera v. Aetna Casualty Co. (In re A. H. Robins Co. Inc.), 828 F.2d 1023 (4th Cir. 1987), (product liability plaintiff stayed in action against debtor s insurer). In re Davis, 691 F.2d 176 (3d Cir. 1982); Related Asbestos Cases, 23 B.R. 523 (N.D. Cal. 1982); Lynch v. Johns-Manville Sales Corp., 23 B.R. 750 (S.D. Ohio 1982); Red River Family Farms. Inc. v. Federal Land Bank of Omaha (In re Red River Family Farms, Inc.), 85 B.R. 816 (Bankr. N.D. Iowa 1987) (court held that the bankruptcy court s power to enjoin actions against co-debtors or co-guarantors should be used only where the determination is made that failure to enjoin would adversely affect bankruptcy estate and pressure the debtor through the third party; a showing must be made that the absence of the stay would create substantial demands on the non-debtor s time which would impair the non-debtor/third party s ability to assist in the debtor s reorganization). In re Kleinsasser, 12 B.R. 452 (Bankr. D. S.D. 1981), in which the court noted that bankruptcy courts will utilize section 105 to give debtors a meaningful opportunity to rehabilitate themselves.

In In re Johns-Manville Corp., 68 B.R. 618 (Bankr. S.D.N.Y. 1986), the debtor s plan proposed the establishment of a fund to pay present and future asbestos claimants. The court issued a section 105 injunction protecting the debtor, its subsidiaries, its settling insurance companies and the trusts from any actions, and preventing claimants from asserting punitive damage claims. See also Johns-Manville Corp. v. Equity Security Holders Committee, Case Nos. 82-B-11656 through 11676, Adv. No. 85-6657A, slip opinion (Bankr. S.D.N.Y. 1986) where after reversal and remand by the Second Circuit requiring additional evidence, the bankruptcy court reissued an injunction against proceeding with a shareholder s meeting. See also In re Eagle/Picher Inds., Inc., 963 F.2d 855 (6th Cir. 1992) (corporation could be preliminarily enjoined from proceeding in a separate civil action against non-debtor officers of corporate debtor; irreparable harm would result to the debtor s reorganization otherwise); Myerson & Kuhn v. Brunswick Assoc. Ltd. Partnership (In re Myerson & Kuhn), 121 B.R. 145 (Bankr. S.D.N.Y. 1990) (litigation against attorneys-partners of law firm/debtor enjoined); In re Circle K Corp., 121 B.R. 257 (D. Ariz. 1990) (civil action pending against officers of debtor enjoined because of possible effect on reorganization efforts); In re Monroe Well Service, Inc., 67 B.R. 746 (Bankr. S.D. Pa. 1986) (extends section 105 injunction to non-debtors and containing a lengthy discussion of the existing law in this area at that point in time); Codfish Corp. v. FDIC (In re Codfish Corp.),

97 B.R. 132 (Bankr. D. P.R. 1988) (bankruptcy court used section 105(a) to enjoin suit against guarantor/CEO who had unique skills and around whom the operation of debtor s business revolved); In re Juneau s Builder s Center, Inc., 57 B.R. 254 (Bankr. M.D. La. 1986) (court refused to extend the injunctive powers to non-debtors); Teacher s Ins. Assoc. v. Butler, 803 F.2d 61 (2d Cir. 1986) (the court granted the debtor partnership s request to stay their own appeal but refused to extend the stay to non-debtor general partners); In re Union Carbide Corp v. Newboles, 686 F.2d 593 (7th Cir. 1982) (court enjoined suit against the guarantor who had committed to funding the plan of reorganization); In re Baldwin United Corp. Litigation, 765 F.2d 343 (2d Cir. 1985) (bankruptcy court has authority under section 105 to enjoin third-party complaint); Johns-Manville Corp. v. Asbestos Litigation Group, 40 B.R. 219, Supra In re Mahaffey v. E-C-P of Arizona. Inc., 40 B.R. 469 (Bankr. D. Colo. 1984); In re St. Petersburg Hotel Associates. Ltd., 37 B.R. 380 (Bankr. M.D. Fla. 1984); In re Larmar Estates. Inc., 5 B.R. 328 (Bankr. E.D.N.Y. 1980); In re Aboussie Bros. Const. Co., 8 B.R. 302 (E.D. Mo. 1981); In re Pettit, 17 B.R. 21 (Bankr. S.D. Ark. 1981); First National Bank of Montevideo v. Johnson, 19 B.R. 651 (D.C. Minn. 1982), rev d, 11 BCD 290 (8th Cir. 1983); In re Otero Mills, Inc., 21 B.R. 777 (Bankr. D. N.M. 1982); In re Samoset Assoc., 654 F.2d 247 (1st Cir. 1981).

The court in the case of In re Auto-Train Corp., 6 B.R. 510 (Bankr. D. D.C. 1980) enjoined a railroad from discontinuing service to the debtor railroad but required adequate protection for the party enjoined. The public interest aspect of a railroad proceeding was noted by the judge and adequate protection was subsequently required as of the date of the petition rather than the date of the adequate protection hearing. See also In re Auto-Train Corp., 9 B.R. 159 (Bankr. D. D.C. 1981). In the case of In re Blackwelder Furniture Co.. Inc., 7 B.R. 328 (Bankr. W.D.N.C. 1980) the court issued a mandatory injunction against suppliers who refused to fill cash orders for a chapter 11 retailer. The court may have been influenced by the fact that three and a quarter million dollars of new financing had been provided by a financier in reliance upon a belief that the suppliers would continue to sell to the debtor. In the case of In re Northern Energy Products, 7 B.R. 473 (Bankr. D. Minn. 1980) the court determined it could not enjoin the Better Business Bureau from accurately reporting the filing of a chapter 11 case by the debtor even though the publicity would jeopardize the reorganization. Courts have addressed the bankruptcy court s jurisdiction over disputes between non-debtors under 28 U.S.C. §1334(b). Randall & Blake, Inc. v. Evans, (In re Canion), 196 F.3d 579 (5th Cir. 1999) (bankruptcy court has jurisdiction over matters related to bankruptcy case, that is if out come of proceeding would have any conceivable effect on estate); Lindsey v. O Brien (In re Dow Corning Corp.), 86 F. 3d 482 (6th Cir. 1996) (same holding).

3. Payment of debtor s debts by third parties

Although In re Twist Cap. Inc., 1 B.R. 284 (Bankr. N.D. Fla. 1979) initially cast some doubt on the matter, payment of the debtor s obligations by third parties does not violate section 362 and will not generally be enjoined by the courts pursuant to section 105. See In re Fulghum Construction Corp., 23 B.R. 147 (Bankr. M.D. Tenn. 1982) (payments by project owner to debtor s subcontractors); In re Printing Dep t. Inc., 20 B.R. 677 (Bankr. E.D. Va. 1981); In re Planes. Inc., 29 B.R. 370 (Bankr. N.D. Ga. 1983); In re North Shore & Central Illinois Freight

Co., 30 B.R. 377 (Bankr. N.D. Ill. 1983) (payments under letters of credit); In re Woerner, 19 B.R. 708 (Bankr. D. Kan. 1982) (payments by insurance company under surety bonds). But see In re Jandel, 8 B.R. 855 (S.D. Ohio 1981) in which the court held that the secured party violated the automatic stay when it transferred collateral postpetition to a third party who paid the debtor s obligation to the secured party.

4. Subsidiaries.

The protection of the automatic stay provision does not extend to assets of subsidiaries of the debtor. See In re Unishops, Inc., 494 F.2d 689 (2d Cir. 1974); In re Beck Industries. Inc., 479 F.2d 410 (2d Cir.1973), In re Bobandal Realties, Inc., 10 CBC 276 (S.D.N.Y. 1976); In re Aboussie Bros. Const. Co., 8 B.R. 302 (E.D. Mo. 1981). The district court in Los Angeles exercised jurisdiction, however, over suits brought against non-bankrupt subsidiaries in the case of In re Equity Funding, 396 F. Supp. 1266 (C.D. Cal. 1975). The holding of the court was apparently predicated upon the impression that the subsidiaries were a sham or that the differences between the entities had not been maintained and that authority for the exercise of jurisdiction was founded in the broad equitable authorities of the bankruptcy court. The bankruptcy court may, under the circumstances set forth below, be able to issue injunctions with respect to property of subsidiaries under the broad jurisdiction granted by 28 U.S.C. §§ 157 and 1334.

D. Exclusions from the Automatic Stay.

1. Pursuant to Bankruptcy Code § 362(b)

Bankruptcy Code § 362(b) contains seventeen specific exclusions from the automatic stay. The seventeen items that specifically are not shielded by the stay are:

a. The commencement or continuation of a criminal action or proceeding against the debtor. Bankruptcy Code § 362(b)(1).

b. The commencement or continuation of a paternity action, the establishment or modification of an order for alimony, maintenance or support, or the collection of alimony, maintenance or support from property that is not property of the debtor s estate. Bankruptcy Code § 362(b)(2).

c. Any act to perfect an interest in property to the extent that the trustee s rights and powers are subject to such perfection under section 546(6) or to the extent that perfection occurred within the ten day period provided under Bankruptcy Code § 547(e)(2)(A). Bankruptcy Code § 362(b)(3).

d. Commencement or continuation of any action or proceeding by a state local or governmental unit to enforce police or regulatory powers; the enforcement of a judgment, other than a money judgment, obtained by a governmental unit to enforce police or regulatory powers. Bankruptcy

Code § 362(b)(4). (For example, in In re Bilzerian, 146 B.R. 871 (Bankr. N.D. Fla. 1992), the SEC s pursuit in district court of its equitable remedy of disgorgement of debtor s profits was exempt from the automatic stay. Similarly, in Boricua Motors Leasing Corp. v. Commonwealth of Puerto Rico, 154 B.R. 834 (D. P.R. 1993) the debtor s car was used in the commission of a crime postpetition and became subject to a state forfeiture action. The court held that this action fell within the police powers exempted from the automatic stay in Section 362(b)(4). In National Labor Relations Board v. John Sawulski, 158 B.R. 971 (S.D. Mich. 1993), contempt orders issued against debtor were excepted from the stay because they are intended to uphold dignity of court. But see In re Del Mission Limited, 998 F.2d 756 (9th Cir. 1993) (state s refusal to transfer debtor s liquor license, based on debtor s failure to pay postpetition interest and tax penalties violated stay); In re Horizon Air, Inc., 156 B.R. 369 (N.D.N.Y. 1993) (F.A.A. revoked debtor s operating license; court held even though F.A.A. issued license to debtor airlines, license was still property of the estate over which bankruptcy court had subject matter jurisdiction, but because matter involved interpretation of federal law, the district court withdrew the reference from the bankruptcy court to decide if the F.A.A. s action should be enjoined)).

e. The setoff of any mutual debt and claim which arose out of any commodity futures contracts. Bankruptcy Code § 362(b)(6).

f. Setoff by a repo participant. Bankruptcy Code § 362(b)(7).

g. Commencement of any action by the Department of Housing and Urban Development to foreclose a mortgage or a Deed of Trust insured under the National Housing Act so long as the property consists of five or more living units. Bankruptcy Code § 362(b)(8).

h. The audit to determine tax liability, issuance of a notice of tax deficiency, a demand for tax returns, or making of an assessment and issuance of a notice and demand for payment of such an assessment. Bankruptcy Code § 362(b)(9).

i. Any act to obtain possession of property by a lessor to the debtor of nonresidential real property if the lease has terminated by the expiration of the stated terms of the lease either pre-petition or post-petition. Bankruptcy Code § 362(6)(b).

j. Presentment, notice and protest in connection with a negotiable instrument. Bankruptcy Code § 362 (b)(11).

k. Ninety days after filing of the bankruptcy petition the Secretary of Transportation, under the Merchant Marine Act of 1936, is free to proceed with a pre-petition admiralty action against the debtor to foreclose on a ship and any and all related interests. Bankruptcy Code § 362(b)(12).

l. Ninety days after filing of the bankruptcy petition the Secretary of Commerce, under the Merchant Marine Act of 1936, can proceed with a pre-petition action to foreclose on a ship, fleet mortgage, deed of trust, or other security interest in a fishing facility. Bankruptcy Code § 362(b)(13).

m. Any action by an accrediting agency regarding the accreditation status of the debtor as an educational institution. Bankruptcy Code § 362(b)(14).

n. Any action by a State licensing body regarding the licensure of the debtor as an educational institution. Bankruptcy Code § 362(b)(15).

o. Any action by a guaranty agency, as defined in section 435(j) of the Higher Education Act of 1965 (20 U.S.C. 1001 et. seq.) or the Secretary of Education regarding the eligibility of the debtor to participate in programs authorized under such Act. Bankruptcy Code § 362(b)(16).

p. The setoff by a swap participant, of any mutual debt and claim under or in connection with any swap agreement that constitutes the setoff of a claim against the debtor for any payment due from the debtor under or in connection with any swap agreement against any payment due to the debtor from the swap participant under or in connection with any swap agreement or against cash, securities, or other property of the debtor held by or due from such swap participant to guarantee, secure or settle any swap agreement. Bankruptcy Code § 362(b)(17).

q. Creation or perfection of a Statutory lien for post-petition ad valorem property taxes by the District of Columbia or a political subdivision of a State.

2. Exceptions to the Stay Pursuant to Other Statutes

There is a special exemption to the stay for secured parties with rights in connection with aircraft, aircraft engines, propellers or spare parts, and vessels. Section 1110 of the Code limits the stay as to these parties to 60 days. See, e.g., First Nat l Bank of Boston v. Schugrue (In re Ionosphere Clubs Inc.), 123 B.R. 166 (S.D.N.Y. 1991). See also In re Continental Airlines, Inc. 32 F.2d 282 (3d Cir. 1991) (section 1110 applies to sale leaseback transactions, not merely acquisition leases); accord In re Pan Am Corp., 124 B.R. 960 (Bankr. S.D.N.Y.). Similarly, there is a special exception with respect to secured party rights in connection with railroad rolling stock, equipment or accessories. Section 1168 of the Code limits the stay as to these parties to 60 days.

E. Duration of the Stay

The automatic stay becomes effective upon the date of filing of the petition and no formal notice to creditors is required. In re Waters, 22 B.R. 387 (Bankr. N.D. Tex. 1982); In re Miller, 22 B.R. 479 (D.C. Md. 1982); In re Sandmar Corp., 12 B.R. 910 (Bankr. D.N.M. 1981). See also Paine v. Sealy, 956 S.W. 2d 803 (Tex. App. Houston [14th Dist.] 1996, no writ) (automatic stay triggered upon bankruptcy filing, regardless of whether state court or the party to litigation has knowledge). A stay under Bankruptcy Code § 362 continues in effect with respect to acts against property until either it is affirmatively lifted by the court or until the property is no longer in the estate. In re Morgan, 23 B.R. 700 (Bankr. E.D. Pa. 1982); In re Knight, 8 B.R. 925 (Bankr. D. Md. 1981). With respect to any other act stayed by Bankruptcy Code § 362, the stay continues in effect until either the case is closed, In re Solar Equipment Corp., 6 CBC 2d 1219 (W.D. La. 1982), the case is dismissed, In re Weathers, 15 B.R. 945 (Bankr. D. Kan. 1981), or in the instance of an individual debtor under Chapter 7, until a discharge is granted or denied, In re Andrews, 22 B.R. 623 (Bankr. D. Del. 1982); In re Berry, 11 B.R. 886 (Bankr. W.D. Pa 1981). In the case of In re Gruetzmach, 145 B.R. 270 (Bankr. W.D. Wis. 1991), the court held that the reopening of an individual debtor s Chapter 11 case merely for the limited purpose of considering whether to enforce a stipulation entered into in the prior case did not reinstate the automatic stay so as to preclude the IRS garnishment.

Practicioners should note, that the automatic stay arising on the filing of a partnership bankruptcy case, however, does not prevent partnership creditors from suing the general partners individually on partnership obligations. In re Landmark Air Fund II, 19 B.R. 556 (Bankr. N.D. Ohio 1982); Matter of Aboussie Brouthers Construction Co., 8 B.R. 302 (Bankr. E.D. Mo. 1981); *but see* Litchfield Co. v. Anchor Bankr, 135 B.R. 787 (W.D. N.C. 1992) (court held that an action against a general partner by a creditor of the partnership was subject to the automatic stay).

IV. CASH COLLATERAL

As mentioned above, the filing of a petition under Chapter 11 of the Bankruptcy Code automatically creates an estate consisting of all property owned by the debtor at the time of filing. *See* Bankruptcy Code § 541(a). For any business, this property includes cash. Bankruptcy Code § 363(a) defines cash and cash equivalent as cash collateral. Accordingly, cash collateral is defined by the Bankruptcy Code as cash, negotiable instruments, documents of title, securities, deposit accounts, or other cash equivalents whenever acquired in which the estate and an entity other than the estate have an interest.... Bankruptcy Code § 363. Property cannot be cash collateral unless it is property of the estate. In re Kingsport Ventures, L.P., 251 B.R. 841 (E.D. Tenn. 2000). Typically, the term is also used to describe the cash proceeds of a secured creditor s collateral.

Under Bankruptcy Code § 363(c)(2), the debtor is absolutely prohibited from spending cash collateral without the consent of all parties that have an interest in the collateral, or a court order. *See* Bankruptcy Code § 363(c)(2); *see also* In re Archer, 34 B.R. 28, 30 (Bankr. N.D.

Tex. 1983). The basis for this prohibition is that security interests are constitutionally protected property rights. *See* In re George Ruggiere Chrysler-Plymouth, 727 F.2d 1017, 1019 (11th Cir. 1984); *see also* In re Woodfield Gardens Assocs., 1998 WL 276453 (Bankr. N.D. Ill. 1998) (law firm retainer paid by debtor constituted cash collateral derived from pre-petition rents collected by debtor to which creditor had valid lien and court held no fees could be paid to firm out of retainer). This rule proscribing the use of cash collateral is simple and straightforward. Sometimes a debtor will make expenditures without the consent of the secured creditors or the authority of the court. When this happens, the entire Chapter 11 case is placed at risk and the representative of the debtor who directed the misuse of the cash collateral may face significant financial penalties.

The first days of any sizeable Chapter 11 case bring a flurry of activity. A host of issues must be addressed and resolved immediately or the case can grind itself to a halt before it even gets underway. One such first day activity deals with certain operational issues, including cash collateral. Typically, the Chapter 11 debtor files an emergency motion for the use of cash collateral when the petition is filed. Court usually grant these emergency motions and authorize debtors to make the appropriate expenditures. The determination of whether a debtor may use cash collateral can determine whether a debtor remains in possession of an operating business or becomes merely the jetsam of a business that was closed unexpectedly and prematurely.

Sometimes a debtor uses the cash collateral and later contends that the secured creditor gave implied consent for expenditures, giving rise to a dispute over whether consent was in fact given. The term consent suggests an act of reason, accompanied with deliberation. Black s Law Dictionary, 276 (5th ed. 1979). In Freightliner Market Dev. v. Silver Wheel Freight, 823 F.2d 362, 368-369 (1987), the Ninth Circuit ruled that consent must be expressed and that implied consent is insufficient as a matter of law to satisfy the requirements of Bankruptcy Code § 363(c)(2)(A). A contrary ruling was made in Matter of National Safe Northeast, Inc., 76 B.R. 896, 907 (Bankr. D. Conn. 1987), in which the debtor expended cash collateral without the express consent of the secured creditor. In National Safe, the secured creditor knew that the debtor was spending cash collateral but did not seek to prohibit its use. The court placed the burden on the secured creditor holding a secured creditor on notice may not choose to ignore unauthorized use of cash collateral until a Chapter 11 case is converted and then seek to recover damages for all of the funds so misused. *Id.* The same result occurred in In re Unity Foods, Inc., 75 B.R. 222 (Bankr. N.D. Ga. 1987), in which the secured creditor asserted that the debtor misused its cash collateral. The secured creditor, who was also the principal of the debtor, sought a replacement lien as a remedy for the purported misuse of cash collateral. The court denied the request, noting that the debtor used the cash with the knowledge of the secured creditor and while it was under the control of the secured creditor. The court further emphasized that the secured creditor was the principal of the debtor. Therefore, the equities did not favor the secured creditor. Despite the authority that a secured creditor may consent to use of cash collateral through acts or failure to protect its interests, the penalties for misuse of cash collateral can be severe. In re Fay Associates Ltd. Partnership, 225 B.R. 353 (Bankr. S.D.N.Y. 1998) (unauthorized use of cash collateral can lead to finding of bad faith filing and dismissal of case).

In today's chapter 11 bankruptcies, it is common for cash-collateral orders to provide replacement liens to secured creditors as adequate protection for any diminution in the value of the secured creditors' interests in cash collateral used. When a secured creditor has a valid and perfected security interest in and lien on collateral, as well as the proceeds therefrom, those proceeds constitute cash collateral pursuant to Bankruptcy Code §§ 363(a) and 552(b)(2). Cash collateral may be used, however, pursuant to the provisions of Bankruptcy Code §363(c), if a debtor-in-possession (DIP) provides adequate protection, as discussed below, of the secured party's interests in the cash collateral. Adequate protection may be provided in many forms under Bankruptcy Code § 361, including, but not limited to, granting replacement liens to the extent that the use of the cash collateral actually diminishes the value of the secured party's interests therein.

V. ADEQUATE PROTECTION

Bankruptcy Code §§ 362 (automatic stay), 363 (use, sale, or lease of property) and 364 (obtaining credit) authorize the court to grant adequate protection of a party s interest in property. *See* Bankruptcy Code §§ 363, 364 & 364. Bankruptcy Code § 362(d)(1) permits a party to seek relief from the automatic stay where its interest in property is not adequately protected. *See* Bankruptcy Code § 362(d)(1). Accordingly, a party is entitled to adequate protection of an interest if the automatic stay prevents it from enforcing such interest. *See* Id. Bankruptcy Code § 363(e) permits a party to seek adequate protection of its interest in property when a debtor seeks to use, sell, or lease such property. *See* 11 U.S.C. § 363(e). Likewise, Bankruptcy Code § 364(d)(1)(B) requires a debtor to provide adequate protection to a creditor where the debtor obtains credit or other debt secured by a lien on estate property that is senior to the creditor s lien on such property. *See* 11 U.S.C. § 364(d)(1)(B).

Adequate protection is intended to protect creditors from the risk that their collateral may decline in value during the pendency of the bankruptcy case. In a chapter 11 case adequate protection is provided to safeguard the creditor against depreciation in the value of its collateral during the reorganization process. *See* First Federal Bank of California v. Weinstein (In re Weinsten), 227 B.R. 284, 296 (B.A.P. 9th Cir. 1998). The Bankruptcy Code does not specify what constitutes adequate protection . Rather, Bankruptcy Code § 361 provides the following three examples of what may provide adequate protection of a party s interest in property:

> (1) requiring the trustee to make a cash payment or periodic cash payments to the secured creditor, to the extent that the stay under section 362 of this title, use, sale, or lease under section 363 of this title, or any grant of a lien under section 364 of this title results in a decrease in the value of such entity s interest in such property;
>
> (2) providing the secured creditor with an additional or replacement lien to the extent that such stay, use, sale, lease, or grants results in a decrease in the value of such entity s interest in such property; or
>
> (3) granting such other relief, other than entitling such entity to compensation

> allowable under section 503(b)(1) of this title as an administrative expense, as will result in the realization by such entity of the indubitable equivalent of such entity s interest in such property.

See Bankruptcy Code § 361; *See also* Bankruptcy Code § 1107) (Under Bankruptcy Code § 1107, a debtor in possession has the same rights as a trustee, except for the right to compensation, and is subject to same limitations as a trustee.)

Bankruptcy Code § 361 is not the exclusive means of providing adequate protection. For example, if the value of the collateral exceeds the value of the secured creditor s claim by a sufficient amount, there exists an equity cushion. This equity cushion alone could constitute adequate protection. *See* In re Sentry Park, Ltd., 87 B.R. 247 (Bankr. W.D. Tex. 1988) (substantial equity afforded creditor adequate protection). Further, when adequate protection is required in connection with automatic stay, debtors are often required to protect the collateral from declining in value. Accordingly, adequate protection in the automatic stay context may take the form of simply requiring the debtor to pay taxes, maintain insurance, and keep current on senior indebtedness. *See* In re Briggs Transp. Co., 780 F.2d 1339 (8th Cir. 1985) (payment of taxes); Allied Credit Corp. v. Davis (In re Davis), 989 F.2d. 208 (6th Cir. 1993) (maintenance of insurance); Ridgemont Apartment Assocs., Ltd. v. Atlanta English Village, Ltd., 110 B.R. 77 (N.D. Ga.) *aff d without opinion*, 890 F.2d 1166 (11th Cir. 1989) (current interest payments to oversecured creditors). Where adequate protection is granted in connection with the debtor s use, sale or lease of property, it may take the more active forms of periodic cash payments or additional or replacement liens. *See* Hansen, Kristopher M., Adequate Protection: Entitlement and Provision, 14 Corp. Renewal Journal 5 (May 2001). When granted in connection with the issuance of priming liens, the adequate protection granted to the primed creditor generally takes the form of additional and replacement liens and periodic cash payments. *Id.*

In order to determine whether adequate protection is required, reference to Bankruptcy Code § 506 is warranted because adequate protection is limited to amount of the party s interest in property. Reimbursement for the use of proceeds that a creditor is deprived of during the term of the stay is not an interest in property warranting adequate protection . *See* United Sav. Ass n of Texas v. Timbers of Inwood Forest Assocs., Ltd., 484 U.S. 365, 108 S. Ct. 626 (1988). Bankruptcy Code § 506 determines to what extent a creditor holds a secured interest and to what extent it holds an unsecured interest. Depending on the facts of the case, a creditor can be either oversecured the debt secured by the property is less than the value of the property ; undersecured the debt secured by the property is greater than the value of the property ; or unsecured liens senior to the creditor s lien encumber the property and the total amount of debt securing senior liens exceeds the value of the property. *See* Robin E. Phelan and Stephanie D. Curtis, You No Sooner Get Your Head Above Water and Someone Pulls Your Flippers Off: Recent Developments in Bankruptcy (May 20, 1993). The distinction is crucial because only secured creditors, i.e. oversecured and undersecured creditors, are entitled to adequate protection. It has been recently held that unsecured, administrative claimants can no longer pursue a secured creditor for recoupment costs under section 506(c). In other words, an administrative claimant cannot look to a secured creditor whose property was improved for

payment of its claim; only a trustee can pursue such a claim against the secured creditor if it would benefit the estate. *See* Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A., 530 U.S. 1, 6-9, 120 S.Ct. 1942, 1947-1948 (2000). In Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A., the United States Supreme Court held that only a trustee can invoke section 506(c) to recover reasonable, necessary costs and expenses of preserving, or disposing of secured property to the extent of any benefit of the secured party, thus giving even more protection to the secured creditor. *Id.* Under section 506(b) a fully secured creditor is entitled to interest on its claim, and any reasonable fees, costs, or charges provided for under the agreement under which its claim arose. *See* Bankruptcy Code § 506(b); United Sav. Ass n of Texas v. Timbers of Inwood Forest Assocs., Ltd., 484 U.S. 365, 108 S. Ct. 626 (1988).

Because adequate protection is intended to protect the value of a creditor s interest in property, a question that often arises is whether the value to be protected is the value of the interest as of the date of the request for adequate protection or the date of the commencement of the debtor s bankruptcy proceeding. *See* Hansen, Kristopher M., Adequate Protection: Entitlement and Provision, 14 Corp. Renewal Journal 5 (May 2001). A literal reading of the Bankruptcy Code supports the view that adequate protection should be provided only from the date of the request for relief. *Id.* Courts generally adhere to this view as well, often justifying the result on the creditor s delay in seeking protection. *See Id.* (*citing* In re Carson, 190 B.R. 917 (Bankr. N.D. Ala. 1995), In re Continental Airlines, Inc., 146 B.R. 536 (Bankr. D. Del. 1992), In re Best Prods. Co., 138 B.R. 155 (Bankr. S.D.N.Y. 1992)).

VI. SINGLE ASSET REAL ESTATE CASES

A. History of Single Asset Real Estate Cases

1. Bankruptcy Reform Act of 1978

In the context of bankruptcies, a large percentage of partnerships that petition for relief under the Bankruptcy Code have only one asset, real property. These types of bankruptcies are referred to as Single Asset Real Estate cases. The Bankruptcy Reform Act of 1978 created a single chapter for all types of business reorganization. *See* Bankruptcy Reform Act of 1978, Publ L. No. 95-598, 92 Stat. 2549, reprinted in 1978 U.S.C.C.A.N. 5787-6573, (codified as amended at 11 U.S.C. §§ 101-1330 (1978)). Although Chapter 11 was created to promote efficiency in business reorganization, problems arose due to abuse of the reorganization provision by single asset real estate filers. *See* Scott Carlisle, Single Asset Real Estate in Chapter 11: Secured Creditors Perspective and the Need for Reform, 1 Am. Bankr. Inst. L. Rev. 133, 134 (1993) (describing typical situation for single asset real estate filing); Roger S. Cox, Annual Survey of Texas Law: Bankruptcy & Creditor s Rights, 48 SMU L. Rev. 875, 880 (1995) (noting single asset real estate debtors would often file Chapter 11 on eve of foreclosure, for no purpose other than to delay or gain bargaining position over secured creditor, and rarely would there be any realistic chance of successful reorganization). In the early 1980s, buoyed by the booming real estate market, banks and institutional lenders happily lent money to real estate investors. The partnership usually had only one significant creditor, a secured lender, whose mortgage fully

encumbered the real estate. Erich J. Stegich, The National Bankruptcy Review Commission: Proposal for Single Asset Real Estate, 5 Am. Bankr. Inst. L. Rev. 530, 532-33 (1997); *see also e.g.* Bonner Mall Partnership v. U.S. Bancorp Mortgage Co. (In re Bonner Mall Partnership), 2 F.3d 899, 907 (9th Cir. 1993) (involving single asset real estate where partnership owned single piece of real estate and mortgagor held senior and largest security interest); In re Pensignorkay, Inc., 204 B.R. 676, 678 (Bankr. E.D. Pa. 1997) (discussing single asset real estate case in classic sense and as defined under Bankruptcy Code § 101(5)(1)(B)); In re Kkemko, Inc., 181 B.R. 47, 50 (Bankr. S.D. Ohio 1995) (providing summary of case law involving single asset real estate issues). However, the real estate market suffered a collapse in the late 1980's, and, combined with the steep drop in real estate values, many single asset borrowers became unable to meet their mortgage obligations. *See* Stegich, 5 Am. Bankr. Inst. L. Rev. at 533; C. Daniel Motsinger, The Bankruptcy Reform Act of 1994: New Mines in the Minefield, 38 RES GESTAE 16 (Dec. 1994) (stating that listless real estate market of the past few years has sent a steady stream of so-called single asset debtors-usually tax driven limited partnerships that owned apartment complexes or office buildings into Chapter 11); *see also* Jeff Bohm & David B. Young, Small Business and Single Asset Real Estate Reorganizations and the Bankruptcy Reform Act of 1994, 753 PLI/COMM 465, 499-500 (1997) (discussing real estate downturn of 1980's forcing partnerships and corporations formed solely to own single development to seek refuge under Chapter 11). Because many of the mortgages granted to single asset debtors were non-recourse, the only means of loan repayment was the value of the real estate. *See e.g.* Stegich, 5 Am. Bankr. Inst. L. Rev. at 533; Albert J. Cardinali & David C. Miller, Tax Aspects of Non-Corporate Single Asset Bankruptcies and Workouts, 1 Am. Bankr. Inst. L. Rev. 87, 113-14 (1993) (stating effects of non-recourse mortgage debt with respect to single asset debtor).

One bankruptcy judge described what followed the downturn in the market as follows: [l]awyers had quickly discovered how effective Chapter 11 could be for handling the financial difficulties of single asset real estate ventures and...suddenly there were thousands of single asset real estate cases, not just dozens as there had been in years past. Hon. Leif M. Clark, Chapter 11 Does One Size Fit?, 4 Am. Bankr. Inst. L. Rev. 167, 179 (1996). Many single asset entities filed Chapter 11 because the automatic stay provision of Chapter 11 granted them protection from foreclosure by their secured lenders. *See* Bankruptcy Code § 362(a) (establishing automatic stay provision, which provides that all proceedings against debtor must be stayed upon filing of petition); Stegich, 5 Am. Bankr. Inst. L. Rev. at 534. In these cases, the debtor had no prospect of a successful reorganization, rather, faced with the possibility of a lost investment and corresponding tax consequences, the debtor s only choice was to try and prevent foreclosure by filing for Chapter 11 protection. *Id.; see also* Daniel B. Bogart, Games Lawyers Play: Waivers of the Automatic Stay in Bankruptcy and the Single Asset Loan Workout, 43 UCLA L. Rev. 1117, 1126 (1996) (discussing inevitability of foreclosure forcing debtors to seek refuge by filing Chapter 11). Many single asset real estate entities also filed Chapter 11 in order to gain the benefit of the cramdown (discussed supra), and renegotiate the financing of the property based on its current market value. *See* Bankruptcy Code § 1129(b) (outlining limitations of this method of confirmation frequently called cramdown); Stegich, 5 Am. Bankr. Inst. L. Rev. at 534.

Based on the reasoning behind many single asset real estate filings in Chapter 11 during this

time, allegations began to surface that such filings were an abuse of the bankruptcy system. *See* Lumber Exch. Bldg. Ltd. Partnership v. Mutual Life Ins. Co. (In re Lumber Exch. Bldg. Ltd. Partnership), 968 F.2d 647, 650 (8th Cir. 1992) (agreeing with bankruptcy court s conclusion that debtor real estate partnership did not belong in Chapter 11 because it was substantially a single liability case); In re Mill Place Ltd. Partnership, 94 B.R. 139, 141-142 (Bankr. D. Minn. 1988) (stating proposition that single asset Chapter 11 cases may be deemed in bad faith virtually as matter of law); In re Fry Road Assocs., Ltd., 66 B.R. 602, 607 (Bankr. W.D. Tex. 1986) (holding that single asset debtor abused process by filing Chapter 11 where there was no evidence debtor could benefit from Chapter 11 filing). Of concern to many secured lenders was that debtors, with a slim chance of reorganization could avail themselves of the broad protection of the automatic stay in bankruptcy (Bankruptcy Code § 362) and hold off foreclosure by secured lenders for lengthy periods of time. *See* Stegich, 5 Am. Bankr. Inst. L. Rev. at 535. To that end, one judge described the unfair advantage that the automatic stay provides debtors over their secured creditors stating that [t]he plans proposed in most of these [single asset real estate] cases attempt to buy a few year s delay in foreclosure in the hope that the real estate market will improve, shifting the risk of failure to the secured creditor, while trying to preserve the upside potential for the equity holders. Hon. Lisa Hill Fenning, The Future of Chapter 11: One View From the Bench, 650 PLI/COMM 317, 331` (1993).

In addition to the numerous allegations of abuse of the bankruptcy process lodged by courts, numerous bankruptcy scholars contend that single asset real estate filers should not be allowed to file Chapter 11 because single asset filings do not meet the legitimate ends of Chapter 11 reorganization. Stegich, 5 Am. Bankr. Inst. L. Rev. at 536. Critics made this argument because single-asset real estate entities usually have few employees, and are usually worth more in dissolution than they are in going concern value, making Chapter 7 liquidation a more proper avenue of relief. *Id.* Traditionally, Chapter 11 relief was sought by a company to prevent foreclosure by a secured lender, which usually led to liquidation by creditors looking for assets to offset their claims. Single asset filings, however, usually involve a two party dispute between the debtor and the secured creditor. By definition in a single asset case, only one asset is available for distribution to creditors, which is usually fully encumbered by the secured creditor s mortgage. Still other critics argued that single asset cases do not belong in Chapter 11 because Chapter 11 does not maximize recovery to unsecured creditors. *Id.*

The problems created by single asset cases extended beyond increased litigation and the misuse of court time. Often, in order to get a plan approved, a single asset debtor used all of its available funds to pay down the debt on the property, and was thereby, unable to maintain the property adequately. *Id.* citing Nat l Bankr. Rev. Comm n, Small Business Working Proposal # 4: Repeal The $4 Million Cap on the Definition of Single Asset Real Estate, (1997) (stating that [d]uring the Chapter 11 proceeding it is not uncommon for single asset real estate properties to receive minimal repairs, capital improvements, and capital replacements.).

In light of the economic conditions, number of filings, and criticisms of single asset real estate filings, the courts responded in several ways to the unnecessary litigation, cost, and delay created by abuse of Chapter 11 by single asset filers. *See e.g.* California Mortgage Serv. V. Yukon

Enters. (In re Yukon Enters.), 39 B.R. 919, 921 (Bankr. C.D. Cal. 1984) (examining certain recurring, but not exclusive factors, traditionally considered badges of bad faith); Meadowbrook Investors Group v. Thirtieth Place, Inc. (In re Thirtieth Place, Inc.), 30 B.R. 503, 506 (B.A.P. 9th Cir. 1983) (dismissing on ground that petition initiating proceeding was not filed in good faith). Some courts expedited or fast tracked proceedings in these cases, in order to force single asset filers to either confirm a plan or lose the benefit of the automatic stay. *See* Martwick v. Agribank, FCB (In re Martwick), 60 F.3d 482, 483 (9th Cir. 1995) (not abuse of discretion when court denies debtor s motion for continuance when purpose of filing was to delay proceedings). Other courts required that single asset real estate debtors introduce new equity or hard cash in order to get their plan confirmed. In re Investors Fla. Aggressive Growth Fund, Ltd., 168 B.R. 760, 765-66 (Bankr. N.D. Fla. 1994); In re Longfellow Properties, Inc., 149 B.R. 12, 15-16 (Bankr. D. N.H. 1992) (sustaining objection to confirmation of proposed Chapter 11 plan since debtor s proposal relied on uncertain real estate market).

One method adopted by some courts for dealing with single asset cases, was the imposition of the good faith requirement on filers. (The courts dismissed cases for bad faith under Bankruptcy Code § 1112(b), which allows for dismissal for cause). *See* Little Creek Dev. Co. v. Commonwealth Mortgage Corp. (In re Little Creek Dev. Co.), 779 F.2d 1068, 1073 (5th Cir. 1986) (finding several factors establishing that debtor was not ongoing business which was evidence of bad faith); Phoenix Piccadilly, Ltd. v. Life Ins. Co. (In re Phoenix Piccadilly, Ltd.), 849 F.2d 1393, 1394-95 (11th Cir. 1988) (dismissing Chapter 11 petition when only reason for filing petition was to avoid foreclosure). The good faith requirement became an effective tool against bankruptcy petitions that did not meet with traditional goals of the Bankruptcy Code. *See* Humble Place Joint Venture v. Fore (In re Humble Place Joint Venture), 936 F.2d 814, 816 (5th Cir. 1991) (affirming lower courts dismissal of Chapter 11 petition because debtors only sought to relieve their personal guarantees instead of protecting creditors); In re Little Creek Dev. Co., 779 F.2d 1068, 1072 (5th Cir. 1986) (noting good faith requirement prevents abuse by debtors and advances protection of creditors); In re Phoenix Piccadilly, Ltd., 849 F.2d 1393, 1395 (11th Cir. 1988) (stating bad faith dismissal will stand despite possibility of successful reorganization); Carolin Corp. v. Miller, 886 F.2d 693 (4th Cir. 1989) (agreeing that bad faith filing warrants dismissal of Chapter 11 petitions); Albany Partners, Ltd. v. Westbrook (In re Albany Partners, Ltd.), 749 F.2d 670, 674 (11th Cir. 1984) (noting that dismissal of petition is appropriate when it was filed in bad faith).

The good faith requirement was widely adopted by courts and was used to strike down a wide variety of petitions. A debtor s petition filed in bad faith, however, was not always grounds for dismissal. *See* In re Victoria Ltd. Partnership, 187 B.R. 54, 60 (Bankr. D. Mass. 1995) (stating that good faith doctrine conflicted with Bankruptcy Code); In re James Wilson Assocs., 965 F.2d 160, 170-71 (7th Cir. 1992) (determining that clearest indiction of bad faith is where debtor knows there is no chance of reorganization, but files Chapter 11 petition anyway). Even where bad faith was found, courts were sometimes reluctant to dismiss unless the circumstances were truly egregious. *See* PNC Bank Nat l Ass n v. Park Forest Dev. Corp. (In re Park Forest Dev. Corp.) 197 B.R. 388, 394 (Bankr. N.D. Ga. 1996) (stating that filing without intention to frustrate creditors claims, courts often deny dismissal for bad faith); In re Mill Place Ltd. Partnership, 94

B.R. 139, 141 (Bankr. D. Minn. 1988) (explaining that dismissal of Chapter 11 petition for bad faith should be subject to clear and convincing proof). For example, if bad faith was found, evidence of an apparent honest effort to reorganize could permit the case to survive dismissal. *See* In re Quorum Ltd. Partnership, 198 B.R. 5, 8 (Bankr. D. N.H. 1996) (noting that although facts warranting dismissal were present, court does not always have to implement such drastic remedy). Although the good faith filing requirement was the method most widely used by courts in dealing with single asset cases, it was not universally accepted. Some critics stated that the good faith requirement deprived worthy Chapter 11 filers of the opportunity for legitimate reorganization.

2. Bankruptcy Reform Act of 1994

Based partly on the allegations of abuse of the bankruptcy process on the part of single asset real estate filers, Congress enacted the Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, 108 Stat. 4106 (the Reform Act) which President Clinton signed into law on October 22, 1994. The Reform Act provided that the Bankruptcy Code now expressly address single asset real estate filings for the first time. Accordingly, under the Reform Act, the rights of secured creditors were enhanced, and it is now possible to obtain a lifting of the automatic stay in single asset cases without any need to show that the debtor has no equity in the property or that the mortgage lender lacks adequate protection. Moreover, the Reform Act helped to ensure that creditors could maintain their liens on post-petition rents and hotel revenues. Ultimately, because most single asset real estate cases are filed by small business, usually partnerships (of one form or another), the Reform Act gave specific statutory attention to this type of debtor, treating single asset cases separately from other small businesses. *See* Hon. Arthur B. Federman, The Bankruptcy Reform Act of 1994, 51 J. Mo. B. 105 (1995); C. Daniel Motsinger, The Bankruptcy Reform Act of 1994: New Mines in the Minefield, 38-Dec. Res. Gestae 16, (1994).

The reason for the provisions of the 1994 Reform Act protecting creditors in single asset bankruptcy is that, typically, there is no need for bankruptcy protection to protect the debtor. There is no need to preserve jobs, because a change in ownership will not eliminate the need for employees. Moreover, there is no reason to protect an equitable distribution, since the only material debt is held by the creditors whose priorities are fixed by state law and are not changed by bankruptcy law. In addition, approval (confirmation) of a Chapter 11 plan requires acceptance by at least one impaired (contract modified) class. Single asset cases with few creditors may have trouble qualifying for confirmation, assuming that the bankruptcy was filed in an attempt to force the creditors to take less than full value on the debt. Most creditors in such cases hold only secured or undersecured claims, whose interest the creditors would generally have settled in a state court proceeding.

The central feature of the Reform Act for single asset real estate cases was Section 218(b), codified as Bankruptcy Code § 362(d)(3), which provides for a new and less burdensome method of lifting the automatic stay so that the mortgage lender may foreclose. Before Bankruptcy Code § 362(d)(3) may even come into play, however, the debtor must qualify as a single asset real estate entity. Section 218(a) of the ReForm Act, codified as Bankruptcy Code § 101(51B),

defines single asset real estate. Bankruptcy Code § 101(51B) establishes four criteria to qualify as a single asset real estate debtor.

First, the debtor must own real property constituting a single property or project, other than residential property with fewer than four residential units. In other words, the property does not meet the definition of single asset real estate if the property owned by the debtor consists of more than one legally defined property, multiple pieces of real property owned by the debtor are not part of one single project, such as an apartment complex, or the property is a residential property with fewer that four units, such as a duplex. This aspect of the Bankruptcy Code § 101(51B) definition was at issue in In re Philmont Dev. Co., 181 B.R. 220 (Bankr. E.D. Pa. 1995). That case involved three debtor limited partnerships and their common general partner. Each partnership owned between eight and ten semi-detached houses that had been built by the general partner. The limited partnerships argued that these semi-detached units were separate properties, and thus that these debtors did not fall withing the definition of single asset real estate. The court disagreed. Even if the semi-detached houses were separate properties, each group of homes nonetheless constituted a single project. The units owned by each limited partnership were contiguous, and each project contained more than three residential units. Accordingly, the limited partnerships were single asset real estate debtors. *See* Bankruptcy Code § 101(51b); Marvin Krasny & Kevin J. Carey, What Is a Single Asset Real Estate Case?, The Legal Intelligencer, May 26, 1995, at 7.

Second, the real property must generate substantially all of the debtor s gross income. This criterion was drawn from the large number of single asset cases filed under Chapter 11 in which the debtor had no significant asset or income apart from one property or project. *See* C. Daniel Mostinger, The Bankruptcy Reform Act of 1994: New Mines in the Minefield, 38-Dec. Res Gestae 16 (1994); Susan Mills Richmond, Overview of the Bankruptcy Reform Act of 1994, 67-Nov. N.Y. St. B. J. 10 (1994). Certainly each of the limited partnerships in Philmont Dev. Co., 181 B.R. at 220, met this criterion. On the other hand, the Court ruled that the general partner could not be considered a single asset real estate debtor. *Id.* The general partner s assets consisted of its partnership interests, together with two parcels of raw land that it meant to develop in the future. *Id.* This scarcely fit either the statutory definition or the traditional pattern of a single asset real estate debtor. *See Id.*; *see also* Deborah D. Williamson & Ronald Hornberger, Benchnotes, 14-Aug. Am. Bankr. Inst. J. 4 (1995).

This second criterion was also at issue in In re Oceanside Mission Assocs., 192 B.R. 232 (Bankr. S.D. Cal. 1996). In that case, the question was whether a debtor whose only asset was underdeveloped land that produced no income qualified for single asset real estate treatment. As matter of logic, if the debtor has no income, then a single parcel of real property that generates no revenue does indeed produce substantially all of the debtor s income. As a matter of policy and legislative history, Congress meant to impose expedited treatment upon debtors whose only asset was a single property or project, even (or perhaps especially) if the property provides no revenue. Finally, prior to the Reform Act, courts had consistently treated debtors whose only asset was raw land as single asset real estate debtors, *see e.g.* In re Humble Place Joint Venture, 936 F.2d 814 (5th Cir.1991) (property was partially developed but was referred to as raw land generating

no income); In re Nattchase Assocs. Ltd. Partnership, 178 B.R. 409 (Bankr. E.D. Va.1994); In re Clinton Fields, Inc., 168 B.R. 265 (Bankr. M.D. Ga. 1994), and Congress apparently meant to codify the pre-Reform Act understanding of single asset real estate. Hence the Oceanside Missions Assocs. court concluded that Bankruptcy Code § 101(B51) does apply to debtors whose only major asset is undeveloped property or property that produces no rents or profits. 192 B.R. at 235.

Third, under Bankruptcy Code § 101(B51), the debtor must not conduct any significant business on the property apart from managing the real estate and activities incidental thereto. This fits the normal pattern of a single asset debtor as a largely passive owner or investor. *See* Motsinger, The Bankruptcy Reform Act of 1994, 38-Dec. Res Gestae at 16. Conversely, if the debtor is actively using the property for business operations, then this requirement is not met. For example, in In re KKEMKO, Inc., 181 B.R. 47 (Bankr. S.D. Ohio 1995), the debtor was a marina. The major secured creditor argued that the case involved a single asset debtor because the marina rented docking space. The court disagreed. Assuming arguendo, that the docks could be considered real estate under the law of fixtures so as to otherwise qualify the debtor for single asset treatment, the court held that the debtor was certainly no passive renter. The marina company s activities on the real property included not only renting docking space, but also repairing, servicing and storing boats; selling fuel and lubricants; and operating concessions. The court held that the marina was not a single asset real estate debtor. *Id.*; *see also* In re Larry Goodwin Golf, Inc., 219 B.R. 391, 393 (Bankr. M.D.N.C. 1997) (operation of golf course constitutes operation of business); In re Prairie Hills Golf & Ski Club, Inc., 255 B.R. 228 (Neb. 2000) (Debtor was not merely the owner of income-producing buildings and raw land. It was involved in other significant income-producing activities. Bankruptcy provisions regarding single asset real estate did not apply); In re CBJ Development, Inc., 202 B.R. 467 (9th Cir. B.A.P. 1996) (operation of hotel did not constitute singe asset real estate); In re Perry Hollow Mgmt. Co., 2000 BNH 13; 2000 (N.H. 2000) (Debtor's bankruptcy case was not a single asset real estate case; operating golf course included revenues other than investment return on real property. Secured creditor was granted relief from automatic stay; debtor did not show confirmable plan.). By contrast, in Philmont Dev. Co., the three limited partnerships conducted no significant business other than managing their respective projects, and thus they qualified for single asset treatment. 181 B.R. at 220.

Fourth and finally, Bankruptcy Code § 101(51B) requires that the debtor have no more than $4,000,000.00 in aggregate, non-contingent, liquidated secured debts. Thus, very large and heavily indebted owners will not qualify for single asset treatment, even if they otherwise meet the criteria of a single asset real estate debtor. *See* In re Midway Inv. Ltd., 187 B.R. 382 (Bankr. S.D. Fla. 1995) (noting that single asset real estate debtor had more than $4,000,000.00 in secured debt, and thus were inapplicable); Timothy T. Panacea, N.Y.L.J., Feb. 6, 1995, at 7; Richmond, Overview of the Bankruptcy Reform Act of 1994, 67 Nov. N.Y. St. B. J. at 10.

Litigation quickly arose regarding the $4,000,000.00 debt limit, especially in cases where the property secured by a debt of more the $4,000,000.00 was worth less that the $4,000,000.00 debt limit. This dilemma of Bankruptcy Code § 101 (51B) was at issue in Oceanside Mission

Assocs., 1996 WL 69567, 19996 Bankr. LEXIS 1444. There, the debtor had scheduled secured debt in excess of $4,000,000.00, but the principal secured creditor maintained that the property was worth less than that amount, and hence, as a matter of law, the total secured debt could not exceed $4,000,000.00. Therefore, the creditor argued, the debtor qualified for single asset real estate treatment. The court found the question to be a close one. On the one hand, the language and the 1978 legislative history of Bankruptcy § 506(a) appeared to support the creditor s view that, where the property was worth less than $4,000,000, there simply could not be secured debt in excess of that amount, and the debtor would automatically be a single asset real estate entity. On the other hand, the Supreme Court s decision in Dewsnup v. Timm, 502 U.S. 410, 112 S. Ct. 773, 116 L.Ed.2d 903 (1992) showed that, under Bankruptcy Code § 506(d), an allowed secured claim meant the full value of the creditor s claim, irrespective of the value of the collateral. Moreover, the language and the 1978 legislative history of Bankruptcy Code § 1129(b)(2)(A)(i) seemed to indicate that fluctuations in the value of the collateral should not effect the amount of a claim that was deemed secured. Unfortunately, the 1994 legislative history of the Reform Act was unhelpful in resolving the dilemma.

Ultimately, as a matter of policy, the Oceanside Mission Assocs. court ruled against the creditor. 192 B.R. at 235. The court reasoned that the purpose of the provisions of the Reform Act dealing with single asset real estate debtors was to place such cases on a fast track. *Id.* To allow valuation disputes and to hold valuation hearings early in the case would cut against the very goal that Congress had in mind. *Id.* To hold in the creditor s favor would invite wasting time and resources in cases that should be moved along quickly. *Id.* Therefore, the court concluded, the debt ceiling of Bankruptcy Code § 101(51B) would be taken to refer to the full amount of asserted secured claims, regardless of the value of the property. *Id.*

In contrast with the Oceanside Mission Assocs. court, the court in In re Pesignorkay, Inc., 204 B.R. 676 (Bankr. E.D. Pa. 1997) disagreed with the Oceanside Mission Assocs. court s definition and calculation of secured debts as used in Bankruptcy Code § 101(51B). As discussed above, the Oceanside Mission Assocs. held that the phrase aggregate non-contingent, liquidated secured debts in an amount no more that $4,000,000.000" as contained in Bankruptcy Code § 101(51B) refers to the total amount of all secured claims without regard to the value of the property securing such claims. As a result, the Oceanside Mission Assoc. court ruled against the creditor. In In re Pensignorkay, Inc., however, the court stated that while it was mindful of the delay issues related to valuation of the secured property, which was of great concern to the Oceanside Mission Assocs. court, it was be no means a foregone conclusions, however, that delay will result from an inquiry into the value of collateral. 204 B.R. at 682 n.4. Moreover, the In re Pensignorkay, Inc. held that as a matter of well established principles of statutory construction, the term debt as used in the Bankruptcy Code is defined in the same manner as the word claim, and are essentially the flip sides of the same coin. *Id.* at 683. Therefore, the court reasoned that pursuant to Bankruptcy Code § 506(a), the allowed claims of a creditor holding a lien on property of the estate is a secured claim only to the extent of the value of such creditor s interest in the estate s interest in such property..., and is an unsecured claim to the extent that the value of such creditor s interest...is less than the amount of such allowed claim. *Id. citing* Bankruptcy Code § 506(a). Accordingly, the court held that the determination of the extent to which a claim, in this case [a single asset case where the debtor argue there was more

than $4,000,000.00 secured debt on the property] a debt , is secured, depends on the value of the collateral to which the creditor s lien attaches. *Id.* By using Bankruptcy Code § 506(a), the court determined that since the value of the property was stipulated at $1,300,000.00 in In re Pensignorkay, Inc., the $4,000,000.00 debt ceiling had not been reached under Bankruptcy Code § 101(51B). Stated another way, the court in In re Pensignorkay, Inc. held that the word debt as used in Bankruptcy Code § 101 (51B) is defined the same as the word claim under Bankruptcy Code § 101(5)(a). Accordingly, Bankruptcy Code § 506(a) provides that the valuation of a creditors allowed claim (or debt as defined by the In re Pensignorkay, Inc.) is determined by the value of the property. Therefore, in direct contrast to the Oceanside Missions Assocs. court s holding, the court in In re Pensignorkay, Inc. decided that the valuation of secured claims related to the $4,000,000.00 debt ceiling in Bankruptcy Code § 101(51B) is determined by the value of the property and if the value of the property is less that $4,000,000.00, the debt ceiling requirement of Bankruptcy Code § 101(51B) has been satisfied.

Disputes of this nature may become a thing of the past, however, and even very large or heavily indebted entities may be eligible for single asset treatment in the not-to-distant future. The $4,000,000 debt ceiling is to be removed from the Bankruptcy Code under current legislation, as discussed in detail below, that has passed both the House of Representatives and the Senate and awaits signature of President Bush to be passed into law. Accordingly, the removal of the debt ceiling will resolve the conflict between the opinions of the Oceanside Mission Assocs. and In re Pensignorkay, Inc. courts.

B. Weapons of a Mortgage Lender in Single Asset Cases

1. Prior to the Reform Act of 1994

Prior to the enactment of the Reform Act, creditors, especially mortgage lenders, developed methods with which to deal with single asset cases. These methods were developed to deal with the realities that there was no serious prospect of any sort of reorganization in many single asset real estate cases, and it was abundantly clear that a Chapter 11 petition had been filed only to forestall the mortgagee and to gain a bargaining advantage when foreclosure on the debtor s only asset was imminent.

First, many courts would dismiss a single asset case for cause under Bankruptcy Code § 1112(b) on the ground that the filing was in bad faith and as abuse of the bankruptcy process when the debtor (i) had only one significant creditor (usually the mortgage lender); (ii) the petition had been filed merely to acquire leverage in what was essentially a two party dispute; (iii) the debtor was a passive investor/owner; and (iv) a foreclosure proceeding was pending. In re Humble Place Joint Venture, 936 F.2d 814 (5th Cir.1991); Matter of Little Creek Dev., Co., 779 F.2d 1068 (5th Cir. 1986); *accord* In re Phoeniz Piccadilly, Ltd., 849 F.2d 1393 (11th Cir.1988); In re Pleasant Pointe Apts., Ltd., 139 B.R. 828 (W.D.Ky.,1992); In re Nesenkeag, Inc., 131 B.R. 246 (Bankr.D.N.H.1991). Not all courts, however, recognized the bad faith filing doctrine as a basis for dismissal, In re Victoria Ltd. Partnership, 187 B.R.54 (Bankr. D. Mass. 1995); *see* Matter of James Wilson Assocs., 965 F.2d 169 (7th Cir.1992), and even those that did recognize

this doctrine were often reluctant to apply it unless the circumstances were truly egregious. *See e.g.* In re Mill Place Ltd. Partnership, 94 B.R. 139 (Bankr. D. Minn.1988).

Second, a mortgage lender could seek to lift the automatic stay under Bankruptcy Code § 362(d). Under Bankruptcy Code § 362(d)(1), the stay could be lifted for cause, including a lack of adequate protection. *See* In re Shady Grove Tech Center Assocs. Ltd. Partnership, 216 B.R. 386 (Bankr. D. Md. 1998) (cause is not defined in the Bankruptcy code and lack of adequate protection or finding of bad faith not the only reasons for cause). Accordingly, many creditors sought to lift the stay if the debtor lacked equity in the property and if the property was not necessary for an effective reorganization. Under this method, the debtor bore the burden of proof on the adequate protection, while the creditor bore the burden of proof on the debtor s lack of equity. *See* Bankruptcy Code § 362(g).

Third, pre-petition agreements to waive the automatic stay sometimes arose in single asset cases. In an attempt to workout the imminent foreclosure, mortgage lenders often demanded a contract term to the effect that, if the debtor defaulted under the workout agreement and then filed a bankruptcy petition, the debtor would waive the automatic stay. Some courts honored such provisions reasoning that a pre-petition waiver of the automatic stay was merely an agreement to forego one aspect of the Bankruptcy Code, not a contract purporting to foreswear bankruptcy protection altogether. An agreement which sought to contract around bankruptcy protection altogether would have been void as blatantly contrary to public policy; while an agreement to waive the automatic stay was seen as valid and enforceable. *See e.g.* In re Powers, 170 B.R. 480 (Bankr. D. Mass. 1994) (pre-petition agreement was primary factor in determining whether there was cause to lift automatic stay); In re Cheeks, 167 B.R. 817 (Bankr. D.S.C. 1994); In re McBride Estate, 154 B.R. 339 (Bankr. N.D. Fla. 1993) (opposition to lift stay motion is sanctionable if debtor had entered into pre-petition stay waiver agreement); In re Club Tower L.P., 138 B.R. 307 (Bankr. N.D. Ga. 1991).

On the other hand, some courts were reluctant to enforce pre-petition stay waivers for fear that an agreement between the debtor and one creditor might prejudice other creditors. Farm Credit of Cent. Fla., ACA v. Polk, 160 B.R. 870 (M.D. Fla.1993); *See also* In re Jenkins Court Assocs. Ltd. Partnership, 181 B.R. 33 (Bankr. E.D. Pa. 1995). This reasoning was likely to carry special weight if the debtor had more than one significant creditor. In re Atrium High Point Ltd. Partnership, 189 B.R. 599 (Bankr. M.D.F.C. 1995) (lender could not enforce stay waiver against other creditors, even though waiver was enforceable against debtor).

Fourth, if the debtor were able to get as far as plan confirmation, and if the mortgage lender were undersecured, the debtor usually could not achieve a cramdown unless the unsecured portion of the mortgagee s claim were classified separately from other unsecured creditors. In this situation, it was likely that no class would vote in favor of the plan and confirmation would be impossible. The overwhelming majority of appellate decisions, however, condemned such a classification system as improper. In re Greystone III Joint Venture, 995 F.2d 1274 (5th Cir.), *cert.*, 506 U.S. 821, 113 S.Ct., 72, 121 L.Ed. 37 (1992); *accord* In re Boston Post Rd., Ltd. Partnership, 21 F.3d 477 (2d Cir.1994), *cert. denied* 115 S.Ct. 897, 130 L.Ed.2d 782 (1995);

John Hancock Mut. Life Inc. Co. v. Route 37 Bus. Park Assocs., 961 F.2d 154 (3d Cir.1993); In re Bryson Properties XVIII, 961 F.2d 496 (4th Cir.) *cert denied* 506 U.S. 866, 113 S.Ct. 91 121 L.Ed. 2d 134 (1992); *contra* Matter of Westbrook Assocs., 19 F.3d 312 (7th Cir.1994).

Despite the wide variety of weapons available to creditors in the single asset cases, none was foolproof. Courts were generally reluctant to act too quickly; and employing any of the weapons available to the mortgage lender involved time and expense. The Reform Act attempted to avoid this unnecessary cost and delay and to limit abusive single asset filings. *See* Timothy T. Brock, Creditor Benefits Are No Panacea, N.Y.L.J., Feb. 6, 1995, at 7; Susan Mills Richmond, Overview of the Bankruptcy Reform Act of 1994, 67-Nov. N.Y. St. B.J. 10 (1995).

2. New Remedies for Mortgage Lenders Under the Reform Act of 1994.

If the debtor does qualify as a single asset real estate entity, then Section 218(b) of the Reform Act (codified as Bankruptcy Code § 362 (d)(3)) gives the mortgage lender a new weapon for lifting the automatic stay. In a single asset case, upon the request of a mortgage lender, a bankruptcy court must lift the automatic stay unless, within 90 days of the filing of the petition, the debtor has either: (a) filed a plan that has a reasonable probability of being confirmed within a reasonable time; or (b) begun payments to each secured creditor (apart from creditors whose claims are secured by a judgment lien or by an unmatured statutory lien such as a mechanic s lien) in an amount at least equal to a current market rate of interest on the value of the creditor s (mortgagee s) interest in the property. *See* Barry L. Zaretsky, Real Estate Issues in the Code Amendments, N.Y.L.J., Nov. 17, 1994, at 4. The 90 day period may be extended for cause, provided that the extension order (not the motion) is filed withing the 90-day period. *See* Brock, Creditor Benefits Are No Panacea, N.Y.L.J., Feb. 6, 1996, at 7. In other words, within 90 days of filing a petition for relief under the Bankruptcy Code, the single asset real estate debtor must be prepared to start making payments to the mortgagee, to file a confirmable plan, or to face lifting of the stay and a foreclosure. Hon. Arthur B. Federman, The Bankruptcy Reform Act of 1994, 51 J. Mo. B. 105 (1995); In re Archway Apartments, Ltd., 206 B.R. 463, 465 (M.D. Tenn. 1997); In re Kaplan Breslaw Ash, LLC, 264 B.R. 309 (S.D.N.Y. 2001) (relief from stay granted where debtor failed to make payments pursuant to §362(d)(3)). Making payments to the secured creditor, however, will not typically be a viable option. Indeed, it is usually precisely the debtor s inability to make such payments that led to the bankruptcy in the first instance. Stuart Kromrower & Ilana Volkov, New Debtors Hurdles in Single-Asset Cases, N.J.L.J., Jan 16, 1995, at 4. Thus, unless the debtor, within 90 days, files a plan of reorganization that has a reasonable possibility of being confirmed within a reasonable time, a lift-stay order and foreclosure are all but certain. Bankruptcy Code § 362(d)(3)(A); Richmond, Overview of the Bankruptcy Reform Act of 1994, 67-Nov. N.Y. St. B. J. at 10.

Some commentators have suggested that the phrase reasonable possibility of being confirmed within a reasonable time is opaque and likely to generate litigation. Thus, the effectiveness of the mortgage lender s new remedy under the Reform Act may be diluted. These commentators, however, overlook that the phrase is a term of art drawn from United States Sav. Ass n of Tex v. Timbers of Inwood Forest, Ltd., 484 U.S. 365, 108 S. Ct. 626, 98 L.Ed.2d 740

(1988). In that decision, the Supreme Court was construing the lift-stay requirement of Bankruptcy Code § 362(d)(2)(B): that the property is not necessary for an effective reorganization. Timbers of Inwood has produced a considerable progeny discussing what constitutes a plan that has a reasonable possibility of being confirmed and what constitutes a reasonable time within which the plan is likely to be confirmed. *See e.g.* John Hancock Mut. Life Ins. Co. v. Route 37 Bus. Park Assocs., 987 F.2d 154 (3d Cir. 1993); Matter of Canal Place Ltd. Partnership, 921 F.2d 569 (5th Cir. 1991); In re 266 Washington Assocs., 141 B.R. 275 (Bankr. E.D.N.Y.) *Aff d*, 147 B.R. 827 (E.D.N.Y. 1992); In re Wilks, 123 B.R. 555 (Bankr. W.D. Tex. 1991). There can be little doubt that this well developed case law construing Bankruptcy Code § 362(d)(3)(B) will govern the requirements of the new statute, Bankruptcy Code § 362 (d)(3)(A). *See* Kromrower & Volkow, New Debtors Hurdles in Single-Asset Cases, N.J.L.J., Jan. 16, 1995, at 4.

Unlike Bankruptcy Code § 362(d)(1), a mortgage lender using Bankruptcy Code § 362(d)(3) will not have to show cause or a lack of adequate protection in order to obtain a lifting of the automatic stay. Moreover, unlike Bankruptcy Code § 362(d)(2), Bankruptcy Code § 362(d)(3) does not require valuation or proof that the debtor lacks equity in the property. As a practical matter, a mortgage lender will be able to have the stay lifted and to foreclose if the single asset debtor has not filed a confirmable plan within 90 days. *See* Philmont Dev. Co., 181 B.R. at 220; In re Pacific Rim Investments, LLP, 243 B.R. 768 (Bankr. D. Colo. 2000) (holing that Bankruptcy Code § 362(d)(3) is not the only option available for lifting the stay against single asset real estate debtors); Kromrower & Volkov, New Debtors Hurdles in Single-Asset Cases, N.J.L.J., Jan. 6, 1995, at 4.

Finally, creditors in single asset cases should not forget a court s broad power to expedite case management and to require accelerated disclosure statements and plan procedures under Bankruptcy Code § 105(d). This power of the bankruptcy court may be used effectively to dispose of egregious single asset cases before the expiration of the 90 days required by Bankruptcy Code § 362 (d)(3).

In most respects, there can be no serious question that Bankruptcy Code § 362(d)(3) is cumulative with respect to a creditor s other remedies in single asset real estate cases. For example, there is no reason that a mortgage lender should not seek to lift the automatic stay under Bankruptcy Code § 362(d)(1) (lack of adequate protection) or § 363(d)(2) (no equity or property not necessary to effective reorganization) rather than under § 362(d)(3) if the circumstances make the use of one of these older provisions more appropriate in a particular single asset case. Similarly, Bankruptcy Code § 362(d)(3) does not even purport to affect plan confirmation requirements under Bankruptcy Code § 1129. Accordingly, if a single asset case does not progress as far as the plan confirmation stage, and if the debtor classifies the mortgagee s deficiency separately from the claims of other unsecured creditors in order to achieve a cramdown, the mortgagee still has every right to object to the improper classification. *See* Gadsen & Smith, The Bankruptcy Reform Act of 1994, 122 No. 3 Banking L.J. 212 (Mar.1995).

Some courts, however, have questioned whether the Reform Act leaves a creditor with

the remedy of dismissal for bad faith filing in a single asset case as was available before enactment of Bankruptcy Code § 362(d)(3). In re 203 North LaSalle St. Ltd. Partnership, 190 B.R. 567 (Bankr. N.D. Ill.), *stay denied*, 190 B.R. 595 (N.D. Ill.1995); In re Victoria Ltd. Partnership, 187 B.R. 54 (Bankr. D. Mass. 1995). The courts in In re 203 North LaSalle St. Ltd. Partnership and In re Victoria Ltd. Partnership held that the enactment of Bankruptcy Code § 362(d)(3) signified a congressional intent that single asset cases should not be dismissed out of hand, and that mortgagees should be provided with an alternative and reasonably swift remedy in appropriate instances. These cases, however, have not relied exclusively or even primarily on Bankruptcy Code § 362(d)(3). It is quite clear that these courts have been hostile to the bad faith filing doctrine from its inception, deeming it a kind of unwarranted discrimination against single asset real estate debtors. These opinions have relied chiefly on the legislative history and the language of Bankruptcy Code § 1112(b) and the Supreme Court s opinion in Toib v. Radloff, 501 U.S. 1157, 11 S.Ct. 2197, 115 L.Ed. 2d 45 (1991), holding that individuals who are not engaged in business may file under Chapter 11 and that Chapter 11 is not restricted to any particular sort of debtor; and on the fact that plans actually have been confirmed in some single asset cases. The enactment of Bankruptcy Code § 362(d)(3) simply reinforced what these court s already believed. Despite these court s distaste for the bad faith dismissal doctrine, none of these decisions held, however, that Bankruptcy Code § 362(d)(3), standing alone, was meant to overthrow the bad faith filing doctrine. *See also* In re Star Trust, 237 B.R. 827 (Bankr. M.D. Fla. 1999) (the enactment of single asset real estate requirement may change emphasis that some courts place on factors which indicate bad faith filing, but does not preclude court from dismissing such a case if filed in bad faith, even if the debtor complied with the requirement of the stay provision); In re Fay Assocs. Ltd. Partnership, 225 B.R. 353 (Bankr. S.D.N.Y. 1998) (debtor s use of cash collateral without authorization did not rise to level of willful misconduct that would warrant a finding of bad faith to justify dismissal or conversion not would fact that single asset case filed for sole purpose of avoiding adverse tax consequences constitute finding case was filed in bad faith); In re Villamont-Oxford Assocs. Ltd. Partnership, 230 B.R. 457 (Bankr. M.D. Fla 1998) (cause did not exist to lift stay to allow foreclosure based on alleged bad faith in filing petition on eve of scheduled foreclosure sale to protect limited partners, who might incur substantial tax liability if divested of value of partnership interests as a result of foreclosure on partnership s only asset).

Moreover, these decisions should have little impact in jurisdictions such as the Fifth and Eleventh Circuits where dismissal for bad faith filing is a well established principle. In re Humble Place Joint Venture, 936 F.2d 814 (5th Cir. 1991); Matter of Little Creek Dev. Co., 779 F.2d 1068 (5th Cir. 1986); *accord* In re Phoenix Piccadilly, Ltd., 849 F.2d 1993 (11th Cir.1988). Moreover, at least one court has held expressly that the Bankruptcy Code § 362(d)(3) was not meant in any way to limit the rights of mortgagees in single asset cases; dismissal for bad faith filing is a weapon that secured lenders may still use. In re Midway Inv., Ltd., 187 B.R. 382 (Bankr. S.D. Fla. 1995). In addition, the legislative history shows that Congress intended to expand the remedies available to mortgage lenders, not to take away remedies that lenders already had. *See* 140 Cong. Rec. H10, 771 (daily ed. Brroks [D.-Tex.]); *see also* In re Delray Assoc. Ltd. Partnership, 212 B.R. 511 (Bankr. D. Md 1997); *but see* Singer Furniture Acquisition Corp. v. SSMC, Inc. N.V., 254 B.R. 46 (Bankr. M.D. Fla. 2000) (holding that bad faith factors enunciated in Phoenix Piccadilly do not apply to single asset real estate cases); Jacksonville

Riverfront Dev. Ltd., 215 B.R. 239, 244 (Bankr. M.D. Fla. 1997) (holding that bad faith factors enunciated in Phoenix Piccadilly do not apply to single asset real estate cases); In re Wells, 227 B.R. 553, 560 (Bankr. M.D. Fla. 1998) (holding that bad faith factors enunciated in Phoenix Piccadilly do not apply to single asset real estate cases); In re Blunt, 236 B.R. 861 (Bankr. M.D. Fla. 1999). Accordingly, the argument can be made that the bad faith filing doctrine was in no way curtailed by the Reform Act, and that a mortgage lender has the option of seeking dismissal in addition to the option of moving to lift the automatic stay under Bankruptcy Code § 362(d)(3).

C. Problems With Post-petition Rents as Collateral

1. Bankruptcy Reform Act of 1978

Prior to the Reform Act of 1994, one of the most difficult problems that secured lenders faced was asserting the validity of their liens on rents that accrued post-petition. Typically, commercial mortgage lenders demand an assignment of rents and profits as additional security for their loans. If such an assignment had been properly recorded, a mortgagee might believe that he or she had a duly perfected lien on rents, irrespective of when they accrued. A number of bankruptcy decisions, however, came as a rude shock to lenders. Although this issue was not necessarily confined to single asset real estate cases, it did arise frequently in that context. David Gray Carlson, Rents in Bankruptcy, 46 S.C.L. Rev. 1075 (1995).

Under the 1978 version of Bankruptcy Code § 552(a), property that the debtor acquired post-petition generally was free of any pre-petition lien or security interest. That statute, for example, would usually nullify an after-acquired property clause. The important exception to that rule was provided Bankruptcy Code § 552(b). Under Bankruptcy Code § 552(b), a pre-petition lien or security interest would attach to post-petition property if the property that the debtor acquired were the rents, profits, proceeds, product, or offspring of pre-petition collateral. In order for Bankruptcy Code § 552(b) to apply, the creditor had to (i) have a valid and enforceable interest in the pre-petition collateral; (ii) the property arising post-petition had to fall into one of the specified categories (rents, profits, proceeds, product, or offspring); (iii) the security agreement, mortgage, deed of trust, or other lien-creating instrument had to cover the category in question; and, most important, (iv) the creditor s rights to the property arising or flowing from the pre-petition collateral had to be enforceable under applicable non-bankruptcy law. If all of these conditions were met, then post-petition property was subject to a pre-petition lien. If the post-petition property took the form of cash payments to the debtor, then it would be cash collateral under Bankruptcy Code § 363, and the debtor could not use it without court approval or the creditor s consent. Bankruptcy Code § 552(b), however, gave the bankruptcy court an amorphous right to avoid the lien on post-petition property based on the equities of the case (as discussed in detail below). *See* Kathryn R. Heidt, The Effect of the 1994 Amendments on Commercial Secured Creditors, 69 Am. Bankr. L.J. 395 (1995).

The difficulty for mortgage lenders with even a duly recorded assignment of rents and profits was that such an assignment, without more, was not necessarily valid and enforceable

under State law, at least if the assignment were not absolute. An assignment given as collateral, standing alone, might not be recognized by applicable non-bankruptcy law as vesting any interest in the creditor. Carlson, Rents in Bankruptcy, 46 S.C.L. Rev. at 395. The traditional American common law rule, expounded in Teal v. Walker, 111 U.S. 242, 4 S.Ct. 420, 28 L.Ed. 415 (1884), was that a mortgagee has no enforceable right in rents and profits unless the mortgagee has taken effective steps to obtain actual or constructive possession of the property or to have a receiver appointed. Until then, an intervening judgment creditor might seize the rents and profits, and, moreover, the mortgagor was under no duty to account to the mortgagee for the rents and profits received. In Butner v. United States, 440 U.S. 48, 99 S.Ct. 914, 59 L.Ed.2d 136 (1979), codified in Bankruptcy Code § 552(b), the bankruptcy court had to look to state law to determine whether a mortgagee s security interest extended to rents, and, if so, whether it were avoidable by the estate. Hence, a number of courts held that, if a mortgage lender had not taken possession of the property, or had not sought the appointment of a receiver, then a collateral assignment of rents and profits did not extend to post-petition rents. Alternatively, the assignment might be avoidable by the estate. In either event, post-petition rents were not cash collateral, and the debtor was free to use such rents to fund a plan or reorganization or to satisfy post-petition expenses. *e.g.* In re Casbeer, 793 F.2d 1436 (5th Cir. 1986); Matter of Village Properties, Ltd., F.2d 441 (5th Cir.), *cert. denied*, 446 U.S. 974, 104 S.Ct. 2350, 80 L.Ed.2d 823 (1984); In re Multi-Group III Ltd. Partnership, 99 B.R. 5 (Bankr. D. Ariz. 1989); In re TM Carlton House Partners, Ltd., 91 B.R. 349 (Bankr. E.D. Pa. 1988); In re Association Cntr. Ltd. Partnership, 87 B.R. 142 (Bankr. W.D. Wash. 1988).

2. Reform Act Changes Enhancing a Creditor s Rights in Post-Petition Rents

Section 214 of the Reform Act of 1994 was designed precisely to overrule this line of cases and to ensure that, as a matter of federal law, an assignment of rents and profits would give a mortgage lender a valid security interest in post-petition rents, event if state law would require some affirmative step to enforce this assignment. *See* 140 Cong. Rec. H10,768 (daily ed. Oct. 4, 1994)(statement of Rep. Brooks [D.Tex.]); H.R. Rep. No. 835, 103d Cong., 2d Sess., 48-49 (1994), *reprinted in* 1994 U.S.C.C.A.N. 3340, 3357-58. Section 214 of the Reform Act divided Bankruptcy Code § 552(b) into two subsections. Bankruptcy Code § 552(b)(1) now contains most of former Bankruptcy Code § 552(b), but the new Bankruptcy Code § 552(b)(1) refers only to the proceeds, product, profits, and offspring of pre-petition collateral; it does not refer to rents. Subject to the bankruptcy estate s avoiding powers and to the court s authority to consider the equities of the case, a pre-petition security interest in these sorts of property derived from pre-petition collateral will continue post-petition, provided that state law would recognize the validity of the security interest. *See* Heidt, Effect of the 1994 Amendments, 69 Am. Bankr. L. J. at 395.

In addition, section 214 of the Reform Act created Bankruptcy Code § 552(b)(2), which applies specifically to rents. Under Bankruptcy Code § 552(b)(2), a pre-petition security interest in rents will extend to rents that accrue post-petition, regardless of whether the creditor activated the assignment by collecting the rents, seizing the property, or seeking the appointment of a receiver. All references to applicable non-bankruptcy law are deleted. Accordingly, even if state law would require some such affirmative step for perfecting the security interest, that is now

irrelevant as a matter of federal law. Congress clearly meant to overturn Butner v. United States, 440 U.S. 48, 99 S.Ct. 914, 59 L.Ed.2d 136 (1979), and to create a uniform national system for protecting a mortgage lender s rights in bankruptcy. As evidenced in more and more cases, this now means that rents will be cash collateral under Bankruptcy Code § 363(a), irrespective of state law. In re County of Orange, 245 B.R. 138 (Bankr. C.D. Cal. 1997) (Bankruptcy Code § 552(b)(2) offers a compelling example of Congressional intent not to let states decide freely what shall be property of the debtor.); *accord* In re Barkley 3A Investors, Ltd., 175 B.R. 755 (Bankr. D. Kan. 1994). This is a significant victory for secured creditors because as cash collateral, the debtor may not use post-petition rents for any purpose (i.e. pay down debt, maintain property, etc...) without court approval or the consent of the secured creditor, which are hard to come by for the debtor.

The new Bankruptcy Code § 552(b)(2) reflected the growing weight of decisional law, scholarly commentary, and even state legislation before the Reform Act. Increasingly, courts recognized that whether a mortgagee has a valid security interest in rents, and whether the mortgagee had a right to immediate possession of the rents, were distinct questions. A creditor could have a lien on the rents and profits of real estate, thus making them cash collateral, even if the creditor had no right to immediate possession at the time the petition was filed. Matter of Wheaton Office Oaks Partners Ltd. Partnership, 27 F.3d 1234 (7th Cir.1994); 641 Ave. of the Americas Ltd. Partnership v. 641 Assocs., Ltd., 189 B. R. 583 (S.D.N.Y. 1995) (decided under the pre-Reform Act version of section 552(b)); Matter of Foxcroft Square Co., 178 B.R. 659 (E.D. Pa. 1995) (noting the growing trend toward recognizing the simple recordation of assignment of rents as sufficient to give assignee a valid and non-avoidable security interest); In re River Village Assocs., 181 B.R. 795 (E.D. Pa. 1995) (suggesting that Section 214 of the Reform Act, codified as Bankruptcy Code § 552(b)(2), is in keeping with the modern trend); Barkley Clark & Barbra Clark, Bankruptcy Reform Act of 1994: For Secured Creditors, Is it a Gaggle of Clitches?, 11 No. 3 Clarks Secured Transactions Monthly 1 (May 1995). It is of little surprise that, even when bankruptcy petitions were filed before the effective date of the Reform Act, some courts found the new statute highly persuasive in determining that a duly recorded pre-petition assignment of rents meant that post-petition rents and profits were cash collateral. River Village Assocs., 181 B.R. at 795; In re KAR Dev. Assocs., 180 B.R, 629 (D. Kan.), *stay denied*, 182 B.R. 870 (D. Kan. 1995).

The new statute, then, undoubtedly enhances and clarifies the rights of creditors with respect to post-petition rents. Nonetheless, the Reform Act is not as clear as it might be, and several problems remain. *See* Carlson, Rents in Bankruptcy, 46 S.C.L. Rev. at 1075. Not all of these problems can be addressed here, but some of them should be noted.

a. Assignments of Rents and the Bankruptcy Estate s Avoidance Powers.

One problem with the new Bankruptcy Code § 552(b) is that assignments of rents may remain subject to the bankruptcy estate s strong-arm avoidance powers. It might still be possible to argue that, if state law requires an affirmative step such as securing the appointment of a receiver or taking possession of the property in order to perfect an assignment of rents and

profits, and if the creditor has failed to do so pre-petition, then the creditor s interest in post-petition rents would be valid, but it would nonetheless be unperfected and therefore avoidable. Heidt, Effect of the 1994 Amendments, 69 Am. Bankr. L. J. at 395; *see also* Brian L. Holman, Perfection and Enforcement of California Assignments of Rent under the Bankruptcy Reform Act of 1994, 22 Cal. Bankr. J. 285 (1995). To this dilemma, the short answer is that such an interpretation would violate every canon of statutory construction. This type of argument would render Bankruptcy Code § 552(b)(2) self-nullifying and meaningless, and it would frustrate the obvious intent of Congress. Theodore L. Freedman, Patrick H. Autry & G. Christopher Meyer, Changes in the Landscape for Secured Creditors: New Strategies, New Powers and New Probelms, 14-Jun. Am. Bankr. Inst. L. J. 1 (1995); *accord*, Clark & Clark, Bankruptcy Reform Act of 1994, 11 No. 3 Clarks Secured Transactions Monthly at 1.

At the other extreme, some statements in the legislative history might be taken to mean that Congress intended that bankruptcy courts should ignore completely all state law requirements for the perfection of an assignment of rents and profits. So long as a creditor has a contract with a debtor giving the creditor a lien on rents, then the creditor s interest will be automatically perfected. *See* 140 Cong. Rec. H10,768 (daily ed. Oct. 4, 1994) (statement of Rep. Brooks [D-Tex.]); H.R. Rep. No. 835, 103d cong. 2d Sess., 48-49 (1994), *reprinted in* 1994 U.S.C.C.A.N. 3340, 3357-58; *see also* Carlson, Rents in Bankruptcy, 46 S.C.L. Rev. at 1075; Heidt, Effect of the 1994 Amendments, 69 Am. Bankr. L.J., at 395. Taken to extremes, this would mean that recordation requirements could be overlooked, and an unrecorded assignment of rents would be perfected automatically by virtue of Bankruptcy Code § 552(b)(2) as soon as the debtor filed a bankruptcy petition. Indeed, one bankruptcy court appears to have interpreted the statute in precisely this fashion, albeit in dicta. In re Geary s Bottled Liquors Co., 184 B.R. 408 (Bankr. D. Mass. 1995).

Once again, the appropriate reply is that such an interpretation is absurd. Clearly, Congress meant for bankruptcy courts to disregard any state law requirements for an affirmative activation of an assignment of rents, but not to give careless creditors a windfall. Under this argument, an unrecorded mortgage or deed of trust could be avoided as a lien on the property, but, if the unrecorded instrument contained an assignment of rents, the assignment would survive the avoidance as a valid lien on the rents. This outcome is hardly what Congress had in mind. Rather, the sensible interpretation of Bankruptcy Code § 552 (b)(2) is that an assignment of rents becomes a valid lien in bankruptcy if, but only if, the creditor has recorded the assignment so as to make it enforceable against a junior creditor or a good faith purchaser. *See* Freedman, Autry & Meyer, Changes in the Landscape for Secured Creditors, 14-Jun. Am. Bankr. Inst. J. at 1, *but see* In re Geary s Bottled Liquors, 184 B.R. at 408 (holding that, under Massachusetts law, an absolute assignment of rents-as opposed to a collateral assignments does not have to be recorded in order to be perfected).

b. The Equities of the Case Exception

Apart from the estate s avoidance powers, the recognition of a secured creditor s lien on post-petition rents is subject to a bankruptcy court s discretion to consider the equities of the

case. This phrase was also in the pre-Reform Act version of Bankruptcy Code § 552(b). Courts recognized, however, that this was not an avenue to alter the rights of secured creditors. In re Cross Banking Co., 818 F.2d 1027 (1st Cir. 1987); Matter of Ed Woods Livestock, 172 B.R. 294 (Bankr. D. Neb. 1994). A lien might be avoided if the creditor were oversecured or otherwise adequately protected. In re Lawrence, 56 B.R. 727 (D. Minn. 1987); In re 680 5th Ave. Assocs., 154 B.R. 38 (Bankr. S.D.N.Y. 1993). A lien might also be avoided if the post-petition property (including rents) were being used to maintain or preserve the creditor s collateral. In re 5028 Wisconsin Ave. Ltd. Partnership, 167 B.R. 699 (Bankr. D. D.C. 1994); In re Raleigh/Spring Forest Apt. Assocs., 118 B.R. 42 (Bankr. E.D.N.C. 1990). Apart from such instances, the equities of the case exception was seldom raised.

Apparently, Congress meant for bankruptcy courts to weigh the value of preserving the debtor s business as a going concern against the rights of the secured creditor when applying the new Bankruptcy Code § 552(b)(2). *See* 140 Cong. Rec. H10, 768 (daily ed. Oct. 4, 1994) (statement of Rep. Brooks [D.-Tex.]). Commentators have been virtually unanimous in maintaining that an inquiry into the equities of the case should focus on, and indeed collapse into, an inquiry into whether the lender is adequately protected under Bankruptcy Code § 363, and perhaps into whether the rents are being used to protect and preserve the lender s collateral under Bankruptcy Code § 506(c). An unguided and free-ranging inquiry into the equities of the case could virtually undo the main thrust of Bankruptcy Code § 552(b)(2) in some instances. Heidt, The Effect of the 1994 Amendments, 69 Am. Bankr. L. J. at 395; *see also* Freedman, Autry & Meyer, Changes in the Landscape for Secured Creditors, 14-Jun. Am. Bankr. Inst. J. at 1; Richmond, Overview of the Bankruptcy Reform Act of 1994, 67 Nov. N.Y. St. B.J. at 10. Courts appear to be following this advice and concentrating on the adequate protection of the secured creditor s interest, rather than attempting to invalidate an otherwise valid lien covering post-petition rents on the basis of some discretionary doctrine drawn from equity. *See* River Village Assocs., 181 B.R. at 795. Such an avenue of procedure conforms to pre-Reform Act precedent.

c. Priorities Among Creditors Holding Assignments of Rents.

Creditors must remember that Bankruptcy Code § 552(b)(2) speaks only to the rights of an assignee of rents and profits against the property of the estate. The statute does not even purport to address the rights and priorities of two or more such assignees against one another. As to priority questions, state law is dispositive. *See* In re Geary s Bottled Liquors, 184 B.R. at 408 (applying state law to determine priority between two holders of assignments of rents and discussing, *inter alia*, whether assignments were conditional or absolute). Thus, if state law would require the appointment of a receiver or some similar step in order to perfect a security interest in rents, it is possible that a creditor who had activated an assignment pre-petition (as by seeking the appointment of a receiver) might take priority over one who had not done so, although both would have valid liens on post-petition rents. Heidt, Effect of the 1994 Amendments, 69 Am. Bankr. L. J. at 395; *see* In re Geary s Bottled Liquors, 184 B.R. at 408 (noting that neither of the competing creditors had entered the premises or secured the appointment of a receiver).

d. Post-petition Rents as the Creditor s Property Rather Than the Creditor s Collateral

By its plain terms, Bankruptcy Code § 552(b)(2) speaks only of a lien or security interest in rents that are property of the estate. In at least some jurisdictions, creditors may be able to claim that the rents in question do not belong to the debtor or the estate at all. Hence, the rents would not be cash collateral, but rather the creditor s property as of the commencement of the case. This issue arose in In re Jason Realty, L.P., 59 F.3d 423 (3d Cir. 1995), where the court applied New Jersey law. The Third Circuit ruled that the assignment in question was absolute, not merely collateral or conditional, and that it passed title to the rents as soon as it was executed. The Court held that the debtor had a license to collect the rents so long as the debtor was not in default. In that case, however, the debtor had defaulted pre-petition, and the creditor had begun to collect the rents.

Under these circumstances, the court held that the debtor had ceased to have any interest in the rents, and hence the estate acquired no interest. The rents were not cash collateral; they were the property of the creditor as of the commencement of the case. Although the creditor had not completed foreclosure proceedings pre-petition, the court observed that a mortgage on the real property and an assignment of rents are not fungible concepts. Each involves a distinct interest in realty. Moreover, the assignment of rents was contained in an instrument separate from the mortgage itself, although this point did not appear to be dispositive. The upshot, according to In re Jason Realty, was that the debtor s interest in the land itself became part of the estate, but the debtor s former interest in the rents did not, and the rents could not be used to fund the debtor s proposed plan. *See* In re 5877 Poplar, L.P. ___ B.R. ___, 2001 WL 1181238 (Bankr. W.D. Tenn., Sep 27, 2001); Harris Ominsky, Banks Win the Tug of War Over Rents, Pa. L. Weekly, Dec. 11, 1995 at 13.

The old version of Bankruptcy Code § 552(b) applied in In re Jason Realty, but the outcome would have been the same under the Reform Act. In re Jason Realty was actually carried a step further in First Fidelity Bank, N.A. v. Eleven Hundred Metroplex Assocs., 190 B.R. 510 (S.D.N.Y. 1995), decided after the new Bankruptcy Code § 552(b)(2) had taken effect. Like In re Jason Realty, First Fidelity was decided under New Jersey law. In First Fidelity, the creditor had received an absolute assignment of rents. Indeed, the court held that under New Jersey law, all rent assignments pass title immediately upon execution, even if the assignment appears to be conditional or collateral in form. Accordingly, the debtor had received a license to collect the rents until default, but the debtor had defaulted pre-petition. The creditor had not completed foreclosure, nor apparently had the creditor taken any affirmative steps to secure possession of the rents. Nonetheless, the court ruled that the absolute assignment had divested the debtor of all interest in the rents, and rent accruing after default never became part of the bankruptcy estate at all.

The debtor in First Fidelity argued that the new Bankruptcy Code § 552(b)(2) meant that the creditor only had a valid security interest in the rents, and that the rents were cash collateral. The court disagreed, pointing out that the new Bankruptcy Code § 552(b)(2) governed security

interests in the debtor s property; and did not preempt state law in resolving whether the post-petition rents were the debtor s property in the first instance.

It appears, then, that the distinction between collateral or conditional assignments and absolute assignments of rent- a distinction sometimes fraught with arcane complexities may still be significant in the bankruptcy context, at least in some jurisdictions. Particularly in single asset cases, creditors may argue that their assignments were absolute, and hence that the rents belonged to the creditor as of the commencement of the case. Debtors may argue that the assignment in question was only collateral, and, even if absolute, state law would require the creditor to take possession of the rents before it owned them. *See* Carlson, Rents in Bankruptcy, 46 S.C.L. Rev. at 1075; Heidt, Effect of the 1994 Amendments, 69 Am. Bankr. L.J. at 395.

e. Other Problems: How Rents Paid During Bankruptcy Should be Applied

The reform Act did not address still less resolve all questions concerning rents in bankruptcy. One particularly troublesome problem is whether rents paid to a creditor during bankruptcy should be applied to reduce the secured claim or the total claim (i.e. the deficiency). Considerations of adequate protection only complicate the issue. Courts remain divided on this question, which has generated a great deal of very subtle and deep analysis. *See, e.g.* In re Duval Manor Assocs., 191 F.B. 622 (Bankr. E.D. Pa. 1996); In re Cason, 190 B.R. 917 (Bankr. N.D. Ala. 1995); In re Gramercy Twins Assocs., 187 B.R. 112 (Bankr. S.D.N.Y. 1995); In re Addison Properties Ltd. Partnership, 185 B.R. 766 (Bankr. N.D. Ill. 1995). A full treatment of this matter is beyond the scope of this article. Both debtors and creditors, however, should be aware that there are disputes over this matter, and that the Reform Act did nothing to lay the issue to rest. *See generally* Heidt, Effect of the 1994 Amendments, 69 Am. Bankr. L.J. at 395.

f. Hotel and Lodging Revenues Before the Reform Act

Logically and practically, there is no reason applicable in a commercial financing context to distinguish hotel revenues from the rents received from a shopping mall or an office building. In either case, the stream of income constitutes much of the property s value, and a mortgage lender will want to include that revenue in the collateral securing the loan. Fred Neufeld, Courts Rule That Postpetition Hotel Revenues Are, Like Rents, A Secured Lender s Cash Collateral; Congress Agrees, 112 No. 2 Bankring L.J. 171 (Feb. 1995). Nonetheless, lenders with an otherwise valid security interest in hotel revenues often found that they were stripped of their collateral in bankruptcy.

The problem lies with former Bankruptcy Code § 552(b). In order to have a lien on property that the debtor acquired post-petition, the new property had to be proceeds, product, offspring, rents, or profits of the pre-petition collateral. The question, then, was into which category did hotel or motel revenues fall. The most logical analysis would be to consider such revenues as rents. In re Drake Hotel Assocs., 147 B.R. 538 (N.D. Cal. 1992). Many courts, however, maintained that, under state law, an innkeeper or hotelier and a guest did not stand in a landlord-tenant relationship, and that providing hotel lodging was in the nature of a service

business rather than leasing real property. Hence, these courts concluded, hotel revenues were accounts, and, if the accounts accrued post-petition, they could not be subject to a pre-petition lien. *See e.g.* In re Northview Corp., 130 B.R. 326 (Bankr. D.R.I. 1994); In re Green Corp., 154 B.R. 819 (Bankr. D. Me. 1993). Still other courts reached what may have been a correct decision, albeit on rather strange grounds, ruling that hotel revenues might not be rents, but that they were profits. *See, e.g.* Great West Life & Annuity Assur. Co. v. Parke Imperial Canton, Ltd., 177 B.R. 843 (N.D. Ohio 1994); In re Miami Cntr. Assocs., 144 B.R. 937 (Bankr. S.D. Fla. 1992); In re Mid-City Hotel Assocs., 114 B.R. 643 (Bankr. D. Minn. 1990).

The two Circuit Courts that addressed the issue before the Reform Act both held squarely that, under state law, hotel revenues are at least analogous to rents, and therefore such revenues should be treated as rents for purposes of former Bankruptcy Code § 552(b). The Fifth Circuit did so applying Louisiana law in Matter of T-H New Orleans Ltd. Partnership, 10 F.3d 1099 (5th Cir.1993), cert. denied, ___ U.S. ___, 114 S.Ct. 1833, 128 L. Ed.2d 461 (1994), and the Ninth Circuit reached the same result under California law in In re Days California Riverside Ltd. Partnership, 27 F.3d 374 (9th Cir. 1994). Both appellate courts were deeply concerned about the obvious practicality of the situation. There simply is no principled reason for treating a mortgage lender with lien on hotel revenues differently than a creditor with a lien on rents from any other sort of commercial property. Neufeld, Postpetition Hotel Revenues, 112 No. 2 Banking L.J. at 171.

g. Changes in the Reform Act Affecting Hotel Revenues

Section 214 of the Reform Act created the new Bankruptcy Code § 552(b)(2), as previously explained. The Bankruptcy Code § 552(b)(2) makes clear that, for purposes of the continuation of a creditor s lien, the fees, charges, accounts, or other payments for the use or occupancy of rooms and other public facilities in hotels, motels, or other lodging properties will be treated in exactly the same fashion as rents. As a matter of federal law, a pre-petition lien that includes such revenues will attach to revenues that accrue post-petition. This is certainly a major victory for lenders, and it continues the trend begun by the Fifth Circuit s decision in T-H New Orleans, 10 F.3d 1099, and the Ninth Circuit s opinion in Days California Riverside, 27 F.3d at 374.

One appellate court has applied the new Bankruptcy Code § 552(b)(2), at least by analogy. The old version of Bankruptcy Code § 552(b) was at issue in Financial Sec. Assur., Inc. v. Tollman-Hundley Dalton, L.P., 74 F.3d 1120 (11th Cir. 1996), but the Eleventh Circuit was persuaded that the new Bankruptcy Code § 552(d)(2) was intended to clarify existing law, not to change it. Accordingly, the court held that a creditor s security interest in hotel revenues extended to post-petition income because, as a matter of federal law not state law that income was to treated as rent. *Id.*; *see also* In re 5877 Poplar, L.P. ___ B.R. ___, 2001 WL 1181238 (Bankr. W.D. Tenn., Sep 27, 2001) (rents and room revenues generated by the hotel constitute cash collateral); *but see* In re Kingsport Ventures, L.P., 251 B.R. 841 (Bankr. E.D. Tenn. 2000) (assignment of rents held to be absolute, thus rents not property of the estate and not cash collateral). Hence, Bankruptcy Code § 552(a) could not be used to deprive the creditor of its

lien. Thus, the Eleventh Circuit reached the same result as in T-H New Orleans and in Days California Riverside, but the result was reached on the basis of federal law.

h. Continuing Problems with Hotel Revenues

As comforting as creditors of hotels or motels may find the new Bankruptcy Code § 552(b)(2), at least three areas remain potential sources of litigation. First, Bankruptcy Code § 552(b)(2) applies rent treatment only to payments for the use or occupancy of rooms or other public facilities. Arguably, other sorts of hotel revenues, such as restaurant or bar income, would not be covered by the statutory language, even on the broadest reading. One might argue further that some components of a hotel bill, such as charges for room service, dry cleaning, or telephone calls, should not be accorded favorable treatment either. Such charges might be considered accounts. In that case, if they accrued post-petition, they would not be collateral for a pre-petition lien by virtue of Bankruptcy Code § 552(a). Future decisions will have to resolve just what sorts of hotel income fall within the coverage of the new statute. *See* Heidt, Effect of the 1994 Amendments, 69 Am. Bankr. L.J. at 395.

Second, Bankruptcy Code § 552(b)(2) still requires a lender to have a security agreement that covers the collateral in question. In In re Brandywine River Hotel, Inc., 177 B.R. 10 (Bankr. E.D. Pa. 1995), the court opined that, for this purpose, the Reform Act had not eliminated a distinction that state law might draw between rents and lodging revenues. If the instrument purporting to create the lien grants the creditor a security interest in rents but not in hotel charges, and if state law would not recognize hotel charges as rents, then the creditor would never have had a lien on the lodging revenue in the first instance, and the creditor could not improve its position under Bankruptcy Code § 552(b)(2) merely because the debtor had happened to file a bankruptcy petition.

These statements in Brandywine River Hotel were dicta; the court actually decided the case on other grounds. Nonetheless, they are disturbing. *See* Bruce Grohsal, Hotel Revenues Under the Reform Act, 14-Apr. Am. Bankr. Inst. J. 20 (1995). Such an analysis flies in the face of the strong emphasis on commercial practicality in the state law analysis of T-H New Orleans, 10 F.3d at 1099, and the Days California Riverside, 27 F.3d at 374. It also flies in the face of the Eleventh Circuit s correct perception in Tollman-Hundley, 74 F.2d at 1120, that Congress meant the new statute to give lenders enforceable federal rights in bankruptcy, irrespective of their state law rights. So far, no court has addressed Brandywine River Hotel, either to agree or to disagree with its analysis. Nonetheless, lenders should take the court s words as cautionary warning and make sure that security agreements cover every possible type of hotel or lodging revenue. Grohsal, Hotel Revenues Under the Reform Act, 14-Apr. Am. Bankr. Inst. J. at 20.

Third, and closely related, there is a question of perfecting a security interest in lodging revenue. If state law would regard hotel revenues as personalty (accounts) rather than realty (rents), then a security interest would have to be perfected in the method provided by Article 9 of the U.C.C. rather than by a real estate filing. *See* Great-West Life & Annuity, 177 B.R. at 843. Under Bankruptcy Code § 552(b)(2), security interests in lodging revenues, like security interests

in rents generally, remains subject to the bankruptcy estate s avoidance powers. The upshot is that an assignment of rents duly recorded in the real estate records might give a creditor a lien on post-petition hotel revenues as a matter of federal law, but the lien would be unperfected under state law, and thus avoidable in bankruptcy. Post-Petition Lodging Revenues: Real or Personal Property?, 11 No. 3 Clarks Secured Transactions Monthly 3 (Mar. 1995).

Probably the better view is that Congress meant Bankruptcy Code § 552(b)(2) to do away with such distinctions and to give a lender with a recorded security interest a valid lien on post-petition hotel revenues, regardless of whether such revenues would be deemed realty or personalty under state law. *See* Freedman, Autry & Meyer, Changes in the Landscape for Secured Creditors, 14-Jun. Am. Bankr. Inst. J. at 1. Nonetheless, given the possible ambiguity, secured lenders may wish to record their revenues both in the real estate records and in accordance with Article 9. Clark & Clark, Post-Petition Lodging Revenues, 11 No. 3 Clarks Secured Transaction Monthly at 3.

i. Further enhancement of Creditor s rights to Post-Petition Rents and Revenues under Revised U.C.C. Article 9.

With the recent adoptionWith the recent adoption of theWith the recent adoption of the Revised Article 9 o
(the(the UCC),(the UCC), many problems creditors previously encountered with lodging revenues, as(the U
above,above, have been eliminated. *See* Tex. Bus. & Comm. Code § 9-101, *et seq.* (Revise (Revised (Revise
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remedy for this problem.

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mostmost instances, will be perfected automatically. *See* Warner, G. Ray, Proceeds Warner, G. Ray, Proceeds in B
Revised Article 9, 20 ABI Journal 3 (March 2001).

The revision to the proceeds rule significantly expands the abilityThe revision to the proceeds rule significa
assert a security interest in property generatedassert a security interest in property generated post-petition. *See* I
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See Bankruptcy Code Bankruptcy Code § 552(a). An exception, An exception, however, under Bankruptcy Code §
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§§ 552(b)(1). Thus, the expanded§ 552(b)(1). Thus, the expanded definition of proceeds under Revised Article§
BankruptcyBankruptcy Code § 552(b)(1) exception, allow a creditor with a pre-petition seBankruptcy Code §
creacreatecreate a lien on after acquired property, including those types of lodging revenues previcreate a l
considered accounts, such as room service, telephone service and dry cleaning.

D. New Value and Cram Down

OneOne of the frequent battlegrounds with respect to single asset real estate cases is inOne of the frequent
of plan confirmation. of plan confirmation. The absolute priority rule will not allow a debtor to confirm a plan o
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claim.claim. Troy Savings Bank v. Travelers Motor Inn, Inc.,, 215 B.R. 485,, 215 B.R. 485, 493 (Bankr. N.D.N.Y
In re Fur Creations by Varriale, Ltd., 188 188 B.R. 754, 762 (Bankr. S.D.N.Y. 1995). Stated another
way,way, theway, the rule requires that all dissenting senior classes be paid in full before any juniorway, the rule requ
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creditors object.

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InIn re Figter Ltd., 118 F.3d 635 (9th Cir. 1997). In Figter, the, the Ninth, the Ninth Circuit held that a creditor acte
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fact, however, that a creditorfact, however, that a creditor has purchased additional claims for the purpose of prot existingexisting claim, does not demonstrate bad faith or anexisting claim, does not demonstrate bad faithor an ulteri from voting. from voting. Moreover, asfrom voting. Moreover, as long as the creditor acts to preserve what it r fairfair share of thefair share of the debtor s estate, bad faith will not be attributed to its purchase of claimsfair sh aa class vote. a class vote. *Id.* Therefore, a creditor can block the confirmation of a plan by purchasing additional claimsclaims thereby fortifying its position as theclaims thereby fortifying its position as the dominant creditor in bo

However,However, the new value exception to the absolute priorityHowever, the new value exception t contributescontributes new value to the debtor, the contributes new value to the debtor, the junior contri debtor) may be permitted to retain its interestdebtor) may be permitted to retain its interest even though the seni TheThe exception is not describedThe exception is not described in the BankruptcyThe exception is not described law,law, dating back to dicta from alaw, dating back to dicta from a 1929 Unitedlaw, dating back to dicta from a 1 <u>LumberLumber ProductsLumber Products Co.</u>, 308 U.S. 106 (1939); *seesee also* <u>In re Ambanc La Mesa Limite</u> 115115 F.3d 650, 654; <u>In reIn re Crosscreek Apartments, Ltd.</u>,, 213 B.R. 521, 545 (Bankr. E.D. Tenn. 1997); <u>InIn re Dwellco I Limited Partnership</u>, 219 B.R., 219 B.R. 5 (D. Conn. 1998) (plan is fair and equitable with respectrespect to class of unsecured clairespect to class of unsecured claims,respect to class of unsecured claim complied with absolute priority rule, under which old equity may not receive any property via plan on account of its prior ownership if all senior claim classes are not paid in full).

With regard to single asset real estateWith regard to single asset real estate cases,With regard to single as of creditors:

A. Priority real estate tax claims;
B. thethe secured creditorthe secured creditor (whose claim may be partiallythe secured credito is worth less than the debt);
C. thethe unsecured creditors (often including the unsecured portion of the secured creditors claim) and
D. thethe equity class (partners, LLC membethe equity class (partners, LLC me debtor) sometimes referred to in the cases as old equity.

IfIf the debtor s owners areIf the debtor s owners are unable to reach agreementIf the debtor s owners are unable to willwill swill sometimes trwill sometimes try to retain their interest in the debtor by offering a capital injection o propertyproperty to be added to the debtor s estate in order to meet the new valueproperty to be added to the debt consconsidconsideredconsidered actual new value, such a contribution must be up front, must consist of one o assetsassets that have more than nominal value, and must be necessaryassets that have more than nominal valu debtor.debtor. However, the Supreme Court recently limiteddebtor. However, the Supreme Court recently limited <u>of America v.of America v. 203 North LaSalle Street Partnership</u>, 526 U.S. 449, 119 S.Ct., 526 U.S. 449, 119 S. case,case, the court refused to rule oncase, the court refused to rule on the issue of whether the new value excepti ofof theof the 1978 BankruptcyCode, but instead held that,of the 1978 Bankruptcy Code, but instead held that, ass debtordebtor could not contributedebtor could not contribute new capital and receive ownership interest indebto returnreturn without allowing others to compete for that equity or proreturn without allowing others to comp plan.plan. Thus, in orderplan. Thus, in order to confirm a new valueplan. Thus, in order to confirm a new value pl thosethose equity holders must show that they have exposed thethose equity holders must show that they have exp

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own plan of reorganization.

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with legally cognizable claims.

The Supreme Court s opinion in 203 North203 North LaSalle raised a myriad of questions regarding
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LosLos AngelesLos Angeles Lumber. Although the court declined to rule on the subject, the majority. Although th
out of its way to issue dictum in support of the continued vitality of the new value exception.

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TimeTime and again, the Court emphasized that the old equity holders muTime and again, the Court emphasiz
dollar and that they not be permitted to obtain an equity interest at a bargain. *Id.* at 1421-23.

Third,Third, the means of satisfying the foregoing requirement is toThird, the means of satisfying the forego
oror new value plan to competition and market valuation. *Id.* at 1424. The Court exat 1424. The Court ex
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ofof Bankruptcy Code § 1129(b)(2)(B)(ii). *Id.* at 1424; *see also* Beal Bank, S.S.B. v. Waters Edge
Ltd.Ltd. Partnership, 248 B.R. 668 (D. Mass., 2000), 248 B.R. 668 (D. Mass., 2000) (absolute priority rule, 248 B.I
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ofof market valuationof market valuation or competitive bidding, insider private transactions proposed by a plan re
greater scrutiny by the bankruptcy court to ensure fairness).

Fourth,Fourth, and finally, the requirement that a bid by oldFourth, and finally, the requirement that a bid by
be subjected to market forces does not entirely supersede orbe subjected to market forces does not entirely super
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need need to show that no one else would pay as much to satisfy need to show that no one else would pay as
1422.1422. Based on1422. Based on the Court s1422. Based on the Court s holding, therefore, the new value ex
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value value plan has been presented to the market valuation forces and that the old equitvalue plan has been p
paying top dollar to retain their equity interests.

AssumingAssuming the debtor can meet this market place valuation test, it can still only force the new
valuevalue exception on creditors through the cramdown procedures of the Bankruptcy Code, whivalue excep
requirerequire that at least one impaired class of creditors voterequire that at least one impaired class of creditors v
serval examples of this important aspect of partnership and LLC bankruptcy law is in order.

In In re Woodmere Investors, L.P., 178 B.R. 346 (Bankr. S.D. N.Y. 1995) the partnership
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ofof trade creditors, and the unsecured portion of theof trade creditors, and the unsecured portion of the secured l
plan,plan, whichplan, which would have paid those creditors less than their claims. The partnerplan, which would
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post-petitionpost-petition rents frompost-petition rents from the apartment complex. The court held that neitherpos
sincesince sweat equity doesn t count as newsince sweat equity doesn t count as new value, and post-petition rents a
up front.

IInIn In Matter of Woodbrook Associates, 19 F.3d 312 (7th Cir. 1994), the debt Cir. 1994), the debtor c
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securedsecured claimsecured claim and a substantial unsecured claim.secured claim and a substantial unsecured cla
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holdingholding that infusion ofholding that infusion of $100,000 was just a token infusion, insufficientholding tha

TheThe Second Circuit looked at new value in the Circuit looked at new value in the context of a single ass
rere Coltex Coop. Centralre Coltex Coop. Central Three Partners, L.P., 138, 138 F.3d 39 (2nd Cir. 1998) where th
a 10-story officea 10-story office building in Houston,a 10-story office building in Houston, Texas and the secure

partiesparties agreedparties agreed that the building was worth less than the debt, but the debtor valued itparties agre
while the secured creditor said it was worth $5.7 million. Thewhile the secured creditor said it was worth $5.7 mi
securedsecured clasecured claim of $2.95 million plus certain tax claims, but the plan provided that the unsec
creditors (includingcreditors (including thecreditors (including the secured lender s undersecured claim) would ge
addition,addition, the partneraddition, the partners paddition, the partners proposed to retain their partnershi
creditorscreditors were not being paid in full, by contributingcreditors were not being paid in full, by contributing $3
courtcourt confirmed the placourt confirmed the plan, but the Discourt confirmed the plan, but the District Co
SecondSecond Circuit affirmed the District Court s denial of confirmationSecond Circuit affirmed the District Cou
ofof new capital by old equity (even though substantial) does not sof new capital by old equity (even though
absentabsent a showing that no other capital is available. Theabsent a showing that no other capital is available. Th
the United States Supreme Court s later holding in 203 North LaSalle Street, as described above.

MoreMore litigation can be expected in this area as the parties propose pMore litigation can be expecte
havehave tested the equity market and ashave tested the equity market and as the courtshave tested the equity r
North LaSalle.

E. Valuation of the Property

OneOne important aspect of single asset reOne important aspect of single asset real estOne importan
herein,herein, deals with the valuation ofherein, deals with the valuation of the subject property. herein, deals with
inin the context of thein the context of the amount of secured debt under thein the context of the amount of secured
Moreover,Moreover, when the value of the property is less than the mortgage, valuation is important in
determiningdetermining the amount to which the creditor isdetermining the amount to which the creditor is
properpropertyproperty (the sproperty (the secured creditor s collateral), the courts generally agree that one (or
appraisalappraisal techniques should be employed: market approach, cost approach, or capitalization of
incomeincome approach. In re Tamarack Trail Co., 23 Bankr., 23 Bankr. 3 (Bankr. S.D. Ohio 1982) ; In reIn re
Associates, 5 Bankr. Ct. Dec. (CPR) 1136 (Bankr. E.D.N.Y. 1979).

UnderUnder the market approach, property is valued in accordance with the price that would be
receivedreceived in received in a commercially reasonable disposition of the property. Court primarily utilize m
approachapproach eitherapproach either when valuing non-income producing assets or whenapproach either when
reorganization.reorganization. With respecreorganization. With respect to reorganization. With respect to th
price price a willing price a willing buyer would pay a willing seller in a price a willing buyer would pay a willing
Bankr.Bankr. 3, 5 (Bankr.Bankr. 3, 5 (Bankr. S.D.Bankr. 3, 5 (Bankr. S.D. Ohio 1982); *see* In re Frost, 47 Bankr.
premisedpremised onpremised on a simulated conversion of the collateral into cashpremised on a simulated conve
mannermanner practicable under the circumstances). With respect to liquidating reorganimanner practicable
relevant value isrelevant value is the price that would be obtained as part of anrelevant value is the price that woul
assets. In re Commerce Capital Corp., 8 Bankr. 168, 171 (Bankr. E.D. Wis. 1981).

UnderUnder the cost approach, an examination is made of either the cost at which theUnder the cost a
properpropertyproperty was acqproperty was acquired or built or the cost for which it would be replaced,
circumstances. *See* In re Tamarack Trail Co., 23 Bankr. At 7.

TheThe capitalization of income approach recognizes that an investor consideringThe capitalization of inc
ofof incomeof income producing property willof income producing property will evaluate not only the present va
expectedexpected future income stream generated by that property. Consolidated Rock ProductsConsolidated Roc
312312 U.S. 510 (1941). The capitalization of income approach was312 U.S. 510 (1941). The capitalization of inc
rere Oakdale Associates, in determining the, in determining the value of a functioning shopping center., in determin
(CPR) 1136 (Bankr. E.D.N.Y. 1979). After(CPR) 1136 (Bankr. E.D.N.Y. 1979). After noting the three traditio
Oakdale court held that the capitalization on income approach was appropriate and applied the classic
valuation formula: value equals income divided by rate of capitalization (V = I/R). Income is the
averageaverage projectedaverage projected annual net income of the subject property for aaverage projected annua
thethe rate of capthe rate of capitathe rate of capitalization is the rate of return on the investment that w
sophsophistsophisticatedsophisticated investor analyzing the actual performance of the property in juxtapositio
reasonablyreasonably predicreasonably predictable future income. *Id.* at 1138. The court set a value for r
establishingestablishing an annual projected gross income stream (pestablishing an annual projected gross in
expensesexpenses of operation (includingexpenses of operation (including taxes, utilities andexpenses of operatio
netnet income by the appropriate capitalizationnet income by the appropriate capitalization rate for the particular pr
ofof income-producing realof income-producing real estate, the capitalization of income approach has long been t
method.method. *See* In re 750 Ave. Associates, 5 Bankr. Ct. Dec. (CRR), 5 Bankr. Ct. Dec. (CRR) 368 (Ba
(apartment(apartment house); In re Castle Village Co., 4 Bankr. Ct. Dec. (CRR) 730 (Bankr. S.D.N.Y. 1978)
(apartment(apartment complex); In reIn re KRO Associates, 4 Bankr. Ct., 4 Bankr. Ct. Dec. (CRR) 462 (Bankr. S.
(prime(prime commercial office building); In re MariettaIn re Marietta CobbIn re Marietta Cobb Apartments, 3 Ba
(Bankr.(Bankr. S.D.N.Y. 1977)(Bankr. S.D.N.Y. 1977) (apartment complex); In re Pine Gate Associates, 3 Bankr
301301 (Bankr. N.D.301 (Bankr. N.D. Ga. 1977) (apartment building); *see also* In re Jartan, Inc., 44 Bankr. 331 (
N.D.N.D. I..N.D. I.. 1984) (going concern valuation of vehicle rental company in context of planN.D. I.. 1984) (goi
InIn re Huckabee Auto Co., 3, 33 , 33 Bankr. 132, 141 (Bankr. M.D. Ga. 1981); In re Barringhton Oaks
GeneralGeneral Partnership, 15 Bankr. 952, 966 n.31 (Bankr. D. Utah 1981); inin re Fiberin re Fiberglass Indus
Bankr.Bankr. 738 (Bankr. N.D.N.Y. 1987) (fiberglassBankr. 738 (Bankr. N.D.N.Y. 1987) (fiberglass production c
Valley Power Ass n., 77 Bankr. 991 (Bankr. S.D. Ind. 1987).

F. The Bankruptcy Reform Act of 2001as it Applies to Single Asset Real Estate Cases

Congress recently passed the Bankruptcy Reform Act of 2001, House Rule 333 and
SenateSenate Bill 420 (collectively the Bills),Senate Bill 420 (collectively the Bills), but due to recent nationa
signed into law by President Bush. Belowsigned into law by President Bush. Below issigned into law by Presiden
on single asset real estate cases.

1. Generally

In many large metropolitan areas, single asset cases have been of little significance
becausebecause the $4,000,000.00 debt ceiling under Bankruptcybecause the $4,000,000.00 debt ceiling under Bank
projects.projects. The Bills eliminate thisprojects. The Bills eliminate this $4,000,000.00projects. The Bills eliminat
assetasset real estate rules will apply in large cases. Note however, that theasset real estate rules will apply in large ca
estateestate projects upon which the debtor operates a real businessestate projects upon which the debtor operat
forth.forth. Also, there will be significant pressure on defforth. Also, there will be significant pressure on
purposespurposes of application of single assetpurposes of application of single asset real estate rules, as multiple p

The Bills revise Section 362(d)(3) in the following manner:

d. On request of a party in interest and after notice and hearing, the court shall grant reliefrelief from the stay provided under subsectrelief from the stay provided under subsec terminating, annulling, modifying, or conditioning such stay

3. withwith respect to a stay of anwith respect to a stay of an actwith respect to a stay of an act ag (a),(a), by a creditor whose claim is secured by a(a), by a creditor whose claim is secur unless,unless, no later that the date that is 90 days after the entry of tunless, no later that reliefrelief (or such laterrelief (or such later daterelief (or such later date as the court may dete withinwithin within thwithin that 90-day period) or 30 days after the court determines debtor is subject to this paragraph, whichever is later

a. thethe dethe debtor hathe debtor has filed a plan of reorganization that has a rea possibility of being confirmed within a reasonable time; or

b. the debtor has commenced monthly payments that

1. may,may, inmay, in the debtor s sole discretion, notwithstanding Section 363(c)(2),363(c)(2), be made from rents or other inc363(c)(2), be made before or afterbefore or after the commencement of the case bybefore or aft propertyproperty to each creditor whose claimproperty to each creditor who estateestate (other than a claim secured byestate (other than a claim secured unmatured statutory lien); and

2. are in an amount equal to interest at the thenare in an amount equal to inter default contract rate of interest on the value of the creditor s interest in the real estate;

ToTo date, there is little caseTo date, there is little case law or experience with Bankruptcy CodeTo date, there is lit oror dealing withor dealing with the $4,000,000.00 debt ceiling. or dealing with the $4,000,000.00 debt ceiling. It r realreal estate rules will be in practice in light of this limited experience. But atreal estate rules will be in practice in li willwill havewill have towill have to pay to play; that is stay current on monthly payments to secured creditors. Ap ofof those monthly payments will depend on whether the crof those monthly payments will depend on wheth creditorcreditor is undersecured, under <u>United Sav. Ass nUnited Sav. Ass n of Texas v. TimbersUnited Sav. Ass n o</u> <u>Ltd.</u>,, 484 U.S. 365 (1988), the payments should be applied to reduce principal. *See* Bills, §Bills, § 444Bills, § Alternatively,Alternatively, the debtor can avoid foreclosure byAlternatively, the debtor can avoid foreclosure by

AsAs under existing law, revised BAs under existing law, revised Bankruptcy CoAs under existing presumablypresumably any party resisting relief from stay) topresumably any party resisting relief from stay) to move ofof payments withinof payments within 90 days for cause. The Bills further loosen up the timeof payments withi ofof monthly payments by allowing the debtor to contest theof monthly payments by allowing the debtor to contest rules and by only requiringrules and by only requiring paymentsrules and by only requiring payments to commenc

assetasset real estate rules are applicable. *See* Bills § 444. Especially inBills § 444. Especially in larger cases, de
take advantage of these provisions to defer payment.

2. Monthly Payments from Pledged Rents

TheThe currentThe current Bankruptcy CodeThe current Bankruptcy Code allows a creditor whose claim
estateestate relief from the automatic stay unless (1) the debtor has filed a confirmable plan of
reorganizationreorganization or (2) thereorganization or (2) the debtor is making monthly payments toreorganizatio
byby suchby such realby such real estate... which payments are in an amount equal to interest at a current fair market
valuevalue fo the creditor s interest in the real estate. Bankruptcy Code § 362(dvalue fo the creditor s interes
authority, however, under current Bankruptcyauthority, however, under current Bankruptcy Code § 362(d)(3) on
ofof required adequate protection payments. The Bills reviseof required adequate protection payments. The Bills rev
itit possible for debtors toit possible for debtors to commence making payments toit possible for debtors to comme
BillsBills § 444.Bills § 444. Since rents are the only likely source of cash paymentsBills § 444. Since rents are the
this is a major concession to debtors.

3. Rate of Interest

UnderUnder current Bankruptcy Code § 362(d)(3)(B), a Under current Bankruptcy Code § 362(d
commencecommence making monthly payments equal to interest atcommence making monthly payments equal to
inin real estate. in real estate. The Bills change the applicable rate of interest toin real estate. The Bills change th
thenthen applicable non-default contract rate of interest on the value of the creditor s interestthen applicable non-d
estate.... estate.... estate.... *See* Bills § 444. This shouldBills § 444. This should simplify administration of Ba
under current market conditions of falling rates probably worksunder current market conditions of falling rates pr
thatthat thethat the payments are measured in the amount of interest; they are not interest payments.that the paym
they will be attributable to interest orthey will be attributable to interest or principal probably should depend on w
over or undersecured.

4. CreationCreation and Perfection of LiensCreation and Perfection of Liens for SpecialCreation and P

TheThe SecoThe Second Circuit The Second Circuit in Lincoln Sav. Bank, et al v. Suffolk County Tr
MeadowsMeadows Racing Ass n, Inc.), 880 F.2d 1540, 1542 (2d Cir. 1989) held that the autom, 880 F.2d 15
prohibitedprohibited the creation of a local tax lien upon real property unless the county has a pre-petition
interestinterest in the real property.... The 1994 amendmentinterest in the real property.... The 1994 ame
Meadows by creating an additional exception by creating an additional exception to the automatic stay for the crea
aa statutory lien for an ad valorem property tax imposed by the Dia statutory lien for an ad valorem property t
subdivision of the State, if such tax comes due after the filing of the petition. Bankruptcy Code §
362(b)(18).362(b)(18). The Bills expand the362(b)(18). The Bills expand the overruling of Parr Meadows by clari
staystay applies to all special taxes and assessments onstay applies to all special taxes and assessments on real estate
333 §1226; S. 420 § 1225.

WhileWhile not yet singed intoWhile not yet singed into law, the Reform Act ofWhile not yet singed into law
assetasset real estate cases. If nothing else, onceasset real estate cases. If nothing else, once enacted, the Reform A
scopescope of cases to fall under thescope of cases to fall under the purview of the single asset real estate rules ofs

IV ENVIRONMENTAL ISSUES IN REAL ESTATE BANKRUPTCIES

ThereThere are several concerns for creditors of debtors whose estate consists of a piece of real propert y.property. High among theseproperty. High among these concerns surrounds actions by federal or state ofof environmental statutes orof environmental statutes or regulations. of environmental statutes or regulations. S bankruptcy,bankruptcy, including: whether such claims are avoidable; whether claims forbankruptcy, including: wh thethe costs of environmental clean up are recoverable from a debtor; should the court estimthe costs of enviror cleanclean up costs ifclean up costs if such claims are contingent; what priority do such claims haveclean up costs if suchsuch claims dischargeable; and what is the effect of the automatic stay on such environmental claims. Although this paper cannot provide an exhaustive discussion of these topics, it seeks to provide an overviewoverview of potential issues of importance to anyoverview of potential issues of importance to environmental claim in the bankruptcy context.

TherThereThere are certain conflicts inherent in the mixture of the policies underlying environmental laws,laws, i.e., protecting public health and the environment, and the policieslaws, i.e., protecting public health and t i.e., settling a debtor s liabilities equitably and providing a debtori.e., settling a debtor s liabilities equitably and pro moremore noticeable areas where these conflictsmore noticeable areas where these conflicts collide are those affe (ii)(ii) the priority of environmental claims(ii) the priority of environmental claims against a bankruptcy estate; and environmental liabilities as debts in bankruptcy.

A. Contribution Claims

Many federalMany federal and state environmental statutes provideMany federal and state environmental broughtbrought during or after abrought during or after any civil actibrought during or after any civil action potentiallypotentially liable under those statutes. A person may also retain the right to bring apotentially liable under contribution.contribution. However, some statutescontribution. However, some statutes provide that a party who aa state in an administrative or judiciaa state in an administrative or judicially aa state in an administrative or regardingregarding matters addressed in the settlement. regarding matters addressed in the settlement. This contr forfor settlement by allowing the settlingfor settlement by allowing the settling parties to sue other persons who hav withwith the EPA for contribution in thewith the EPA for contribution in the amount of the difference between the cost of the response action.

ItIt is problemIt is problematiIt is problematic for an entity with a claim for contribution or inder environmentalenvironmental statutes if the party against whom the entityenvironmental statutes if the party agains thethe Bankruptcy Code. The timing involved in Bankruptcy and environmental statutes differ greatly. InIn an attempt toIn an attempt to promote rapid cleanup of environmental waste sites,In an attempt to promote r delaying litigationdelaying litigation regarding clean up costs until after the cleanup. Therefore,delaying litigation environmentalenvironmental statutes may not be assessedenvironmental statutes may not be assessed until after the sitesite in question, decided what remedial measuressite in question, decided what remedial measures needsite in qu ResponsibleResponsible Parties (PRP s) Responsible Parties (PRP s) will beaResponsible Parties (PRP s mattersmatters to further its policy of granting a debtor a fresh start and lend some finalitymatters to fur bankruptcy process.

TheThe date of the filing of a petition for bankruptcy relief is also an important tiThe date of the filing o
withwith respectwith respect to dischargewith respect to discharge and priority issues. The debtor will generally be d
claimsclaims arising before that date or pre-petition. If distributions are made onclaims arising before that date o
claims,claims, the claimant may receivclaims, the claimant may receive only aclaims, the claimant may receive
petition,petition, the debtorpetition, the debtor may be liable for the entire amountpetition, the debtor may be liable f
atat which an environmental claim arises is a relevant issue at which an environmental claim arises is a releva
recognizedrecognized in the bankruptcy case, what priority willrecognized in the bankruptcy case, what priority w
be discharged by the bankruptcy.

BankruptcyBankruptcy Code §Bankruptcy Code § 502 governs the allowance ofBankruptcy Code § 502
CodeCode § 502(a) accords claims prima facieCode § 502(a) accords claims prima facie allowabilityCode § 502(a) a
in-interestin-interest objects. Bankruptcy Cin-interest objects. Bankruptcy Code § 502(e)in-interest objects.
entities liable withentities liable with the debtor, such as sureties and guarantors, forentities liable with the debtor,
Bankruptcy Code § 502(e) provides:

(e)(1) NotwithstandingNotwithstanding subsections (a), (b) andNotwithstanding subsections (a), (b) and
subsection,subsection, the court shall disallow any claimsubsection, the court shall disallow any claim
entityentity that is liable with the debtentity that is liable with the debtor oentity that is liable wit
extent that

A such creditor s claim against the estate is disallowed.
B. Such claimSuch claim for reimbursement or contribution isSuch claim for reimbursement or
allowanceallowance or disallowance of suchallowance or disallowance of such claim for re
or
C. Such entity asserts a right of subrogation to theSuch entity asserts a right of subrogation to
section 509 of this title.

BankruptcyBankruptcy Code § 502(e) isBankruptcy Code § 502(e) is a unique provision of the Code and mayBank
contingentcontingent claims for contribution will be disallowedcontingent claims for contribution will be disallowed
courtcourt ifcourt if certain criteria are met. *See* In re Kent HollandIn re Kent Holland Die Casting & Plating, Inc., B
W.D.W.D. Mich.W.D. Mich. 1991) (claimsW.D. Mich. 1991) (claims of third party against the debtor were disallow
thethe EPA and the State ofthe EPA and the State of Michigan against third party for violationthe EPA and the State
lawslaws were pending at the time of the third party s claim and, thereforelaws were pending at the time of the thir
rere Drexel Burnham Lambert Group, Inc., 148 B.R. 982 (Bankr. S.D.N.Y. 1, 148 B.R. 982 (Bankr. S.D.N
particularlyparticularly harsh Section 502(e) consequences wparticularly harsh Section 502(e) consequences
exceptionexception to section 50exception to section 502(e)). exception to section 502(e)). Note, however, th
unliquidated claims for contribution, but only on contingent claims for contribution.

IfIf a claims is disallowed pursuant to BaIf a claims is disallowed pursuant to BankruptcyIf a claims is d
withoutwithout prejudice to the refiling of thewithout prejudice to the refiling of the claim pursuant to Bankruptcy C
isis no longer contingent, section 502is no longer contingent, section 502(e)is no longer contingent, sec
contributioncontribution as a pre-petition claimcontribution as a pre-petition claim even if payment is madecontribut
B.R.B.R. at 846. It appeaB.R. at 846. It appears, thereB.R. at 846. It appears, therefore, that a PRP shou

determinationdetermination of its response costs liability and expend the required funds to fix its claim indeterminatio
party s bankruptcy case.

B. Estimation Pursuant Bankruptcy Code § 502(c)

TheThe mere fact that a claim is contingent or unmatured does not render it unenforceable
pursuantpursuant to Bankruptcy Code § 502(b)(1). pursuant to Bankruptcy Code § 502(b)(1). Bankruptcypursuan
typestypes of claims, requiring the court to estimate any claim when the types of claims, requiring the court to
claimclaim would unduly delay the administration of theclaim would unduly delay the administration of the c
B.R.B.R. Va.B.R. Va. 1982) (the language of Bankruptcy CodeB.R. Va. 1982) (the language of Bankruptcy Code
dutyduty upon the courtsduty upon the courts to estimate claims). This section requires that allduty upon the cour
converted into dollar amounts. The purpose ofconverted into dollar amounts. The purpose of the estimation ofco
isis to afford a claimantis to afford a claimant the opportunity tois to afford a claimant the opportunity to share in an
isis assured a fresh stat via dischargeis assured a fresh stat via discharge of its pre-petitionis assured a fresh stat via di
885,885, 897 (Bankr. S.D.N.Y. 1985).885, 897 (Bankr. S.D.N.Y. 1985). 885, 897 (Bankr. S.D.N.Y. 1985).
however, as to the manner in which contingent or unliquidated claims are to be estimated pursuant
to Bankruptcy Code § 502(c).

BankruptcyBankruptcy Code § 502(c) must be viewed from the standpoint of a creditorBankruptcy Code § 5
§§ 502(e)(1)(B) must be viewed from the§ 502(e)(1)(B) must be viewed from the stan§ 502(e)(1)(B) must b
mandates that amandates that a claim be estimated for allowance purposes if the actual fixing or liquidationmanda
claimclaim would unduly delay claim would unduly delay the administclaim would unduly delay the adminis
creditor screditor s claim be estimated for allowance purposes so that thecreditor s claim be estimated for allowance
fromfrom the estate. A surety or co-debtor, however, holds a different status from a creditor in that it has
nono right to share in the distributions frono right to share in the distributions fromno right to share in the
Therefore,Therefore, if a claimant with a contingentTherefore, if a claimant with a contingent liabilityTherefore, if a
withwith a debtor, its claimwith a debtor, its claim will fall under the purview of Bankruptcy Codewith a debtor, its c
aa claimant has a claim directly against the debtor such as a state or federal environmental agency, then
the claim can be estimated pursuant to Bankruptcy Code § 502(c).

C. Priority of Claims

InIn bankruptcy, environmentalIn bankruptcy, environmental claimantsIn bankruptcy, environmental claiman
CodeCode § 503 administrative expense. Bankruptcy Code § 503(b) provides that actual, necessary costs
andand expenses of preserving the estate, including wages, salaries, or commissions for servicesand expenses of prese
afterafter the commencement of the case constituted administrative expenses. Pursuantafter the commencement
CodeCode § 507, administrative expenses allowed underCode § 507, administrative expenses allowed under Bankru
overover allover all general unsecured claims. Courts generallyover all general unsecured claims. Courts generally
prioritypriority to a claim, that (i) the right to paypriority to a claim, that (i) the right to payment aropriorit
debtor sdebtor s estate, rather thandebtor s estate, rather than from a pre-petition transactiondebtor s estate, rather
supsupportingsupporting thsupporting the right to payment was beneficial to the estate. Woburn Assoc. v.
HemingwayHemingway Transport, Inc., 954 F.2d 1,, 954 F.2d 1, 5 (1st Cir. 1992), *citing* In re Mammoth Mart, Inc.,
950, 954 (1st Cir. 1976). *See also* in re Jartran, Inc., 732 F.2d 584, 587 (7th Cir. 1984).

EnvironmentalEnvironmental claimsEnvironmental claims arising from clean up of post-petition contamina
administrative expenses.administrative expenses. In re The Circle K Corp., 137 B.R. 346 (Bankr. D. Ariz. 1992)
maymay be liable for an administrative expense for environmentalmay be liable for an administrative expense for env
butbut pre-petition misconduct is a pre-petition debt); but pre-petition misconduct is a pre-petition debt); In reIn re
4646 (Bankr. W.D. Mich. 1991) (any actual costs incurred46 (Bankr. W.D. Mich. 1991) (any actual costs in
petitionpetition will be entitled to administrative expense priority);petition will be entitled to administrative expense p
494494 (Bankr.494 (Bankr. D. Mass. 1987) (claimant entitled494 (Bankr. D. Mass. 1987) (claimant entitled to adr
responseresponse costs incurred in cleaning up the property because theresponse costs incurred in cleaning up the pro
thatthat they were environmental costs). Granting of administratithat they were environmental costs). Gran
BankruptcyBankruptcy Code § 959 ofBankruptcy Code § 959 of the Code and the SupremeBankruptcy Code § 9
NewNew Jersey Dep t of EnvironmentalNew Jersey Dep t of Environmental Protection (In re Quanta Resources Cor
BankrupBankruptcyBankruptcy Code § Bankruptcy Code § 959(b) requires a bankruptcy trustee or debtor in
operateoperate property of the estate in accordance with applicable non-bankruptcy law. Accordingly, in
Midlantic,, the Supreme Court interpreted Bankruptcy, the Supreme Court interpreted Bankruptcy Code § 959(b)
inin possession to comply with envin possession to comply with environin possession to comply with environ
suggestedsuggested asuggested as well that the trustee or debtor in possession could not abandon property so
doing so would present an imminent and identifiable harm to public health or safety.

AA common issue isA common issue is whether a claim should be entitled to an administrative expense pr
wherewhere the contamination occurredwhere the contamination occurred pre-petition, but continueswhere the co
situation,situation, it issituation, it is likelysituation, it is likely that the claim will enjoy administrative priority, partic
ofof imof imminent harm. of imminent harm. *See* In re Chateaugay Corp., 944 F.2d 997 (2nd Cir. 1991) (all cl
assessedassessed post-petition wassessed post-petition with respect tassessed post-petition with respect to sites
petitionpetition release or threatened releasepetition release or threatened release of hazardous wastes were entitl
In re Nat l Gypsum Co., 139 B.R. 397, 139 B.R. 397 (N.D. Tex. 1992) (all response costs, 139 B.R. 397 (N.D. T
asas the resultas the result of pre-petition conduct were entitled to administrative priority underas the result of pre-
§§§§ 507 and 503(b), subject to a determination §§ 507 and 503(b), subject to a determination that th§§ 507
posed an imminent and identifiable harm to the environment and public health).

CostCost incurred pre-petition may obtainCost incurred pre-petition may obtain a less favored status as unsec
InIn re Security Gas Oil,In re Security Gas Oil, Inc., 70 B.R. 786 (Bankr. N.D. Cal. 1987)., 70 B.R. 786 (Bankr. N.I
inin diin dictin dicta that environmental cleanup orders in regard to pre-bankruptcy violations were general,
unsecured claims, whileunsecured claims, while post-petition hazards canunsecured claims, while post-petition haz
partiesparties appear to obtain a less favored status than governmental units, having to meet a higher
standardstandard in order to receive priority for their environmental claims. InIn re Dant & Russell, Inc., 853
F.2dF.2d 700 (9th Cir. 1988); In re Pierce Coal, 65 B.R. 521 (Bankr., 65 B.R. 521 (Bankr. N.D. W.Va., 65 B.R. 521
putput up in favor of government was denied priority status even though tput up in favor of government
subrogationsubrogation to the government s rights); Southern Ry. Co. v. Johnson Bronze Co., 758 F.2d 137 (3rd
Cir.Cir. 1985) (claim for administrativeCir. 1985) (claim for administrative prioriCir. 1985) (claim for adr
purchaserpurchaser of the contaminated property). Moreover, fines imposepurchaser of the contaminated pro
statuesstatues for pre-petition violations of these stastatues for pre-petition violations of these statutes consta
Wisconsin Barge Lines, 91 B.R. 65 (Bakr. E.D. Mo. 1988).

D. Priority over Secured Claims

AA few casesA few cases haveA few cases have hinted that environmental claims may even take priority over s
DespiteDespite an acknowledgment by the court in In reIn re Env t Waste Control, 125 B.R. 546,, 125 B.R. 546, 55
1991),1991), that the debtor s commencement 1991), that the debtor s commencement of both state and federally ma
likelylikely exhaust the debtor s dwindling assets, the courtlikely exhaust the debtor s dwindling assets, the court
thethe secured party s position regarding its priority over tthe secured party s position regarding its priority ov
competing environmental harms. Similarly, in In re Mowbray Eng g Co., Inc.,, 67, 67 B.R. 34 (Bankr.
M.D.M.D. Ala. 1986), theM.D. Ala. 1986), the court granted the EPA priority over even secured parties as aM.D.
policypolicy by allowing the EPA to stand in the shoes of the trupolicy by allowing the EPA to stand in the sho
recoverrecover cleanup costs upon sale of the precover cleanup costs upon sale of the propertyrecover cleanu
property. However, it appearsproperty. However, it appears that priority over a secured claimproperty. Howeve
necessary to cure an immediate threat.

E. Liens Against Estate Property

EvenEven if environmental cleanup costs are not granEven if environmental cleanup costs are not gra
bankruptcy,bankruptcy, these costs may be entitled to priority as liens on property in the estate under Bankruptcy
Code § 506(c). This section grantsCode § 506(c). This section grants a right of recovery, in effect a super lien
forfor the reasonable, common, necessary, costs and exfor the reasonable, common, necessary, costs and ex
propertyproperty to the extent ofproperty to the extent of any benefit to the holder of such secured claim. Howev
appliesapplies only if the secured creditor receives someapplies only if the secured creditor receives some ben
PiercePierce Coal Constr., Inc., 65 B.R. 521 (Bankr. N.D., 65 B.R. 521 (Bankr. N.D. W.Va. 1986); , 65 B.R. 521 (Ba
(Bankr. D. Mass. 1986).

F. Dischargeability

A discharge inA discharge in bankruptcy will mostA discharge in bankruptcy will most likely, with certain
liabilitiesliabilities for environmental damages arising beforeliabilities for environmental damages arising before the b
CodeCode §§Code §§ 727 anCode §§ 727 and 1141. Bankruptcy Code § 523 provides for certain debts to sur
bbankruptcybankruptcy petition. A majority of the cases dealing with the dischargeability of environbankrupt
claims,claims, however, are based on whether such claims, however, are based on whether such claims
BankruptcyBankruptcy Code and not whether Bankruptcy Code § Bankruptcy Code and not whether Bankrup
claims by governmental agenciesclaims by governmental agencies for response costsclaims by governmental agenc
toto be dischargeable debts;to be dischargeable debts; however, the courtsto be dischargeable debts; however, the
environmentalenvironmental liability and, therefore, whether they are dischargeabenvironmental liability and, th
whetherwhether cleanup orders in the nature ofwhether cleanup orders in the nature of injunctive relief give rise t
the definition of claim under the Code and thus are dischargeable in bankruptcy.

G. Effect of Automatic Stay

AsAs discussed throughout this article, the fAs discussed throughout this article, the filing oAs dis
automaticautomatic stay of all judicial,automatic stay of all judicial, administrative, or other actions or proceeding
thethe ethe enforcementhe enforcement of any judgment obtained before the petition was filed. Bankruptcy
362(a)(1).362(a)(1). Certain governmental actions362(a)(1). Certain governmental actions are362(a)(1). Certain
continuedcontinued to enforce a governmental unit s police or regulatory powecontinued to enforce a gov

362(b)(4).362(b)(4). Initial interpretations of the police po362(b)(4). Initial interpretations of the police pow
appliesapplies to non-monetary judgments, and does not allow applies to non-monetary judgments, and does
unclear,unclear, however, whether governmental injunctions andunclear, however, whether governmental injunctio
cleanupcleanup contaminated sites are exempted form or subject to the statute cleanup contaminated sites are
equivalent to monetary judgments.

InIn the case of United States v. Price, 668 F.2d 204, 668 F.2d 204 (3rd Cir. 1982), the Third Circuit held tha
requiringrequiring a landfill owner to conduct a diagnosticrequiring a landfill owner to conduct a diagnostic study o
ofof the court s equitable powers, because it would beof the court s equitable powers, because it would be preven
subsequentsubsequent case, the Third Circuit held that a state s injunction is exempt from the automatic stay and
requiredrequired a Chapter 7required a Chapter 7 debtor to takerequired a Chapter 7 debtor to take cleanup actions
expenditureexpenditure thatexpenditure that would deplete the estate sexpenditure that would deplete the estate s
733733 F.2d 267 (3rd Cir. 1984). The bankruptcy court Cir. 1984). The bankruptcy court and district
automaticautomatic stay to theautomatic stay to the injunctionautomatic stay to the injunction because the effect o
againstagainst Penn Terra. The Third Circuit reversed and reinstated the state s enforcement action,
directingdirecting that the inquiry should focusdirecting that the inquiry should focus on the naturedirecting that the
compensationcompensation from past damages or preventiocompensation from past damages or prevention
automaticautomatic stay would apply to actions to cleanup past harms but not to orders to prevent future harm.
PennPenn Terra does not compl does not completely does not completely clarify the applicability of the automa
leavesleaves open the bankruptcyleaves open the bankruptcy court s authority to issue a discretionary stayleaves op
105 if necessary or appropriate to carry out the provisions of the bankruptcy code.

TheThe Supreme Court s decisionThe Supreme Court s decision in Ohio v. Kovacs, 469 U.S. 274 (1985), f
issueissue of when theissue of when the automatic stay applied to environmentalissue of when the automatic stay app
Kovacs, on behalf of Chem-Dyne Corp. and inKovacs, on behalf of Chem-Dyne Corp. and in his individual capac
to cleanup certain industrial and hazardous waste disposal sites andto cleanup certain industrial and hazardous wa
injury to wildlife, among otherinjury to wildlife, among other things. When Kovacs failed to comply with theinjury
hadhad ahad a receiver appointed who took possession of all property and other assets of Kovacs andhad a receive
cleanupcleanup of the sitcleanup of the sites. Beforcleanup of the sites. Before clean up was completed, Kovac
CourtCourt grantedCourt granted cert to determineCourt granted cert to determine the dischargeability of Kovacs
affirmed the holding ofaffirmed the holding of the Sixth Circuit against theaffirmed the holding of the Sixth Circuit
general,general, the automatic stay applies only to the enforcement of an environmegeneral, the automatic stay a
money frommoney from the bankrupt and does not apply to suits to enforce the regulatory statutes of themoney fro
butbut that (ii) Ohio s environmental injunction against Kovacs was dischabut that (ii) Ohio s environmental inj
debt debt converted into an obligation to pay money, since the receiver was carrying debt converted into an obli
onlyonly wanted money from Kovacs to defray the cleanuponly wanted money from Kovacs to defray the cleanup c
the enforcement of automatic stay and in favor of environmental cleanup.