

AUTOMATIC STAY UNDER THE 1978 BANKRUPTCY CODE: AN EQUITABLE ROADBLOCK TO SECURED CREDITOR RELIEF

The Bankruptcy Reform Act of 1978 substantially altered prior automatic stay and injunction practice. This Comment attempts to define the boundaries of section 362 of the code and the terms "for cause" and "adequate protection" through a review of legislative history and prior Bankruptcy Act practice. The Comment also provides practical guidance on the procedural aspects of obtaining relief from stay.

Equity—The spirit and the habit of fairness, justness, and right-dealing which would regulate the intercourse of men with men,—the rule of doing to all others as we desire them to do to us; or, as it is expressed by Justinian, "to live honestly to harm nobody, to render to every man his due."¹

INTRODUCTION

In a typical credit transaction, the creditor provides the debtor with money or goods in exchange for the debtor's promise to pay at a future date.² In order to protect his interest the creditor will, in many instances, take a security interest in property owned by the debtor. That security interest helps protect the creditor's claim from the claims of competing creditors and the potential trustee in bankruptcy.³

If the debtor defaults in payment, the creditor may foreclose on his bargained-for security interest and receive payment from the

1. BLACK'S LAW DICTIONARY 634 (4th ed. 1951).

2. A "debtor" in bankruptcy means a person or municipality for which a case under the bankruptcy code has been commenced. 11 U.S.C. app. § 102(12) (Supp. II 1978). The new bankruptcy code has substituted the word "debtor" for "bankrupt" as a means of reducing the stigma connected with the term bankrupt. H.R. REP. NO. 95-595, 95th Cong., 1st Sess. 310 (1977) [hereinafter cited as HOUSE REPORT]. Unless otherwise stated, reference to a given section will refer to that section in 11 U.S.C. app. (Supp. II 1978).

3. See Jackson & Kronman, *Secured Financing and Priorities Among Creditors*, 88 YALE L.J. 1143 (1979).

sale of the debtor's property. However, if the creditor institutes a suit in the state courts to foreclose on his lien, the debtor may choose to file one of a variety of petitions in bankruptcy.⁴ When the debtor files a petition in bankruptcy, the creditor's action to foreclose on the lien is automatically stayed⁵ and his state court suit may soon be removed to federal court.⁶ Unless the creditor affirmatively seeks and receives relief from the automatic stay, his bargained-for remedy may be postponed for several years while the debtor continues to use the money or goods originally advanced. Although the concept of "automatic stay" and the procedures for gaining relief were developed under the old Bankruptcy Act,⁷ the Bankruptcy Code applied in cases filed after October 1, 1979 is completely new.⁸

This Comment provides the non-prime or consumer lender with an understanding of the alternatives available under the new Bankruptcy Code when the creditor's attempts to foreclose on a security interest are stayed by the filing of a petition in bankruptcy. Such an understanding is gained through an analysis of (1) the underlying equitable concepts of bankruptcy, (2) the operation of stays under the Act, (3) the automatic stay under the Code, and (4) the definitions of the terms "for cause" and "adequate protection." This Comment will attempt to define the parameters of the above concepts in terms of prior and current case law. This Comment demonstrates that, while the new Code provides workable equitable principles to govern the operation of automatic stays and the use of collateral, it fails to provide predictability upon which a secured creditor can base future dealings.

AUTOMATIC STAY

The relationships between debtors and creditors have not always been as equitable as they are today. During the reign of the laws of the Twelve Tables (450 B.C.), a man who was indebted to

4. Depending on the nature and extent of the debtor's financial problem, the debtor might file a voluntary petition (§ 301) under chapters 7 (liquidations), 9 (adjustments of debts of a municipality), 11 (reorganizations), or 13 (adjustments of debts of an individual with regular income).

5. 11 U.S.C. app. § 362 (Supp. II 1978). This section stops virtually all civil proceedings against the debtor automatically upon the filing of a petition in bankruptcy.

6. 28 U.S.C. § 1478(a) (Supp. II 1978).

7. Act of July 1, 1898, ch. 541, 30 Stat. 544.

8. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (codified in scattered sections of 11, 28 U.S.C. (Supp. II 1978)). The Bankruptcy Reform Act of 1978 will hereinafter be referred to as the "Code" or "new law." The terms "Act" and "prior law" refer to the Bankruptcy Statute of 1898 as amended. *See* Chandler Act, Bankruptcy Revision, ch. 575, 52 Stat. 840 (1938).

several creditors and could not pay his debts was subject to having his body cut up and divided amongst his creditors.⁹ If there was only one creditor, the debtor could have been enslaved or put to death.¹⁰ Although Americans have not treated debtors barbarically, they have traditionally attached a social stigma to the concept of bankruptcy.¹¹ One modern definition of a bankrupt is a person who, to avoid payment of his debts, secretes himself, flees the country, and defrauds or simply avoids his creditors, and is in consequence legally a criminal.¹²

The modernization of debtor and creditor relations in America has occurred through the systematic development of a comprehensive bankruptcy system. The bankruptcy power is granted to Congress in the United States Constitution.¹³ In 1898 Congress enacted the first substantial bankruptcy law,¹⁴ patterning it after the English bankruptcy system.¹⁵ This Act was subsequently amended more than fifty times with the most substantial revision being the Chandler Act of 1938.¹⁶

On October 1, 1979, a new bankruptcy statute became effective.¹⁷ The new law, commonly known as the "Bankruptcy Code," is the first major revision of title 11 of the United States Code in forty years.¹⁸ This enactment is the culmination of more than ten years of congressional hearings, commission studies, and institutional reports.¹⁹

The fundamental approach of the new Code is a continuation of the two basic goals inherent in bankruptcy law: (1) to provide supervised collection of the debtor's property for an equitable liquidation and distribution to creditors; and (2) to give the debtor a

9. S. SHERWIN, *HOW TO GET OUT OF DEBT PAINLESSLY* 47 (1969).

10. *Id.*

11. BLACK'S LAW DICTIONARY 634 (4th ed. 1951).

12. WEBSTER'S NEW INTERNATIONAL DICTIONARY 172 (3rd ed. 1967).

13. U.S. CONST. art. I, § 8, cl. 4.

14. Bankruptcy Act of 1898, ch. 541, 30 stat. 544.

15. Hamilton, *Automatic Stay-Chapter XI Rule 11-44: Rationale, Application, Implication*, 12 SUFFOLK U.L. REV. 891 (1978). The English System had been patterned after the Roman System. *Continental Ill. Nat'l Bank & Trust Co. v. Chicago, R.I. & Pac. Ry.*, 294 U.S. 648, 674 (1935).

16. PRACTICING LAW INSTITUTE, SECURED CREDITORS AND LESSORS UNDER THE BANKRUPTCY ACT OF 1978 at 12 (1979).

17. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (codified in scattered sections of 11, 28 U.S.C. (Supp. II 1978)).

18. Klee, *The New Bankruptcy Act of 1978*, 64 A.B.A.J. 1865 (1978).

19. See Kennedy, *The Background of the Bankruptcy Law of 1978*, in BANKRUPTCY AND BUSINESS REORGANIZATION: MOVING INTO NEW TIMES (1979).

fresh start in life.²⁰ The automatic stay upon the filing of a petition in bankruptcy is a tool utilized by the bankruptcy courts to achieve these two purposes.²¹

The automatic stay is designed to give the debtor a breathing spell from his creditors as well as to preserve what remains of his insolvent estate for the benefit of unsecured creditors.²² The debtor is relieved of the financial pressures that drove him into bankruptcy because the new automatic stay stops virtually all collection efforts, harassment, and foreclosure actions.²³ The stay is also designed to prevent a chaotic and uncontrolled scramble for the debtor's assets in a variety of uncoordinated proceedings in different courts.²⁴ In rehabilitation proceedings the stay provides the debtor an opportunity to negotiate a plan of arrangement with his creditors without having the hope of rehabilitation extinguished by immediate repossession of his encumbered property by secured creditors.²⁵

The automatic stay can have a significant effect on the time the creditor receives payment. Indications are that the inclusion of broader wage earner laws in chapter 13 of the Code has and will continue to increase consumer bankruptcy filings significantly.²⁶ Therefore, creditors should be familiar with the Code and with

20. See *Lines v. Frederick*, 400 U.S. 18 (1970); see also *Kuehner v. Irving Trust Co.*, 299 U.S. 447 (1936), where, in discussing reorganization proceedings, the Court stated that "the object of bankruptcy laws is the equitable distribution of the debtor's assets amongst his creditors; and the validity of the challenged provision must be tested by its appropriateness to that end." *Id.* at 551. See also Donnelly, *The New (Proposed?) Bankruptcy Act; The Development of Its Structured Provisions and Their Impact on the Interests of Consumer Debtors*, 18 SANTA CLARA L. REV. 291, 318 (1978) discussing the impact of the traditional American concern for human dignity on wage earner considerations.

21. See Kennedy, *The Automatic Stay in Bankruptcy*, 11 U. MICH. J.L. REF. 177 (1978).

22. HOUSE REPORT, *supra* note 2, at 340.

23. *Id.*; 11 U.S.C. app. § 362 (Supp. II 1978).

24. *Fidelity Mortgage Investors v. Camelia Builders, Inc.*, 550 F.2d 47, 55 (2d Cir. 1976), *cert. denied*, 429 U.S. 1093, *rehearing denied*, 430 U.S. 976 (1976). The HOUSE REPORT, *supra* note 2, at 340, states "[t]he automatic stay also provides creditor protection. Without it, certain creditors would be able to pursue their own remedies against the debtor's property. Those who acted first would obtain payment of the claims in preference to and to the detriment of other creditors. Bankruptcy is designed to provide an orderly liquidation procedure under which all creditors are treated equally. A race of diligence by creditors for the debtor's assets prevents that."

25. *In re Hamilton Mortgage Corp.*, 13 COLLIER BANKR. CAS. 77 (E.D. Tenn. 1977). A rehabilitation proceeding, reorganization, and arrangement are all proceedings in which the debtor utilizes the court to extend or modify his debts. In a traditional straight bankruptcy, the debtor's non-exempt property is turned over to the court which distributes or sells the property for the benefit of creditors.

26. PRACTICING LAW INSTITUTE, SECURED CREDITORS AND LESSORS UNDER THE BANKRUPTCY ACT OF 1978 at 12 (1979) (consumer bankruptcy filings have increased in recent years to over several hundred thousand filings per year). This statement

their own financial limitations before extending credit to a consumer or small businessman.

Before the advent of automatic stays, the bankruptcy courts used injunctions to protect debtors and their estates from creditors.²⁷ The Supreme Court in *Ex Parte Christy*²⁸ inferred from the bankruptcy statutes existing in 1841 that the power to issue injunctions was inherent in these statutes because, without such power, the courts could not carry out the purposes of the bankruptcy system. The first "automatic stay" was enacted in 1933 as section 75(o) of the first relief for farmers legislation.²⁹ Section 75(s), added in 1934 by the Frazier-Lemke Act, provided for an automatic stay of all proceedings against a farmer-debtor's property for five years.³⁰ The United States Supreme Court promptly held section 75(s) unconstitutional as a violation of fifth amendment due process in the celebrated case of *Louisville Joint Stock Land Bank v. Radford*.³¹

The passing of the Chandler Act of 1938 added business reorganization chapters X, XI, and XII to the Bankruptcy Act and provided for automatic stays in two sections.³² Prior to the enactment of these sections, stays in bankruptcy were not always self-executing.³³ Before an injunction could be effected, it was necessary for the court to receive some affirmative motion by the trustee, receiver, or debtor.³⁴ However, under this practice, debtors lost substantial portions of their estates between the time of filing in bankruptcy and the issuance of the injunction.³⁵ The Chandler Act remedied this problem by making stays auto-

is also based on observations of filings in the Southern District of California Bankruptcy Court since October 1, 1979.

27. 2 COLLIER ON BANKRUPTCY ¶ 362.01(1) (15th ed. L. King 1979).

28. 44 U.S. (3 How.) 292 (1845).

29. Act of March 3, 1933, ch. 204, 47 Stat. 1473; Kennedy, *The Automatic Stay in Bankruptcy*, 11 U. MICH. J.L. REF. 177, 180 (1978). The stay was "automatic" in the sense that a stay was applied upon the filing of the petition in bankruptcy and no separate application for an injunction was needed.

30. Frazier-Lemke Act, ch. 869, 48 Stat. 1289 (1934); Kennedy, *supra* note 29, at 180.

31. 295 U.S. 555 (1935); *see also* note 125 *infra*.

32. 2 COLLIER ON BANKRUPTCY ¶ 362.01(2) (15th ed. L. King 1979); Bankruptcy Act §§ 148, 428, 11 U.S.C. §§ 548, 828 (1976).

33. 2 COLLIER ON BANKRUPTCY ¶ 362.01(2) (15th ed. L. King 1979).

34. *Id.*

35. Coney Island Hotel Corp. v. Van Schaick, 76 F.2d 126, 127 (2d Cir. 1935). *See also* note 24 *supra*.

matic.³⁶

Between 1973 and 1976 eight new rules were added to the Rules of Bankruptcy Procedure in an attempt to fill in the gaps created by the Chandler Act stay provisions.³⁷ One of the major problems with the Act and the rules was that the stay provisions were located in different parts of the Act and each one provided a different rule of application. Confusion also resulted because several of the rules provided for different periods of duration and conflicting prerequisites for gaining relief from the stay.³⁸ For example, Rule 401 provided a stay against enforcement of actions or judgments founded on dischargeable provable debt;³⁹ Rule 601 provided a stay against proceedings to enforce liens against property in the custody of the bankruptcy court and liens against debtor property obtained within four months of bankruptcy by attachment, judgment, levy, or other equitable or legal process or proceedings;⁴⁰ and Rules 13-401, 11-44, 10-601, 12-43, 8-501, and 9-4 each provided a rule of particular applicability to the chapter in which they are contained.

Section 362 of the Bankruptcy Code captures the spirit of a confusing array of provisions under both the old Act and the rules.⁴¹ Section 362 provides extensive procedural and equitable standards for automatic stays upon the filing of a voluntary, joint, or involuntary petition in cases under chapters 7 (liquidations), 9 (adjustments of debts of a municipality), 11 (reorganizations), and 13 (adjustments of debts of an individual with regular income).⁴² Additional specialized stay provisions are contained in the various subchapters to limit or expand the stay provided in section 362.⁴³

36. Chandler Act, chap. 575, 52 Stat. 840 (1938).

37. The Rules of Bankruptcy Procedure were promulgated by the Supreme Court pursuant to 28 U.S.C. § 2075 (1976). Order of Apr. 24, 1973, 411 U.S. 991 (effective Oct. 1, 1973); Order of Mar. 18, 1974, 415 U.S. 1005 (effective July 1, 1974) [hereinafter cited as R. BANKR. P.].

38. See, e.g., R. BANKR. P. 13-401(d) (standing requirement for relief of stay), 8-501 (no expressed standing requirement for relief of stay), 401 (stay continues until bankruptcy case is dismissed or the bankrupt is denied a discharge or waives or otherwise loses his right thereto), 601 (stay shall continue until the bankruptcy case is dismissed or closed, or until the property subject to the lien is, with the approval of the court, set apart as exempt, abandoned, or transferred).

39. R. BANKR. P. 401(a) (1979).

40. R. BANKR. P. 601(a) (1979).

41. 2 COLLIER ON BANKRUPTCY ¶ 362.01 (15th ed. L. King 1979); see Chandler Act §§ 16, 148, 314, 414, 428, 614, 11 U.S.C. §§ 34, 548, 714, 814, 828, 1014 (1976); R. BANKR. P. 401, 601, 13-401, 11-44, 10-601, 12-43, 8-501, 9-4.

42. 11 U.S.C. app. §§ 362, 103(a), 901(a) (Supp. II 1978).

43. See 11 U.S.C. app. §§ 742 (allowing the Securities Investor Protection Corporation to file a protective decree under the Securities Investor Protection Act of 1970 and staying proceedings under chapter 7), 922 (staying proceedings by an officer or inhabitant of the debtor to enforce a claim against the debtor), 1110 (ex-

Upon the filing of a petition in bankruptcy, section 362 stays virtually all court proceedings and collection efforts directed against the debtor. Section 362(b) lists eight exceptions under which a creditor's action is not stayed. The exceptions are: (1) criminal actions or proceedings against the debtor, (2) collection of alimony, maintenance, and support from non-estate property, (3) any act to perfect an interest in property to a limited extent, (4) governmental actions to enforce police or regulatory powers, (5) enforcement of non-money judgments obtained in governmental, police, or regulatory proceedings, (6) set-offs involving mutual debts and claims in certain securities, (7) foreclosure of certain properties by the Secretary of Housing and Urban Development, and (8) issuances of notices of tax deficiency.⁴⁴

Section 362(b) (3) allows the continued perfection of interests in the debtor's property against persons acquiring rights in the property before the date of actual perfection.⁴⁵ This section is limited to situations in which continued perfection is allowed by applicable law.⁴⁶ For example, a state that has adopted Uniform Commercial Code section 9-301(2) can allow a purchase money security interest to relate back and defeat an earlier perfected non-purchase-money security interest if the former is perfected within ten days.⁴⁷ The stay is effective on the date the petition is filed,⁴⁸ and the fact that a person subject to the stay has not received notice and has no knowledge of the filing of the petition does not alter the effectiveness of the stay.⁴⁹ Subsequent to the filing of the petition by the debtor, any action taken by the creditor contrary to the stay is void and without effect unless the stay

empting from stay under particular circumstances parties holding purchase money security interests in certain aircrafts, space parts, and vessels of the United States), 1168 (exempting from stay certain parties with purchase money security interests in railroad rolling stock and equipment), 1301 (staying civil actions against co-debtors on nonbusiness consumer debts) (Supp. II 1978).

44. 11 U.S.C. app. §§ 362(b) (1)-362(b) (8) (Supp. II 1978). The exceptions to the automatic stay do not prevent the possibility that the debtor may obtain an injunction to enjoin creditors exempt from the stay when necessary. *See* HOUSE REPORT, *supra* note 2, at 342. 11 U.S.C. app. § 105(a) (Supp. II 1978) provides that "[t]he bankruptcy court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title."

45. 11 U.S.C. app. §§ 362(b) (3), 546(b) (Supp. II 1978).

46. HOUSE REPORT, *supra* note 2, at 371.

47. *Id.*

48. 11 U.S.C. app. § 362(a) (Supp. II 1978).

49. *In re Ducich*, 3 COLLIER BANKR. CAS. 733, 738 (C.D. Cal. 1974).

itself is annulled.⁵⁰

Another important enhancement of the Code's automatic stay provisions is the court's expanded jurisdiction under 28 U.S.C. § 1481. Under the prior Act, the power of the bankruptcy courts to stay actions on suits was limited to those suits that involved property that was in the actual or constructive possession of the court.⁵¹ The new Code has broadened the jurisdiction of the court to include matters in law, equity, and admiralty.⁵² Thus, the actions of the court can affect property heretofore not within its jurisdiction.⁵³

Once the automatic stay has halted the creditor's suit, the creditor must request relief from the stay in order to foreclose on his lien.⁵⁴ Unless such relief is requested, the stay against actions or suits against property of the estate will remain in force until the property is no longer the property of the estate.⁵⁵ The stay against any other act will continue until the time the case is closed or dismissed or a discharge is granted.⁵⁶ Although the automatic stay does not suspend the statute of limitations period applicable to an action on a claim, a creditor subject to a stay will be allowed only thirty days after notice of termination of the stay in which to commence a suit.⁵⁷

Section 362(d) provides that "on request of a party in interest and after notice and a hearing, the court shall grant relief from the stay . . . by terminating, annulling, modifying, or conditioning the stay."⁵⁸ Under the Act, a proceeding for relief of stay is commenced by the filing of a complaint with the court.⁵⁹ Until the new rules of bankruptcy procedure are promulgated, the old rules

50. *Kalb v. Feuerstein*, 308 U.S. 433 (1940); *Zestee Foods, Inc. v. Phillips Food Corp.*, 536 F.2d 334 (10th Cir. 1976); *but see* 11 U.S.C. app. § 549(c) (Supp. II 1978).

51. 2 COLLIER ON BANKRUPTCY ¶¶ 362.01(1)-362.01(2) (15th ed. L. King 1979).

52. 28 U.S.C. § 1481 (Supp. II 1978); HOUSE REPORT, *supra* note 2, at 448. These powers are limited to the extent that a bankruptcy court may not enjoin another court or punish a criminal contempt not committed in the presence of the judge of the court or warranting a punishment of imprisonment.

53. 1 COLLIER ON BANKRUPTCY ¶ 3.01(2), (5) (15th ed. L. King 1979); 28 U.S.C. §§ 1471, 1478 (Supp. II 1978).

54. 11 U.S.C. app. § 362(d) (Supp. II 1978).

55. 11 U.S.C. app. § 362(c)(1) (Supp. II 1978).

56. 11 U.S.C. app. § 362(c)(2) (Supp. II 1978). *See also* 11 U.S.C. app. § 727(a) (Supp. II 1978) (in a change from prior law, this section does not allow corporations or partnerships a discharge in an attempt to curb the practice of individuals "trafficking in corporate shells and in bankrupt partnerships"); HOUSE REPORT, *supra* note 2, at 384; 11 U.S.C. app. § 524 (Supp. II 1978) (operation of discharge); 11 U.S.C. app. § 524(c)(d) (Supp. II 1978) (in a change from prior law limits the ability of individuals to reaffirm their debts).

57. 11 U.S.C. app. § 108(c) (Supp. II 1978).

58. 11 U.S.C. app. § 362(d) (Supp. II 1978).

59. R. BANKR. P. 401(c), 601(c), 701(b), 703 (1979).

will remain in effect to the extent that they are not inconsistent with the code.⁶⁰ The Southern District of California provides that a request for relief from automatic stay shall be brought by complaint.⁶¹ Upon filing the complaint the clerk of the court will issue a form entitled "Summons and Notice of Request for Relief of Stay."⁶² The summons and complaint must be served on the debtor within three days.⁶³ Although the request for relief of stay is made by complaint the action is really more like a motion.⁶⁴

After the request and complaint for relief from stay have been filed and served on the debtor, the creditor will receive relief from the stay in thirty days, unless the court, after notice and a hearing, orders the stay continued pending a final hearing.⁶⁵ If a final hearing is ordered, it must be commenced within thirty days after the preliminary hearing.⁶⁶ This procedure is an improvement over the relief from stay hearings under the Act. In a proceeding under the Act, the period between filing a complaint for relief from stay and having an adversary trial on that issue was often very long.⁶⁷ This was partly because of the cumbersome compulsory counterclaim provision of the rules.⁶⁸ The House Report helps to expedite the hearing procedure by indicating its intent

60. Bankruptcy Reform Act of 1978, PUB. L. NO. 95-598 § 405(d) (1978).

61. United States Bankruptcy Court, Southern District of California General Order 106, Rule 28 (1979).

62. *Id.*

63. *Id.* Under R. BANKR. P. 704, the complaint must be served within 10 days. The special summons used in the new relief from stay request is only valid for 30 days.

64. United States Bankruptcy Court, Southern District of California form CSD-302 (Dec. 5, 1979). See also R. BANKR. P. 401(c), 601(c), 701(b), 703 (1979). In the case of *In re Groundhog Mountain Corp.*, 4 COLLIER BANKR. CAS. 387 (S.D.N.Y. 1975), Judge Babitt stated that, "Given the reality, what is sought is neither more nor less than an order granting relief from an injunction, a fit aspect of ordinary motion practice and not a plenary suit." See also Smith, *The Secured Creditor's Complaint: Relief from the Automatic Stays in Bankruptcy*, 65 CAL. L. REV. 1216 (1977), where the author favored the promulgation of a motion for relief from stay in the new rules of bankruptcy procedure, no matter what form the commencement of a relief action takes, the legislative history has limited the proceeding to something less than a plenary suit. HOUSE REPORT, *supra* note 2, at 344.

65. 11 U.S.C. app. § 362(e) (Supp. II 1978).

66. 11 U.S.C. app. § 362(e)(2) (Supp. II 1978).

67. See generally Kennedy, *The Automatic Stay in Bankruptcy*, 11 U. MICH. J.L. REF. 177, 229 (1978). See, e.g., *In re Empire Steel Co.*, 228 F. Supp. 316 (D.C. Utah 1964) (over one year).

68. R. BANKR. P. 713 (1979). Under this rule the creditor is required to combine all claims against the bankrupt in one proceeding. These delays were also caused by the court's failure to honor calendar priority afforded to relief from stay actions.

that counterclaims and collateral claims will not be entertained in proceedings commenced under section 362(d).⁶⁹

In Code cases, the preliminary and final hearings will be limited to the issues relevant to whether the factors necessary to prolong the stay have been satisfied.⁷⁰ The question that remains in reorganization cases is whether the limited issues considered in section 362(e) will be expanded when the relief from stay proceedings are held before the debtor's plan is confirmed.⁷¹ Under the Act, there was a chance that the relief from stay action would be heard after the confirmation hearing.⁷² In prior chapter XI cases, the debtor's affirmative action in achieving a confirmation of the plan was a key issue in determining whether restraint would be continued.⁷³

Conversely, under the Code, the shortened period in which relief from stay proceedings must be heard could conceivably push the relief from stay hearing in front of the confirmation hearing.⁷⁴ The wording of the proposed debtor's plan could have a direct impact on the question of whether the secured creditor's property is adequately protected.⁷⁵ Because the confirmation of the debtor's plan is a prerequisite to continuing the stay under section 362(d)(1) and (2),⁷⁶ it would appear that the confirmation issues should be resolved before the relief from stay proceeding is heard.⁷⁷

ADEQUATE PROTECTION VERSUS REALIZATION OF COLLATERAL

The bankruptcy courts represent a legislative attempt to achieve equity between two competing social interests.⁷⁸ The first

69. HOUSE REPORT, *supra* note 2, at 344.

70. *Id.*

71. In a reorganization the debtor submits a payment plan to the court and the creditors. The confirmation of the plan is an order by the court allowing the debtor to rearrange his debts according to the plan.

72. Kennedy, *The Automatic Stay in Bankruptcy*, 11 U. MICH. J.L. REF. 177, 240 (1978).

73. *In re Hamilton Mortgage Corp.*, 13 COLLIER BANKR. CAS. 77, 97 (E.D. Tenn. 1977).

74. See generally notes 72-73 and accompanying text *supra*.

75. See generally 11 U.S.C. app. § 361 (Supp. II 1978) (formal requirements of adequate protection).

76. An issue under this section is whether the property is necessary to an effective reorganization. Logically, this question cannot be completely answered until the actual debtor's plan has been confirmed.

77. Compare the equitable principles of *Lincoln Alliance Bank & Trust Co. v. Dye*, 115 F.2d 234 (2d Cir. 1940) and *In re Hamilton Mortgage Corp.*, 13 COLLIER BANKR. CAS. 77 (E.D. Tenn. 1977) with 11 U.S.C. app. §§ 361-362 (Supp. II 1978) and HOUSE REPORT, *supra* note 2, at 344.

78. See generally *Wright v. Vinton Branch Bank*, 300 U.S. 440 (1937); *Louisville Joint Stock Bank v. Radford*, 295 U.S. 555 (1935).

interest is that a creditor holding a security interest in property should not be deprived of the benefit of his bargain.⁷⁹ The second interest is a combination of economic interests including: the preservation of economic units, jobs, and businesses; the continuation of credit; and the encouragement of the rehabilitation of individual debtors so that the debtors will not need to resort to welfare.⁸⁰ In balancing these competing interests, the courts have decided that contractual rights, even those obtained without undue adhesion, must give way to society's interest in the economic benefits of debtor rehabilitation.⁸¹ This result is consistent with the debtor-oriented approach to automatic stay under both the prior Act and the new Code.⁸²

Section 362(g) provides that at any hearing concerning relief from automatic stay, the party requesting relief from stay will have the initial burden of proof on the issue of whether there is equity in the debtor's property. The party opposing relief from stay will have the burden on all other issues.⁸³ "Equity in the debtor's property" is the value above existing liens that can be realized from the sale of the property for the benefit of unsecured creditors. For example, if the debtor's property is worth \$100,000 and there are \$75,000 in existing liens against the property, \$25,000 is the equity in the property.

The shift to the creditor of the burden of proof on the issue of whether the debtor has equity in the property is one of the features of the Code most favorable to the debtor. Under the Act the creditor initiated the relief from stay proceeding and the debtor generally had the burden of showing cause why the stay should remain in effect.⁸⁴ Lack of debtor equity in the secured property

79. See HOUSE REPORT, *supra* note 2, at 339.

80. See Donnelly, *The New (Proposed?) Bankruptcy Act: The Development of Its Structured Provisions and Their Impact on the Interests of Consumer-Debtors*, 18 SANTA CLARA L. REV. 291, 317 (1978).

81. See generally *In re Groundhog Mountain Corp.*, 4 COLLIER BANKR. CAS. 387, 392 (S.D.N.Y. 1975) (contract rights must give way to purpose of chapter XI); Miller, *The Automatic Stay in Chapter XI Cases—A Catalyst for Rehabilitation or an Abuse of Creditors' Rights?*, 94 BANKING L.J. 676, 678 (1977). See also *G.M. Leasing Corp. v. United States*, 429 U.S. 338, 351 (1977).

82. See generally Note, *Automatic Stay—Chapter XI Rule 11-44: Rationale, Application, Implication*, 12 SUFFOLK U.L. REV. 891, 927 (1978).

83. 11 U.S.C. app. § 362(g) (Supp. II 1978).

84. See *In re Jenifer Mall Corp.*, 2 COLLIER BANKR. CAS. 657 (D.D.C. 1974); *In re American Kitchen Foods, Inc.*, 2 BANKR. CT. DEC. 715 (N.D. Me. 1976). See also *In re Zekendorf*, 326 F. Supp. 182 (S.D.N.Y. 1971), where the court overruled the bankruptcy referee for placing the burden of proof on the creditor.

is probably the most significant factor favoring the granting of relief from stay. A greater problem exists for creditors who hold security in assets that are not easily valued. In some large cases a proper valuation might take more than 30 days to complete. The creditor will need to be adequately prepared if he is to meet his burden of proof within the time constraints of section 362(e). Thus, the Code places a significant roadblock in the creditor's quest for relief from stay. Where the debtor has enjoyed the use of value advanced to him by the creditor, placing the major burden upon the creditor does not appear to be consistent with the general equitable principles inherent in bankruptcy law.⁸⁵

The secured creditor is usually interested in reclaiming his collateral as soon as possible, unless the claim is undersecured and will be maximized by submitting to the rehabilitation plan of the debtor.⁸⁶ Reclaiming collateral is, of course, dependent on the creditor obtaining relief from the stay. The Code provides alternate grounds for relief of stay. Relief shall be granted "for cause," including the lack of "adequate protection" of an interest in property of such party in interest,⁸⁷ or, with respect to a stay of an action against property, relief shall be granted if the debtor does not have "equity in the property" and such property is "not necessary to an effective reorganization."⁸⁸ The statutory term "for cause" expressly includes the concept of "lack of adequate protection," but the legislative history indicates that this is not the only cause.⁸⁹ The facts of each request for relief from stay will determine whether relief is appropriate under the circumstances.⁹⁰

Under the Act the term "for cause" was the key to the court's discretionary power to grant relief from the stay.⁹¹ Likewise, the term "adequate protection" was derived from case law prior to the enactment of the Code.⁹² It is probable that the prior case law developed in confirmation cases will add little meaning to the

85. See generally note 19 and accompanying text *supra*. Furthermore, the added burden is especially inconsistent with cases in which a reorganization is utilized as a means to effectuate a court supervised liquidation plan. See *In re Penn Petroleum Co.*, 188 F.2d 851 (2d Cir. 1951), which theorized that chapter XI was not a proper means for effecting a protracted liquidation under the Act; and *In re Red Carpet Corp.*, 11 COLLIER BANKR. CAS. 487 (N.D. Fla. 1976), where the court released the automatic stay partly because the plan was none other than an orderly liquidation to pay unsecured creditors outside an ordinary bankruptcy proceeding.

86. Webster, *Collateral Control Decisions in Chapter Cases: Clean Rules v. Judicial Discretion*, 51 AM. BANKR. L.J. 197, 201 (1977).

87. 11 U.S.C. app. § 362(d)(1) (Supp. II 1978).

88. 11 U.S.C. app. § 362(d)(2)(A)-(B) (Supp. II 1978).

89. HOUSE REPORT, *supra* note 2, at 343-44.

90. *Id.*

91. R. BANKR. P. 401(d), 601(d), 8-501(c), 9-4(c), 10-601(c), 11-44(d), 12-43(d), 13-401(d) (1979).

92. COLLIER ON BANKRUPTCY ¶ 361.01(1) (15th ed. L. King 1979).

terms as used in the Code.⁹³ The prior case law does, however, illustrate general equitable principles that may be considered by the courts in the future.⁹⁴ The Code is young and lacks judicial definition. The judges of the bankruptcy courts, therefore, must lay the groundwork for future case interpretation.⁹⁵

In relief from automatic stay and injunction cases under the Act, the approaches of the different judicial circuits range from hard and fast rules to wide-open judicial discretion.⁹⁶ In liquidation cases the general rule under the Act was that the stay would be dissolved if the court determined that there was no equity beyond the secured creditor's interest in the debtor's property which could be realized for the benefit of the estate.⁹⁷ If there was a dispute as to the validity of the creditor's lien, the stay was usually continued as a protection against loss of, or injury to, the interest of the debtor's estate in the property.⁹⁸

A concern for possible rehabilitation of the debtor led to more intricate rules in reorganization cases under the Act. In some reorganization cases the debtor had to show that there was equity in the property subject to the security interest; that the security was not in jeopardy because of the delay necessarily caused by the restraining order; that the possibility of an arrangement between a debtor and his unsecured interest was essential to the operation of the debtor's business; and that without a continua-

93. Collier states "that while prior cases may offer some guidance it is more likely that the courts will turn to prior cases under the Act which dealt with the matter at hand, that is stays of creditor action, use, sale, or lease of property and the obtaining of credit, than to be guided by confirmation cases." *Id.*

94. HOUSE REPORT, *supra* note 2, at 339, where in speaking on the subject of adequate protection the legislature opined that the courts would be expected to apply the concept in light of the facts in each case and general equitable principles.

95. HOUSE REPORT, *supra* note 2, at 339 (matters are left to case-by-case interpretation). Locally there is concern about whether the relatively small bankruptcy bar will be overly influenced by writers and seminar leaders. See Trost, *Business Reorganizations Under Chapter 11 of the New Bankruptcy Code*, 34 BUS. LAW. 1309 (1979), in which the author acknowledges Kenneth N. Klee, associate counsel to the House Judiciary Committee, who was one of the principal draftsmen of the new Bankruptcy Code. "Mr. Klee's insight into what the draftsmen 'intended' was pointedly and frequently expressed to the author and occasionally his views influenced the text." *Id.* at 1309.

96. Webster, *Collateral Control Decisions in Chapter Cases: Clear Rules v. Judicial Discretion*, 51 AM. BANKR. L.J. 197 (1977).

97. *In re Haupt & Co.*, 398 F.2d 607 (2nd Cir. 1968).

98. See Kennedy, *The Automatic Stay in Bankruptcy*, 11 U. MICH. J.L. REF. 177, 234 (1978).

tion of the stay the debtor could not consummate the arrangement and the arrangement would be defeated.⁹⁹ Another set of rules, developed for reorganization cases, questioned whether an injunction was necessary to preserve the debtor's estate or carry out the plan, whether the injunction would impair the security of the lien, and whether the owner of the secured indebtedness would be required to accept less than the full periodic payments specified in his contract.¹⁰⁰ Even though in theory these rules balanced the equities in each case, in application the court often looked more at whether there was equity in the property than at anything else.¹⁰¹ Where there was equity in the property to be realized for the benefit of unsecured creditors, courts usually denied relief on that basis alone.¹⁰²

The case of *In re Lax Enterprises*¹⁰³ illustrates the equitable balancing process which some courts used under the Act. In *Lax* the debtor filed a petition for reorganization under chapter XI of the Act. The secured assets in question were a motel, real estate, fixtures, and furniture. By utilizing dollar valuations based on several standard accounting theories, the court found that there was equity in the property. In determining whether the motel business would improve in the future, the court also considered that the Akron area had been affected by the oil embargo, rapid increases in utility rates, the economic recession's effect on travel, high unemployment, and a five month rubber strike. Utilizing policy considerations¹⁰⁴ as a yardstick, the court balanced the debtor's need to use the property, the possible loss of equity in the security in the near future, and the efforts of the debtor to effectively increase occupancy of the motel. The court allowed the creditor to prosecute the foreclosure action to judgment and continued the injunction against execution of the judgment. How-

99. *In re O.K. Motels*, 1 COLLIER BANKR. CAS. 416 (M.D. Fla. 1974).

100. *Hallenbeck v. Penn Mutual Life Ins. Co.*, 323 F.2d 566, 576 (4th Cir. 1963).

101. See Anderson, *Secured Creditors: Their Rights and Remedies Under Chapter XI of the Bankruptcy Act*, 36 LA. L. REV. 1, 15 (1976); Peitzman & Smith, *The Secured Creditor's Complaint: Relief From Automatic Stays In Bankruptcy Proceedings*, 65 CALIF. L. REV. 1216, 1228 (1977).

102. *In re Atlantic Steel Prod. Corp.*, 31 F. Supp. 408 (E.D.N.Y. 1939).

103. 11 COLLIER BANKR. CAS. 628 (N.D. Ohio 1976).

104. "Some of the criteria which might determine whether or not to continue a stay against enforcement of the lien are the relative amount of the debtor's equity in the property or the potential of substantial injury to the secured creditor by loss, destruction or severe diminution of value of the property, or the debtor's need for the property in effecting the plan with its unsecured creditors or whether or not insisting upon performance by the debtor will substantially inhibit the successful course of the Chapter XI case."

Id. at 362.

ever, the debtor was required to submit monthly financial reports to the court for future evaluation and action.

Other case law concepts should be of value to the creditor arguing for relief from the stay. For example, the concepts of "lack of equity" and "necessity of property for an effective reorganization" are clearly carried over from prior case law into the Code's alternative provisions for relief in cases involving acts against property.¹⁰⁵ A non-Code concept that may be argued is the "balance-of-hurt" test.¹⁰⁶ The balance-of-hurt test, as the name suggests, allows the parties to demonstrate how they are being damaged by either continuation of, or relief from, the stay.¹⁰⁷ In *C.I. Mortgage Group v. Nevada Towers Associates*,¹⁰⁸ the court concluded that the possibility of the debtor's successful rehabilitation alone did not mandate the continuation of the stay. The court also considered whether continuation of the stay would cause the creditor immediate and irreparable harm.¹⁰⁹ Because the bankruptcy court is basically a court of equity, with a purpose of avoiding injustice and unfairness,¹¹⁰ the debtor should be able to air almost any grievance under the balance-of-hurt concept. Nevertheless, the overriding deference of bankruptcy courts toward debtor rehabilitation will increase the burden on the creditor to demonstrate significant harm in order to show cause for relief from stay.¹¹¹

Under section 362(d) lack of "adequate protection" of a secured interest is cause for granting relief from stay to a creditor. "Ade-

105. Compare *In re Lax*, 11 COLLIER BANKR. CAS. 628 (N.D. Ohio 1976) with 11 U.S.C. app. § 362(d)(1)-(2) (Supp. II 1978) (relief shall be granted if the debtor does not have equity in the property and the property is not needed for an effective reorganization).

106. See, e.g., *In re Groundhog Mountain Corp.*, 4 COLLIER BANKR. CAS. 387 (S.D.N.Y. 1975) (the "balance of hurt" suggests that the plaintiff be permitted to proceed); *In re Consolidated Motor Inns*, 6 COLLIER BANKR. CAS. 18, 31 (N.D. Ga. 1975).

107. *In re Groundhog Mountain Corp.*, 4 COLLIER BANKR. CAS. 387 (S.D.N.Y. 1975); *In re Consolidated Motor Inns*, 6 COLLIER BANKR. CAS. 18, 31 (N.D. Ga. 1975).

108. 14 COLLIER BANKR. CAS. 146, 153 (S.D.N.Y. 1977).

109. *Id.*

110. *In re Victor Builders, Inc.*, 418 F.2d 880, 882 (9th Cir. 1969).

111. See *Chaplan v. Anderson*, 256 F.2d 416 (5th Cir. 1958) (primary concern in chapter XI is whether continuation of the stay will lead to material harm); *C.I. Mortgage Group v. Nevada Associates*, 14 COLLIER BANKR. CAS. 146 (S.D.N.Y. 1977) (where the mortgagee would not be seriously harmed by continuation of the stay, the debtor's rehabilitation should proceed); HOUSE REPORT, *supra* note 2, at 116-21 (the new chapter 13 should be encouraged to protect consumer debtors against aggressive sales and advertising techniques by consumer creditors).

quate protection" is a term of art under the Code. However, little is known about what adequate protection is or will be. The legislative history indicates that the concept of adequate protection is left to the courts for interpretation and development on a case by case basis.¹¹² What is known is that adequate protection is mandatory when requested by a party in interest,¹¹³ and that lack of adequate protection is cause for terminating, annulling, modifying, or conditioning the stay.¹¹⁴ Also known is that adequate protection is not achieved by merely entitling a creditor to receive an administrative priority,¹¹⁵ and that adequate protection is probably not payment ten years in the future.¹¹⁶ A more precise definition of adequate protection must be developed on a case by case basis.

The phrase adequate protection originated in chapter X reorganization cases under the Act.¹¹⁷ Adequate protection for the realization of value in property dealt with by a reorganization plan was required when the plan was confirmed over the dissent of a secured creditor.¹¹⁸ The concept of adequate protection is derived from the fifth amendment protection of property interests.¹¹⁹ However, the concept is equally dependent on policy considerations.¹²⁰

In 1935 the case of *Louisville Joint Stock Land Bank v. Radford*¹²¹ listed five substantive rights protected by the fifth amendment. In that case the Court held that the Frazier-Lemke Act deprived the secured creditor of:

1. The right to retain a lien until the indebtedness thereby secured is paid.
2. The right to realize upon the security by a judicial public sale.
3. The right to determine when such sale shall be held, subject only to the discretion of the court.
4. The right to protect its interest in the property by bidding at such sale whenever held, and thus to assure having the mortgaged property devoted primarily to the satisfaction of the debt, either through receipt of the proceeds of a fair competitive sale or by taking the property itself.
5. The right to control meanwhile the property during the period of default, subject only to the discretion of the court, and to have the rents

112. HOUSE REPORT, *supra* note 2, at 339.

113. HOUSE REPORT, *supra* note 2, at 338, 342.

114. 11 U.S.C. app. § 362(d)(1) (Supp. II 1978).

115. 11 U.S.C. app. § 361(3) (Supp. II 1978).

116. *In re Murel Holding Corp.*, 75 F.2d 941 (2d Cir. 1935) (adequate protection must be completely compensatory, payment in ten years is not the same thing).

117. 2 COLLIER ON BANKRUPTCY ¶ 361.01(1) (15th ed. L. King 1979).

118. *Id.* (Forced confirmation of the debtor's plan is commonly known as "cram down").

119. HOUSE REPORT, *supra* note 2, at 339.

120. *Id.*

121. 295 U.S. 555, 594 (1935).

and profits collected by a receiver for the satisfaction of the debt.¹²²

Congress then amended the Act, and three years later the Supreme Court in *Wright v. Vinton Branch Bank*¹²³ reviewed a portion of the amended Frazier-Lemke Act and found it constitutional. The new provisions impaired at least two of the five protected rights, but the Court held that mere impairment of rights by the use of an automatic stay is not the equivalent of a deprivation of due process.¹²⁴ Although *Radford* has been limited by subsequent cases,¹²⁵ the right to retain liens until paid in full is still a factor in the new chapter 13 cramdown provision.¹²⁶

The first step in discerning whether the creditor's interest is adequately protected is to determine the value of the secured creditor's interest. This value is the amount of debt plus any interest and expenses that would normally be added thereto.¹²⁷ The creditor's right to adequate protection is limited to the lesser of the value of the collateral or the amount of the secured claim.¹²⁸ Under the Constitution there is no right to demand an excess of collateral value over the amount of the creditor's claim, but maintaining a margin of security may well be a means of adequate protection.¹²⁹

Adequate protection will not necessarily be provided by the

122. *Id.* These rights were guaranteed by the laws of the State of Kentucky. The Court went on to find the Frazier-Lemke Act unconstitutional because the automatic unconsented-to surrender of the property to the bankrupt amounted to a taking without eminent domain.

123. 300 U.S. 440 (1937).

124. *Id.* The major revisions of the Act preserved rights 1, 2, and 4 and left 3 and 5 impaired. The stay under the new Act was not absolute, in terms of length, and could be terminated earlier than the three years maximum prescribed in the Act. See note 122 and accompanying text *supra*.

125. 2 COLLIER ON BANKRUPTCY ¶ 362.01(1) (15th ed. L. King 1979).

126. 11 U.S.C. app. § 1325(a)(5) (Supp. II 1978) provides that the court shall confirm a plan if "[w]ith respect to each allowed secured claim provided by the plan—(A) the holder of such claim has accepted the plan; (B) (i) the plan provides that the holder of each such claim retain the lien securing such claim; and (ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; or (C) the debtor surrenders the property securing such claim to holder; and (D) the debtor will be able to make all payments under the plan and to comply with the plan."

127. Levit, *Use and Disposition of Property Under Chapter 11 of the Bankruptcy Code: Some Practical Concerns*, 53 AM. BANKR. L.J. 275, 287 (1979).

128. Webster, *Collateral Control Decisions in Chapter Cases: Clear Rules v. Judicial Discretion*, 51 AM. BANKR. L.J. 197, 234 (1977).

129. 2 COLLIER ON BANKRUPTCY ¶ 362.01(1) (15 ed. L. King 1979).

courts.¹³⁰ Instead, the trustee or debtor will provide or propose a method of protection.¹³¹ If the secured party objects, the court will then step in and determine whether the chosen method provides adequate protection.¹³²

Section 361 of the Code attempts to define the parameters of adequate protection by illustrating three non-exclusive methods.¹³³ The first method of providing adequate protection is to require the trustee to make periodic cash payments to the extent that a stay, use, sale, lease, or grant of lien results in a decrease in the value of the creditor's interest in the property.¹³⁴ In situations involving the use, sale, or lease of collateral under section 363(e), adequate protection may be provided by periodic cash payments to the creditor under section 361(1). However, this protection may be limited to use, sale, or lease by the trustee.¹³⁵ Adequate protection for use by the debtor could still be demanded under the relief from automatic stay provisions if the use decreases the value of the creditor's lien.¹³⁶

At the time of this writing the only reported case to consider adequate protection under the Code is *In re Lum*.¹³⁷ There the court considered the continued use of a car by the debtor, with a reduction in car payments, in a chapter 13 rehabilitation. The creditor argued that the proposed installment payments would not be the equivalent of the present cash value of the car. The court applied the law under the prior Act and determined the value of the car as of the effective date of the plan. The creditor was allowed ten percent interest per annum on the unpaid balance of its \$5,000 secured claim, with the balance of the claim allowed as unsecured. The actual holding of the court was that the creditor was "adequately protected" because the debtor's monthly payments exceeded the monthly depreciation of the car.¹³⁸ This holding is in accordance with prior decisions regard-

130. HOUSE REPORT, *supra* note 2, at 338.

131. *Id.*

132. *Id.*

133. 11 U.S.C. app. § 361 (Supp. II 1978).

134. 11 U.S.C. app. § 361(1) (Supp. II 1978).

135. 11 U.S.C. app. § 363(e) (Supp. II 1978) (limits request of adequate protection limited to use, sale, lease, or proposed use, sale or lease of trustee.).

136. 11 U.S.C. app. § 362(d) (Supp. II 1978) (any party in interest may request adequate protection).

137. BANKR. L. REP. (CCH) ¶ 67,254 (1979).

138. The legislative history also provides that "periodic payments may be appropriate where the property in question is depreciating at a relatively fixed rate. The periodic payments would be to compensate for the depreciation." HOUSE REPORT, *supra* note 2, at 339.

ing periodic payments.¹³⁹

Legislative history indicates that the periodic cash payment method was derived from *In re Yale Express, Inc.*¹⁴⁰ The *Yale Express* case actually conflicts with the goals of the periodic payment method. The case does recognize periodic payments made to the creditor by the debtor as a method of protecting creditors against depreciation, but adds the proviso that full periodic payments need not be made to all secured creditors if such payments would endanger the reorganization.¹⁴¹ The *Yale Express* rationale could still be viable if it is applied in combination with an additional method of adequate protection.

The second suggested method would provide adequate protection by granting an additional or replacement lien to the extent that the stay, use, sale, lease, or grant results in a decrease in the value of the creditor's interest in the property.¹⁴² The purpose of this method is to provide the protected entity with a means of realizing the value of the original property, in cases in which the value of the property declines while the case is pending, by granting the creditor an interest in additional property of the debtor.¹⁴³

The third method provides for the granting of other relief which would result in the realization by the creditor of the "indubitable equivalent" of the creditor's interest in the property.¹⁴⁴ This method gives the parties and the courts flexibility to adopt new methods of financing and create new protections for the creditor if no other methods would yield the desired results.¹⁴⁵ The phrase "indubitable equivalent" originated in the case of *In re Murel Holding Corp.*¹⁴⁶ In that case the court reasoned that although creditors' consent to rehabilitation plans should be ob-

139. See, e.g., *In re Bermec Corp.*, 445 F.2d 367 (2d Cir. 1971); *In re Gelormino Construction Co.*, 2 BANKR. CT. DEC. 39 (W.D. Pa. 1975).

140. HOUSE REPORT, *supra* note 2, at 339; *In re Yale Express, Inc.*, 384 F.2d 990 (2d Cir. 1967).

141. 384 F.2d 990, 992 (2d Cir. 1967). The court declared that any deficiency between the payment and the actual depreciation could be made up by granting the creditor an administrative priority. The idea of giving an administrative priority though has been expressly disapproved by section 361(3).

142. 11 U.S.C. app. § 361(2) (Supp. II 1978).

143. HOUSE REPORT, *supra* note 2, at 339-40. See also *In re American Kitchen Foods, Inc.*, 9 COLLIER BANKR. CAS. 436 (N.D. Me. 1976) where to the extent of use of prepetition collateral the creditor was given a secured claim against all assets of the debtor.

144. 11 U.S.C. app. § 361(3) (Supp. II 1978).

145. HOUSE REPORT, *supra* note 2, at 340.

146. 75 F.2d 941 (2d Cir. 1935).

tained, if the plan was confirmed without it, the plan must provide adequate protection for the realization by the creditors of the full value of their interest, claims, or liens.¹⁴⁷ The court envisioned adequate protection being met in four ways: (1) the liens may be kept in status quo with the reorganization limited to the equity, (2) the property may be sold free and clear and the liens attached to the proceeds, (3) the value of the liens may be appraised and paid, and (4) the judge is given the power to provide equitably and fairly such protection as is needed when the other methods are not chosen.¹⁴⁸ These requirements insure that the secured creditor will not be subordinated to junior interests unless by a substitute interest of the most indubitable equivalence.¹⁴⁹

The indubitable equivalent alternative is broad and should promote innovative equitable solutions. One authority has stated that "[t]he last alternative should be applied narrowly in a manner consistent with the stand of the *Murel* case bearing in mind that a mere indubitable equivalent is demanded rather than the *most* indubitable equivalence."¹⁵⁰ While the first and second methods may be fraught with collateral valuation problems,¹⁵¹ the third method will adapt to the circumstances of each case, not binding the courts with hard and fast rules.¹⁵²

Although the Code expressly provides for adequate protection of the value of the secured party's interest, it fails to protect the creditor's bargained-for cash flow. General indications are that where the secured collateral is appreciating in value, the passage

147. *Id.* at 942.

148. *Id.*

149. *Id.*

150. 2 COLLIER ON BANKRUPTCY ¶ 361.01(4) (15th ed. L. King 1979).

151. The time and method of valuing the collateral, for adequate protection purposes, is not prescribed by the Code or the legislative history. Apparently this question was left open to allow the courts to apply the concept in light of the facts in each case with general equitable principles. HOUSE REPORT, *supra* note 2, at 339. The Commission on Bankruptcy Laws recommended that adequate protection be measured by the liquidation value of the collateral as of the date of the petition. This recommendation would have protected the creditor more, in that liquidation valuation historically is lower than valuation made as a going concern. The legislature, however, rejected the recommendation in favor of the vague language of section 361. See Trost, *Business Reorganizations Under Chapter 11 of the New Bankruptcy Code*, 34 BUS. LAW. 1309 (1979).

152. The creditor faces other dilemmas in declaring valuation on the collateral. If the creditor asserts a high collateral valuation he runs the risk that the court will find adequate protection without providing any additional protection. Conversely, a low collateral valuation may not be believed, and can lead to unexpected results. 2 COLLIER ON BANKRUPTCY ¶ 361.02 (15th ed. L. King 1979). One of the most pressing problems is how to determine the value of the collateral over time. In *McGill v. Commercial Credit Co.*, 243 F. 637, 647 (D. Md. 1917), Judge Rose stated that "the effort is to find out . . . what a purely imaginary buyer will pay a make-believe seller, under circumstances which do not exist." See also HOUSE REPORT, *supra* note 2, at 339.

of time alone constitutes adequate protection. However, the creditor may be able to use the third method to show extreme hardship or other "balance of hurt" in order to secure cash flow as the indubitable equivalent of his bargained-for interest. The creditor's failure to demand adequate protection persuasively could result in delaying payment for up to ten years after the filing of the petition.¹⁵³ As chapter 13 filings increase, the creditor may soon come to expect delay in payments of up to five years.¹⁵⁴

The actual combinations of possible arguments by the creditor in relief from stay actions are limited only by the creditor's imagination. Arguments which can be made are: (a) the anticipated decrease in value of the interest should be measured by projecting the ultimate liquidation value at a distress sale,¹⁵⁵ (b) the prolonged period of the stay will adversely affect the security or business,¹⁵⁶ (c) the rehabilitation plan of the debtor could never work,¹⁵⁷ (d) the rehabilitation plan could only work on the happening of a remote contingency,¹⁵⁸ (e) the alternatives to current full payment are not completely compensatory,¹⁵⁹ and (f) the *means* by which the debtor brought about his financial problems are considered socially deplorable.¹⁶⁰ No matter what argument the creditor uses, it can be anticipated that the bankruptcy system will balance the equitable scale squarely against the creditor seeking immediate realization of the collateral. If on a first attempt the creditor is unable to gain satisfaction, he may try again at a later date, because property value is subject to change during pendency of the case.¹⁶¹ The creditor should also be aware that, if

153. *Compare In re Murel Corp.*, 75 F.2d 941 (2d Cir. 1935) (payment in 10 years is not indubitable equivalent of current foreclosure on property) *with* 11 U.S.C. app. § 1322(c) (Supp. II 1978) (chapter 13 plan cannot provide for payments exceeding five years) *and* 11 U.S.C. app. § 1129 (Supp. II 1978) (chapter 11 only limits plan to six years for certain governmental priority claims).

154. *Compare* 11 U.S.C. app. § 1322(c) (Supp. II 1978) *with* Di Pietro, *Unlucky Number for the Uninformed Lawyer*, 53 CONN. B.J. 176 (1979) (where the author suggested that in the future it might well be malpractice not to run a consumer debtor through a rehabilitation plan).

155. *See also* Levit, *Use and Disposition of Property Under Chapter 11 of the Bankruptcy Code: Some Practical Concerns*, 53 AM. BANKR. L.J. 275 (1979).

156. *See also In re Bermec*, 445 F.2d 367 (2d Cir. 1971).

157. *See also In re Empire Steel Co.*, 228 F. Supp. 316 (D. Utah 1964).

158. *See also In re Jenifer Mall Corp.*, 2 COLLIER BANKR. CAS. 657 (D. D.C. 1974).

159. *See also In re Murel Corp.*, 75 F.2d 941 (2d Cir. 1935).

160. *See also In re Thompson*, 475 F.2d 1217 (5th Cir. 1973) (court may consider how debtor got into trouble).

161. Kennedy, *The Automatic Stay in Bankruptcy*, 11 U. MICH. J.L. REF. 177, 246 (1978).

he is harmed by the implementation of adequate protection by the trustee, he will be given priority to all other unsecured claims to the extent the debt becomes unsecured.¹⁶²

CONCLUSION

The Bankruptcy Reform Act of 1978 gives the American bankruptcy system an opportunity for a fresh start. The vague terms of the automatic stay provisions and the congressional intention to allow case-by-case development of the new provisions will allow the Code to adapt equitably to almost any factual situation. Court decisions over the next few years will set the trend for what a secured creditor can expect when his security interest remedy is stayed in bankruptcy.

The new Code offers a comprehensive improvement over the Act by consolidating the provisions for automatic stay into one section. The provisions for expedited relief from stay hearings allow the secured creditor to move quickly to obtain relief from stay. However, the shift in the initial burden of proof on the issue of equity in the property appears to place an inequitable burden on the secured creditor. Unless the creditor can show that there is no equity in the debtor's property, he may not get a chance to argue the issue of adequate protection. Having only thirty days to value the debtor's property may also prove to be an undue burden on a creditor who has a security interest in property that is difficult to value.

The creditor must be careful to use the proper forms and be mindful of the special service of summons requirements. Failure to abide by the special requirements prevents the court from having jurisdiction to hear the creditor's request, resulting in a loss of both time and money.

The terms "for cause" and "adequate protection" are in need of refinement and reliable definition. At present, a secured creditor can only guess whether the transaction he enters into today will afford him the security and guaranteed payment that he bargained for.

In the future the courts should fashion remedies that are equitable. The new Code, even with adequate protection, can result in inequitable treatment of secured creditors. While the Code and the concept of bankruptcy seek to foster many important social goals, it would be improvident to require the secured creditor to carry the burden of every debtor's rehabilitation effort. If the spirit of equity is truly the habit of fairness and justness and ren-

162. 11 U.S.C. app. § 507(b) (Supp. II 1978).

dering to every man his due, the concepts of bankruptcy and automatic stay have a long way to evolve.

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