RECENT DEVELOPMENTS IN ADEQUATE PROTECTION UNDER SECTION 361

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I. The Context for Adequate Protection

"Adequate protection" is a term that is used numerous times in the Bankruptcy Code but is not explicitly defined.[1] Adequate protection is introduced in section 361 of the Bankruptcy Code and arises in relation to: (1) the automatic stay (section 362); (2) the use, sale or lease of property (section 363); and (3) priming liens in postpetition financing (section 364).[2]

A. Code Provisions Referencing "Adequate Protection"

1. *Section 362—Adequate Protection for Imposition of the Automatic Stay*

Section 362 of the Bankruptcy Code institutes the automatic stay, which prevents creditors from unilaterally taking any action with respect to estate property during bankruptcy proceedings.[3] However, section 362 provides that on "request of a party in interest and after notice and a hearing, the court shall grant relief from the stay . . . for cause, including the lack of *adequate protection* of an interest in property of such party in interest . . .."[4] In the context of adequate protection, a creditor seeking relief from the automatic stay must make a prima facie

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[1]*See*, *e.g.*, *In re Van Horn*, 2011 WL 1900324, *4 (Bankr. M.D. Pa. 2011) (citing *In re Adams*, 27 B.R. 582, 584, 8 Collier Bankr. Cas. 2d (MB) 843, Bankr. L. Rep. (CCH) P 69118 (D. Del. 1983)).

[2]11 U.S.C. §§ 361 to 364.

[3]11 U.S.C. § 362.

[4]11 U.S.C. § 362(d)(1) (emphasis added).

showing that its interest is not adequately protected and, if it makes such a showing, the burden of proof shifts to the debtor.[5]

2. *Section 363—Adequate Protection for the Use, Sale or Lease of Property*

Section 363 of the Bankruptcy Code provides that "on request of an entity that has an interest in property used, sold, or leased, or proposed to be used, sold, or leased, by the [debtor], the court, with or without a hearing, shall prohibit or condition such use, sale, or lease as is necessary to provide *adequate protection* of such interest."[6] Where the debtor seeks such authority under section 363, the debtor has the initial burden of proof on all issues except its equity value.[7]

3. *Section 364—Adequate Protection for Priming Liens in Postpetition Financing*

Section 364(d) of the Bankruptcy Code provides that the "court, after notice and a hearing, may authorize the obtaining of credit or the incurring of debt secured by a senior or equal lien on property of the estate that is subject to a lien only if (A) the trustee is unable to obtain such credit otherwise; and (B) there is *adequate protection* of the interest of the holder of the lien on property of the estate on which such senior or equal lien is proposed to be

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[5]*See*, *e.g.*, *In re Sonnax Industries, Inc.*, 907 F.2d 1280, 1285, 23 Collier Bankr. Cas. 2d (MB) 132 (2d Cir. 1990); *In re RNI Wind Down Corp.*, 348 B.R. 286, 299, 46 Bankr. Ct. Dec. (CRR) 275 (Bankr. D. Del. 2006), subsequently aff'd, 359 Fed. Appx. 352 (3d Cir. 2010); see generally, Patrick Jackson, Bulletproofing the Secured Creditor's Prima Facie Case for Stay Relief for Lack of Adequate Protection in Chapter 11, 27-7 ABIJ 18 (Sept. 2008).

[6]11 U.S.C. § 363(e) (emphasis added). With respect to a debtor's cash assets that constitute collateral, the Bankruptcy Code conditions the debtor's use of cash collateral on either (i) consent of the secured creditor or (ii) court authorization after notice and a hearing. 11 U.S.C. § 363(c)(2). Absent specific challenge by a creditor, the debtor is not obligated to provide adequate protection for the use of non-cash collateral in the ordinary course of business. 11 U.S.C. § 363(c)(1). In either case, the debtor has the burden of proof to show that a secured creditor is adequately protected. Although proof by a preponderance of the evidence is the norm in a Chapter 11 proceeding, a few courts have required proof that the creditor is adequately protected by clear and convincing evidence. *See In re O.P. Held, Inc.*, 74 B.R. 777, 784 (Bankr. N.D. N.Y. 1987); *In re Leavell*, 56 B.R. 11 (Bankr. S.D. Ill. 1985); *In re Sheehan*, 38 B.R. 859, 11 Bankr. Ct. Dec. (CRR) 835 (Bankr. D. S.D. 1984).

[7]*See*, *e.g.*, *In re Hart-Sahara, LLC*, 2010 Bankr. LEXIS 5379, at *4 (Bankr. D. Nev. Mar. 17, 2010).

granted."[8] Under section 364, the debtor has the burden of proof on the issue of adequate protection.[9]

4. *Other Code Provisions Implicating Adequate Protection and Section 361*

Section 361 of the Bankruptcy Code cites to sections 362, 363 and 364 because they incorporate the term "adequate protection." However, there are a number of other sections not mentioned in section 361 which also incorporate the term "adequate protection" or for which section 361 is illustrative. Those sections include section 507(b), which provides an administrative expense claim when adequate protection proves to be inadequate.[10] Also, adequate protection may be required in connection with turnover of property to the estate under section 542.[11] The legislative history of section 361 states that it applies to section 1111(b), which in certain circumstances gives an undersecured creditor the option of having its claim deemed entirely allowed or disallowed as though it were completely secured.[12] Further, section 1205 governs adequate protection in Chapter 12 cases, excluding the "indubitable equivalent" concept and clarifying that the value of property, not the value of the creditor's "interest" in property, is what must be protected.[13] Section 1325(a)(5) states that a Chapter 13 plan must propose sufficient payments to the holder of an allowed claim secured by personal property to provide adequate protection.[14] Additionally, section 1326(a)(1)(C) requires a Chapter 13 debtor to make payments providing adequate protection to the holder of an allowed claim secured by personal prop-

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[8] 11 U.S.C. § 364(d) (emphasis added).

[9] 11 U.S.C. § 364(d)(2).

[10] 11 U.S.C. § 507(b).

[11] 11 U.S.C. § 542. Courts are split as to whether a creditor must be provided with adequate protection prior to enforcing turnover under section 542. *Compare In re Young*, 193 B.R. 620, 625 (Bankr. D. D.C. 1996) ("[T]he creditor should be entitled to hold onto the property during the pendency of the § 542 action until the adequate protection question is resolved."), *with In re Rutherford*, 329 B.R. 886, 893 (Bankr. N.D. Ga. 2005) (rejecting idea that a secured creditor's right to adequate protection trumps the duty to turn over estate property, because such a result would be contrary to statutory language and congressional intent).

[12] 11 U.S.C. § 1111(b); 124 Cong. Rec. 32,395 (1978) (stating that an undersecured creditor that makes an section 1111(b) election "is entitled to adequate protection of the creditor's interest in property to the extent of the value of the collateral not to the extent of the creditor's allowed secured claim, which is inflated to cover a deficiency as a result of such election.").

[13] 11 U.S.C. § 1205.

[14] 11 U.S.C. § 1325(a)(5).

erty before a Chapter 13 plan can be confirmed, unless the court orders otherwise.[15]

B. Adequate Protection Protects a Secured Creditor's Collateral

The right to adequate protection arises from the Fifth Amendment's property interest protections.[16] As one court recently explained, "[t]he purpose of adequate protection is to guard the secured creditors' interest from a decline in the value of the collateralized property."[17] In other words, the purpose of providing adequate protection is to insure "as nearly as possible under the circumstances of the case" that a secured creditor is provided "with the value of his bargained for rights."[18] As the court noted in *In re Hart-Sahara*, if payment of adequate protection is "more fantasy than expectation," such potential for payment is inadequate.[19] The assurances of adequate protection provided to creditors afford a debtor the ability to retain its protections under the Bankruptcy Code.[20] Therefore, the requirement to provide a secured creditor with adequate protection reconciles "the competing interests of the debtor's need to reorganize and the secured creditor's entitlement to constitutional protection of its bargained-for property interests."[21]

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[15]11 U.S.C. § 1326(a)(1)(C).

[16]U.S. Const. amend. V.; *see also In re Panther Mountain Land Development, LLC*, 438 B.R. 169, 190, 53 Bankr. Ct. Dec. (CRR) 252 (Bankr. E.D. Ark. 2010), aff'd 446 B.R. 282 (B.A.P. 8th Cir. 2011).(citations omitted)

[17]*In re Panther Mountain,* 438 B.R. at 190 (citations omitted).

[18]*In re Swedeland Development Group, Inc.*, 16 F.3d 552, 564, 25 Bankr. Ct. Dec. (CRR) 486, 30 Collier Bankr. Cas. 2d (MB) 1034, Bankr. L. Rep. (CCH) P 75803 (3d Cir. 1994); *see also In re Van Horn*, 2011 WL 1900324, *4 (Bankr. M.D. Pa. 2011) ("The purpose of adequate protection is 'to insure that the creditor receives the value for which the creditor bargained prebankrutpcy.' " (quoting *In re O'Connor*, 808 F.2d 1393, 1396, 15 Bankr. Ct. Dec. (CRR) 735, Bankr. L. Rep. (CCH) P 71571 (10th Cir. 1987))).

[19]*In re Hart-Sahara, LLC*, 2010 Bankr. LEXIS 5379, at *8 (Bankr. D. Nev. Mar. 17, 2010) (citing *In re Chevy Devco*, 78 B.R. 585, 589, 16 Bankr. Ct. Dec. (CRR) 571 (Bankr. C.D. Cal. 1987)).

[20]*In re Panther Mountain,* 438 B.R. at 190 (citing *United Sav. Ass'n of Texas v. Timbers of Inwood Forest Associates, Ltd.*, 484 U.S. 365, 108 S. Ct. 626, 98 L. Ed. 2d 740, 16 Bankr. Ct. Dec. (CRR) 1369, 17 Collier Bankr. Cas. 2d (MB) 1368, Bankr. L. Rep. (CCH) P 72113 (1988)).

[21]*In re Briggs Transp. Co.*, 780 F.2d 1339, 1341, 14 Bankr. Ct. Dec. (CRR) 48, 13 Collier Bankr. Cas. 2d (MB) 1289, Bankr. L. Rep. (CCH) P 70897 (8th Cir. 1985).

A decline in value of collateral can occur in a number of ways. As stated by the court in *In re Young*:

> A decline in the value of the estate's interest in property that is the creditor's collateral, which entitles the creditor to adequate protection, can result from such causes as a decline in the market value of the collateral, non-payment of interest accruing on a senior lien, or non-payment of property taxes having priority over the creditor's lien. A threatened decline in the value of a creditor's collateral entitling the creditor to adequate protection can occur, for example, from lack of insurance, failure to maintain the collateral, failure to permit periodic inspections, or a failure to report information affecting the collateral.[22]

C. Methods of Providing Adequate Protection

What constitutes adequate protection is a question of fact to be determined on a case-by-case basis.[23] Although the Bankruptcy Code is not explicit as to what constitutes adequate protection, section 361 enumerates several specific examples of adequate protection:

1) requiring the debtor to make a cash payment or periodic cash payments to the extent that the automatic stay or the use, sale or lease of property results in a decrease in the value of such entity's interest in such property;
2) providing to such entity an additional or replacement lien to the extent that the automatic stay or the use, sale or lease of property 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 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.[24]

In applying section 361 of the Bankruptcy Code, courts have consistently interpreted the list of adequate protection methods enumerated therein as nonexclusive and have viewed the third option as a "catch all, allowing courts discretion in fashioning the protection provided to a secured party."[25] Courts generally determine whether relief constitutes adequate protection "on a

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[22] *In re Young*, 2011 WL 3799245, *7 (Bankr. D. N.M. 2011) (citations omitted).

[23] In re Young, 2011 Bankr. LEXIS 3300, at *22–23.

[24] 11 U.S.C. § 361.

[25] *In re Swedeland,* 16 F.3d at 564.

case by case basis."[26]

1. *Cash Payments*

Section 361(1) of the Bankruptcy Code states that adequate protection of an interest of an entity in property can be provided by "requiring the trustee to make a cash payment or periodic cash payments to such entity, to the extent that the stay under section 362 of [the Bankruptcy Code], use, sale, or lease under section 363 of [the Bankruptcy Code], or any grant of a lien under section 364 of [the Bankruptcy Code] results in a decrease in the value of such entity's interest in such property."[27]

Periodic payments are an acceptable form of compensation for the depreciation of collateral, the value of which is decreasing at a relatively constant rate.[28]

2. *Replacement Collateral*

Section 361(2) of the Bankruptcy Code states that adequate protection of an entity's interest in property can be satisfied by "providing to such entity an additional or replacement lien to the extent that such stay, use, sale, lease, or grant results in a decrease in the value of such entity's interest in such property."[29]

This method provides a secured creditor "with a means of realizing the value of the original property, if it should decline during the case, by granting an interest in property from whose value the entity may realize its loss."[30] Section 361(2) is consistent with *Wright* v. *Union Central Life Insurance Co.*, which stands for the proposition that a secured creditor has a claim to the value of its interest in collateral but not necessarily to the specific collateral itself.[31]

A security interest in future rents can implicate section 361(2)'s language regarding additional or replacement liens as a form of adequate protection. In *In re Mullen*, the Bankruptcy Court for the District of Massachusetts rejected a secured creditor's argu-

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[26]*In re Swedeland,* 16 F.3d at 564 (citing *In re O'Connor*, 808 F.2d 1393, 1397, 15 Bankr. Ct. Dec. (CRR) 735, Bankr. L. Rep. (CCH) P 71571 (10th Cir. 1987)).

[27]11 U.S.C. § 361(1).

[28]H.R. Rep. No. 95-595, at 339 (1977), reprinted in 1978 U.S.C.C.A.N. 6295.

[29]11 U.S.C. § 361(2).

[30]H.R. Rep. No. 95-595, at 339 to 40 (1977), reprinted in 1978 U.S.C.C.A.N. 6295.

[31]311 U.S. 273, 278 (1940).

ment that the debtor's use of rents collected postpetition did not adequately protect the creditor's security interest in such rents.[32] The court instead concluded that the security interest in one month's rents was replaced by a new security interest in a subsequent month's rents, thus obviating the need to grant an additional or replacement lien under section 361(2) where the underlying security was not depreciating in value.[33] There remains a split among courts on this point, but recent case law suggests that the better interpretation is that the entire accumulation of rent postpetition subject to a lien attaching to newly created or acquired collateral (i.e., a "floating" lien)—net of amounts required to preserve the underlying collateral under section 506(c) or withheld under the "equities of the case" under section 552(b)—is entitled to adequate protection.[34] Under this approach, accumulated postpetition rents subject to a floating lien must be adequately protected if used, whether or not the underlying collateral is declining in value.[35]

In *In re Buttermilk Towne Center*, the debtor had sought to use cash collateral that was otherwise subject to the liens of its secured lender, Bank of America, in order to pay its administrative expenses, including professional fees.[36] Buttermilk Towne Center, the debtor, maintained that Bank of America was adequately protected because the expected future rents pledged to the bank exceeded the value of the bank's claim.[37] Contrarily, Bank of America argued that it was not adequately protected

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[32]172 B.R. 473, 475 (Bankr. D. Mass. 1994).

[33]172 B.R. at 476–78.

[34]*See, e.g., Beal Bank, S.S.B. v. Waters Edge Ltd. Partnership*, 248 B.R. 668, 684–86 (D. Mass. 2000); *In re Lilo Properties, LLC*, 2011 WL 5509401, *5–6 (Bankr. D. Vt. 2011); *In re Columbia Office Associates Ltd. Partnership*, 175 B.R. 199, 202–203, 32 Collier Bankr. Cas. 2d (MB) 621 (Bankr. D. Md. 1994).

[35]*In re Buttermilk Towne Center, LLC*, 442 B.R. 558, 564–67, 54 Bankr. Ct. Dec. (CRR) 13, 64 Collier Bankr. Cas. 2d (MB) 1771 (B.A.P. 6th Cir. 2010); *In re Griswold Bldg., LLC*, 420 B.R. 666, 699 (Bankr. E.D. Mich. 2009) (holding that a creditor who holds both a mortgage on real property and a security interest in rents has "two distinct security interests . . . To protect against that diminution in value [of the secured party's interest in the assignment of rents], a debtor must provide adequate protection for the interest in rents above and beyond any adequate protection for the interest in the real property." (citing *In re River Oaks Ltd. Partnership*, 166 B.R. 94, 97, 31 Collier Bankr. Cas. 2d (MB) 654 (E.D. Mich. 1994))).

[36]*In re Buttermilk Towne Center, LLC*, 442 B.R. 558, 560–61, 54 Bankr. Ct. Dec. (CRR) 13, 64 Collier Bankr. Cas. 2d (MB) 1771 (B.A.P. 6th Cir. 2010).

[37]*In re Buttermilk Towne Center, LLC*, 442 B.R. 558, 561–562, 54 Bankr. Ct. Dec. (CRR) 13, 64 Collier Bankr. Cas. 2d (MB) 1771 (B.A.P. 6th Cir. 2010).

because (1) Buttermilk was not making cash payments; (2) liens on future rents were already included in its collateral and, thus, did not constitute replacement or additional liens; and (3) there was no equity cushion in the property.[38] On June 1, 2010, the Bankruptcy Court for the Eastern District of Kentucky initially approved the debtor's use of cash collateral.[39] On June 29, 2010, the bankruptcy court clarified its prior order and found that Bank of America was adequately protected.[40] On appeal, the Sixth Circuit Bankruptcy Appellate Panel reversed.[41] The Bankruptcy Appellate Panel, looking to prior unpublished Sixth Circuit case law, found that these future rents could not constitute adequate protection for Bank of America since Bank of America already held liens on *all* future rents and not been provided with any replacement liens.[42]

3. *"Indubitable Equivalent"*

Section 361(3) of the Bankruptcy Code states that adequate protection of an interest of an entity in property can be provided by "granting such other relief, other than entitling such entity to compensation allowable under section 503(b)(1) of [the Bankruptcy Code] as an administrative expense, as will result in the realization by such entity of the indubitable equivalent of such

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[38] *In re Buttermilk Towne Center, LLC*, 442 B.R. 558, 561–562, 54 Bankr. Ct. Dec. (CRR) 13, 64 Collier Bankr. Cas. 2d (MB) 1771 (B.A.P. 6th Cir. 2010).

[39] *In re Buttermilk Towne Center, LLC*, 442 B.R. 558, 561, 54 Bankr. Ct. Dec. (CRR) 13, 64 Collier Bankr. Cas. 2d (MB) 1771 (B.A.P. 6th Cir. 2010) (citing "Final Order on Use of Cash Collateral," In re Buttermilk Towne Center, LLC, Case No. 10-21162 [Dkt. No. 94] (Bankr. E.D. Ky. 2010)).

[40] In re Buttermilk Towne Center, 2010 Bankr. LEXIS 4563, at *8 (reversing *In re Buttermilk Towne Center, LLC, Case No. 10-21162*, 2010 Bankr. LEXIS 2126 (Bankr. E.D. Ky. June 29, 2010)).

[41] *In re Buttermilk Towne Center, LLC*, 442 B.R. 558, 54 Bankr. Ct. Dec. (CRR) 13, 64 Collier Bankr. Cas. 2d (MB) 1771 (B.A.P. 6th Cir. 2010).

[42] *In re Buttermilk Towne Center, LLC*, 442 B.R. 558, 566, 54 Bankr. Ct. Dec. (CRR) 13, 64 Collier Bankr. Cas. 2d (MB) 1771 (B.A.P. 6th Cir. 2010) (quoting *In re Stearns Bldg.*, 165 F.3d 28 (6th Cir. 1998) (unpublished table decision) ("[T]he record does not indicate that Debtor possesses any unencumbered assets with which it can offer [the lender] adequate protection . . . [and] this court cannot accept that the use of future rents to replace the expenditure of the prior month's rents somehow provides adequate protection for the secured party.")); *see also*, *e.g.*, *In re Pacific Ave., LLC*, 2010 WL 3911345 (Bankr. W.D. N.C. 2010) (holding that prepetition rents could not be used to pay a retainer to special counsel retained to sue the lender who held a security interest in the rents).

entity's interest in such property."[43] This third option provided in section 361 of the Bankruptcy Code is the most ambiguous. Courts have found that it can be met in a variety of ways, and it is evaluated on a case-by-case basis.[44]

The term "indubitable equivalent," as it relates to adequate protection in bankruptcy, was introduced by Judge Learned Hand in *Metro. Life Ins. Co. v. Murel Holding Corp. (In re Murel Holding Corp.)* where he stated:

> It is plain that 'adequate protection' must be completely compensatory . . . [A] creditor who fears the safety of his principal will scarcely be content with [interest]; he wishes to get his money or at least the property. We see no reason to suppose that the statute was intended to deprive him of that in the interest of junior holders, unless by a substitute of the most indubitable equivalence.[45]

However, adequate protection under section 361(3) need not be, as Judge Hand proposed, of the most indubitable equivalence.[46] Instead, courts simply require that adequate protection be "completely compensatory" or almost completely compensatory.[47] The U.S. Court of Appeals for the Third Circuit held that adequate protection "should as nearly as possible under the circumstances of the case provide the creditor with the value of his

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[43] 11 U.S.C. § 361(3).

[44] *In re Panther Mountain,* 438 B.R. at 190 (citations omitted); *In re BLX Group, Inc.*, 419 B.R. 457, 470 (Bankr. D. Mont. 2009) (citations omitted).

[45] *In re Murel Holding Corp.*, 75 F.2d 941, 942 (C.C.A. 2d Cir. 1935) (cited in *In re Fontainebleau Las Vegas Holdings, LLC*, 434 B.R. 716, 748–49 (S.D. Fla. 2010)).

[46] Judge Learned Hand's approach to indubitable equivalence may not be fully captured in section 361(3) of the Bankruptcy Code, because (i) *In re Murel Holding Corp.* was decided under the former Bankruptcy Act and (ii) that section requires only the "indubitable equivalent" and not the most indubitable equivalence as he had described. *In re Fontainebleau,* 434 B.R. at 748–49 (citation omitted). However, as used in the confirmation context in section 1129(b), a cram down of a plan of reorganization may require the *most* indubitable equivalent as described by Judge Hand. *See* S. Rep. 95-989 (1978) ("The indubitable equivalent language is intended to follow the *strict approach* taken by Judge Learned Hand in In re Murel Holding Corp . . ."). For further discussion, *see River Road Hotel Partners, LLC v. Amalgamated Bank*, 651 F.3d 642, 55 Bankr. Ct. Dec. (CRR) 13, 65 Collier Bankr. Cas. 2d (MB) 1900, Bankr. L. Rep. (CCH) P 82031 (7th Cir. 2011), cert. granted, 132 S. Ct. 845, 181 L. Ed. 2d 547 (2011) and aff'd, 132 S. Ct. 2065, 56 Bankr. Ct. Dec. (CRR) 144, Bankr. L. Rep. (CCH) P 82218 (2012), *sub judice* as of the writing of this article.

[47] *In re Fontainebleau*, 434 B.R. at 748–49 (citations omitted).

bargained for rights."[48] Therefore, adequate protection should provide a creditor whose collateral position is compromised "with the same level of protection it would have had" if the action threatening the creditor's security interest had not occurred.[49]

D. Establishing a Prima Facie Case for a Lack of Adequate Protection

To establish a prima facie case for a lack of adequate protection, a creditor must provide evidence that the automatic stay has caused the decline in value, or threatened the value, of the collateral property.[50] The best proof of declining or threatened value is a comparison of the value of the property at the time of the hearing to the property value as of the petition date.[51] However, this is not the only acceptable proof—a prima facie case may be satisfied if the creditor presents evidence that "its position in the collateral is in jeopardy."[52] To counter evidence of a loss of value in collateral, a debtor must either effectively refute such evidence or show that "there are sufficient protections in place to guard against [the diminution in the value of

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[48] *In re Fontainebleau,* 434 B.R. at 748–49 (quoting *In re Swedeland,* 16 F.3d at 564 (citation and internal quotation marks omitted)).

[49] *In re Fontainebleau,* 434 B.R. at 748–49 (quoting *In re Swedeland,* 16 F.3d at 564 (citation and internal quotation marks omitted)). Similarly, "[w]hen formulating adequate protection in connection with post-petition financing on a priming basis, preserving or enhancing the value of the collateral must be viewed side-by-side with the decrease in value of a creditor's interest in the property caused by the priming lien." *In re Fontainebleau,* 434 B.R. at 748–49 (citing *In re Swedeland,* 16 F.3d at 564).

[50] *In re Panther Mountain,* 438 B.R. at 190 (citations omitted); see also *In re Wrecclesham Grange, Inc.*, 221 B.R. 978, 981 (Bankr. M.D. Fla. 1997) ("Therefore, an undersecured creditor does not lack adequate protection merely by reason of being undersecured." (citation omitted)); *In re Barkley 3A Investors, Ltd.*, 175 B.R. 755, 759, 26 Bankr. Ct. Dec. (CRR) 525 (Bankr. D. Kan. 1994) ("The court said that the value of the creditor's interest must be declining for adequate protection to be necessary. The undersecured creditor does not lack adequate protection merely by reason of being undersecured." (citing *United Sav. Ass'n of Texas v. Timbers of Inwood Forest Associates, Ltd.*, 484 U.S. 365, 108 S. Ct. 626, 98 L. Ed. 2d 740, 16 Bankr. Ct. Dec. (CRR) 1369, 17 Collier Bankr. Cas. 2d (MB) 1368, Bankr. L. Rep. (CCH) P 72113 (1988))).

[51] *In re Panther Mountain,* 438 B.R. at 190 (citing *In re Elmira Litho, Inc.*, 174 B.R. 892, 903, Bankr. L. Rep. (CCH) P 76234 (Bankr. S.D. N.Y. 1994). For example, in *In re Hart-Sahara*, the debtor provided a new valuation in support of its proposed plan of reorganization, which showed that it had no equity in the collateral beyond the senior lender's security interest. 2010 Bankr. LEXIS 5379, at *10–11 (Bankr. D. Nev. Mar. 17, 2010).

[52] *In re Panther Mountain,* 438 B.R. at 190 (citations omitted).

collateral]."[53] For example, the debtor in *Panther Mountain* presented sufficient evidence to refute a prima facie showing of adequate protection by providing that the value of property securing its creditor's claims was likely to continue to increase in value due, in part, to its aggressive marketing campaign to sell plots of the land and its feasible plan which provided that any plots of land not sold within a certain period of time would be sold at public auction.[54]

II. Recent Case Law Addressing Questions of Adequate Protection

What constitutes adequate protection, as provided in section 361 of the Bankruptcy Code, is often an issue in bankruptcy litigation. Given the ethereal nature of adequate protection and the dearth of specific guidance in the Bankruptcy Code, courts and practitioners regularly look to case precedent to shape the contours of adequate protection law. Over the years, a number of aspects of adequate protection have become firmly imbedded in the case law. However, several recent noteworthy cases have addressed certain unresolved issues in the law. Below, we discuss recent case law evaluating equity cushions and what, if any, amount of equity cushion may ensure adequate protection. These cases include *In re Van Horn*, *In re JER/Jameson Mezz Borrower II*, *In re Samshi Homes*, *In re Young* and *In re Podzemny*.[55] We then address recent cases in which courts considered whether adequate protection can be provided by the future value of an unfinished project already serving as security, including *In re Marcus Lee Associates*, *In re DB Capital Holdings, LLC*, *In re Philadelphia Rittenhouse Developer, L.P.*, *In re* 207 *Redwood Street* and *In re Lagoon Breeze Development*.[56] We then discuss *In re Smithfield Crossing*, in which the court held that replacement

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[53]*In re Panther Mountain,* 438 B.R. at 190 (citations omitted); 11 U.S.C. § 362(g).

[54]*In re Panther Mountain,* 438 B.R. at 193.

[55]*In re Van Horn*, 2011 WL 1900324 (Bankr. M.D. Pa. 2011); *In re JER/Jameson Mezz Borrower II, LLC*, 461 B.R. 293 (Bankr. D. Del. 2011); *In re Samshi Homes, LLC*, 2011 WL 3903054 (Bankr. S.D. Tex. 2011); *In re Young*, 2011 WL 3799245 (Bankr. D. N.M. 2011); *In re Podzemny*, 2011 WL 576591 (Bankr. D. N.M. 2011).

[56]*In re Marcus Lee Assocs.*, 2011 U.S. Dist. LEXIS 5372 (Bankr. E.D. Pa. Jan. 20, 2011); *In re DB Capital Holdings, LLC*, 454 B.R. 804 (Bankr. D. Colo. 2011); *In re Phila. Rittenhouse Developer, L.P., 54 Bankr. Ct. Dec. (LRP) 206*, 2011 Bankr. LEXIS 1930 (Bankr. E.D. Pa. May 25, 2011); *In re 207 Redwood Street LLC*, 2011 WL 3799767 (Bankr. D. Md. 2011); *In re Lagoon Breeze Dev. Corp.*, 2011 Bankr. LEXIS 981 (Bankr. S.D. Cal. Mar. 14, 2011).

liens on postpetition rents cannot provide adequate protection to a creditor with a pre-existing security interest in such future rents.[57] We then address cases discussing additional attempted forms of adequate protection, such as *In re Hickory Ridge*, *In re Moritz Walk*, *In re Philadelphia Rittenhouse Developer*, *In re Grand Island Liquor Mart*, *In re Harbour East Development,* and *In re Lodge at Big Sky*.[58]

A. Evaluating an Equity Cushion

The most common factors indicating that a creditor's interest is adequately protected are "the sufficiency of the equity cushion, periodic payments, additional liens, or a good prospect of a successful reorganization."[59] The debtor's equity cushion in collateral is a term of art for the value of the collateral "measured against the amount of the movant's secured claim plus any secured claims senior to the movant's claim."[60] "An equity cushion is the classic form of protection for a secured debt, and its existence, standing alone, can provide adequate protection under the [Bankruptcy Code]."[61] The determination whether the equity cushion in collateral is sufficient is made on a case-by-case basis.[62] Exactly what size (percentage) cushion is sufficient is a subject of much debate. As courts have found previously, courts generally find equity cushions of greater than 20% to be sufficient, almost universally consider an equity cushion of less than 11% to be insufficient, and may find equity cushions of 11 to 20% sufficient or insuf-

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[57]*In re Smithville Crossing, LLC*, 2011 WL 5909527 (Bankr. E.D. N.C. 2011).

[58]*In re Hickory Ridge, LLC*, 2010 WL 2816670 (N.D. W. Va. 2010); *In re Walk*, 2011 WL 830533 (Bankr. S.D. Tex. 2011); *In re Phila. Rittenhouse Developer, L.P., 54 Bankr. Ct. Dec. (LRP) 206*, 2011 Bankr. LEXIS 1930 (Bankr. E.D. Pa. May 25, 2011); *In re Grand Island Liquor Mart*, 2011 WL 739593 (Bankr. D. Neb. 2011); *In re Harbour East Development, Ltd.*, 66 Collier Bankr. Cas. 2d (MB) 1808, 2011 WL 6097063, *1 (Bankr. S.D. Fla. 2011); *In re The Lodge at Big Sky, LLC*, 454 B.R. 138, 140 (Bankr. D. Mont. 2011).

[59]*In re Van Horn*, 2011 WL 1900324, *4 (Bankr. M.D. Pa. 2011) (citing *In re Liona Corp., N.V.*, 68 B.R. 761, 767 (Bankr. E.D. Pa. 1987)); *see also In re Swedeland,* 16 F.3d at 566 (citations omitted).

[60]*In re Swedeland,* 16 F.3d at 552–566; *In re BLX Group, Inc.*, 419 B.R. 457, 470 (Bankr. D. Mont. 2009).

[61]*In re Hefty*, 2011 WL 2470686, *15 (Bankr. D. Mont. 2011); *see also* In re Young, 2011 Bankr. LEXIS 3300, at *22–23("If a secured creditor has a security cushion sufficient to protect it from the declining value of its collateral, then the security cushion may provide adequate protection for the declining value." (citations omitted)).

[62]*In re Panther Mountain,* 438 B.R. at 190 (citations omitted).

ficient depending on the circumstances of the case.[63] A handful of 2011 cases address the contours of equity cushion analysis: *In re Van Horn*, *In re JER/Jameson Mezz Borrower II*, *In re Samshi Homes*, *In re Young* and *In re Podzemny*.[64]

1. *Eroding Equity Cushion*

Courts have generally held that "[a]n oversecured creditor is not entitled to be compensated for any erosion in an equity cushion."[65] However, as indicated in the recently decided cases discussed below, courts consider a declining equity cushion to be an indicator that additional adequate protection may be required.

In re Van Horn exemplifies the type of fact-specific analyses performed by courts to evaluate the suitability of a deteriorating equity cushion.[66] In *Van Horn*, a Chapter 13 debtor owned a piece of property that was subject to a mortgage.[67] Its secured creditor filed a motion for relief from the automatic stay, in part, because it claimed that it had not received adequate protection as provided in section 361 of the Bankruptcy Code and, therefore, it was not being adequately protected. The debtor argued that, because of an equity cushion in the property, the secured creditor was adequately protected.[68] The bankruptcy court held a hearing on valuation of the property and determined that the secured

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[63]*See, e.g.*, *In re Hefty*, 2011 WL 2470686 (Bankr. D. Mont. 2011) (holding that a 38% equity cushion in collateral provided adequate protection for a secured claim); *In re Las Torres Development, L.L.C.*, 413 B.R. 687, 697, 52 Bankr. Ct. Dec. (CRR) 31, 62 Collier Bankr. Cas. 2d (MB) 842 (Bankr. S.D. Tex. 2009); *Suntrust Bank v. Den-Mark Const., Inc.*, 406 B.R. 683, 700 n.24, 63 A.L.R. Fed. 2d 757 (E.D. N.C. 2009) (explaining that a 20% or higher equity cushion almost always was found to constitute adequate protection (citing *In re James River Associates*, 148 B.R. 790, 796 (E.D. Va. 1992))). *Compare SunTrust Bank,* 406 B.R. at 700 n.24 (explaining that 11% or lower equity cushion has almost always been found not to constitute adequate protection, and courts have been divided on whether an equity cushion between 11% and 20% constituted adequate protection), *with Panther Mountain,* 438 B.R. at 191 (explaining that even the complete lack of an equity cushion does not automatically mean that adequate protection is not provided).

[64]*In re Van Horn*, 2011 WL 1900324 (Bankr. M.D. Pa. 2011); *In re JER/Jameson Mezz Borrower II, LLC*, 461 B.R. 293 (Bankr. D. Del. 2011); *In re Samshi Homes, LLC*, 2011 WL 3903054 (Bankr. S.D. Tex. 2011); *In re Young*, 2011 WL 3799245 (Bankr. D. N.M. 2011); *In re Podzemny*, 2011 WL 576591 (Bankr. D. N.M. 2011).

[65]*In re SW Boston Hotel Venture LLC*, 449 B.R. 156, 176, 54 Bankr. Ct. Dec. (CRR) 69 (Bankr. D. Mass. 2011).

[66]*In re Van Horn*, 2011 WL 1900324 (Bankr. M.D. Pa. 2011).

[67]*In re Van Horn*, 2011 WL 1900324, *1 (Bankr. M.D. Pa. 2011).

[68]*In re Van Horn*, 2011 WL 1900324, *1 (Bankr. M.D. Pa. 2011).

creditor's view of value was more accurate.[69] At this valuation, there would have been a $17,401 cushion on property worth $440,000.[70] The court held that, even if this equity cushion were substantial enough to adequately protect the secured creditor, accruing postpetition interest decreased the equity cushion and the remainder would have been entirely destroyed by the commission charged by the debtor's real estate broker to sell the property. Therefore, the court held that there was no adequate protection provided to the secured creditor and granted the secured creditor's motion for relief from the automatic stay.[71]

In *In re JER/Jameson Mezz Borrower II*, a shrinking equity cushion was the impetus for the court's ruling against the debtors.[72] In that case, JER/Jameson Mezz Borrower II, LLC ("Mezz II") had been formed to acquire a chain of hotels for approximately $400 million.[73] Entities controlled by Mezz II, JER/Jameson Properties LLC and JER/Jameson NC Properties LP (the "Jameson Operating Companies"), borrowed $175 million from a syndicate of lenders serviced by Wells Fargo Commercial Mortgage Servicer ("Wells Fargo") for the acquisition. Certain of their affiliates, including Mezz II, borrowed an additional $160 million for the acquisition. After the acquisition, the Jameson Operating Companies owned (or leased) the target real estate. When the debt matured, Mezz II was unable to repay the loan and the lenders commenced enforcement actions.[74] Wells Fargo filed foreclosure proceedings against some of the properties owned by the Jameson Operating Companies.[75] The holders of Mezz II's debt (collectively, the "Jameson Secured Creditors") issued a notice of intention to auction Mezz II's assets under Article 9 of the Uniform Commercial Code. The day before the auction was to take place, the Jameson Operating Companies and the other related affiliates (collectively, the "Jameson Debtors") filed for

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[69] *In re Van Horn*, 2011 WL 1900324, *4–6 (Bankr. M.D. Pa. 2011).

[70] *In re Van Horn*, 2011 WL 1900324, *6 (Bankr. M.D. Pa. 2011).

[71] *In re Van Horn*, 2011 WL 1900324, *6 (Bankr. M.D. Pa. 2011).

[72] 2011 WL 6749058 (Bankr. D. Del. Dec. 22, 2011).

[73] *In re JER/Jameson Mezz Borrower II, LLC*, 461 B.R. 293 (Bankr. D. Del. 2011).

[74] *In re JER/Jameson Mezz Borrower II, LLC*, 461 B.R. 293 (Bankr. D. Del. 2011).

[75] *In re JER/Jameson Mezz Borrower II, LLC*, 461 B.R. 293 (Bankr. D. Del. 2011).

Chapter 11 protection. The Jameson Secured Creditors filed a motion to dismiss and seeking relief from the automatic stay.[76]

With respect to their motion to lift the stay, the Jameson Secured Creditors argued that they were not being adequately protected because the Jameson Debtors had not offered to make adequate protection payments or offered additional collateral.[77] Further, the Jameson Secured Creditors stated that the value of its collateral was diminishing because of accruing interest and that their enforcement costs were extensive and mounting.[78] The Jameson Debtors argued that the Jameson Secured Creditors' interests were adequately protected because the Jameson Debtors were cash flow positive and the hotels were being maintained.[79] The Jameson Secured Creditors countered by citing the Jameson Debtors' budget, which showed a negative cash flow after payment of the interest and expenses of Wells Fargo and the expenses of the Jameson Debtors' professionals.[80]

The Jameson Debtors also argued that the Jameson Secured Creditors' interests were adequately protected by an equity cushion in the value of the enterprise. The Jameson Debtors contended that the enterprise had a mid-point value of $280 million, while the amount owed by the Jameson Debtors to the Jameson Secured Creditors was $242 million, leaving an equity cushion of $38 million. The Jameson Secured Creditors disputed the Jameson Debtors' view of enterprise value and noted that it did not include accrued interest and fees. The court held that, even accepting the Jameson Debtors' view of enterprise value, there was only a "*de minimis* equity cushion which is being eroded daily."[81] The court held that the $38 million equity cushion was really $26 million after taking interest and fees into account,

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[76]*In re JER/Jameson Mezz Borrower II, LLC*, 461 B.R. 293 (Bankr. D. Del. 2011).

[77]*In re JER/Jameson Mezz Borrower II, LLC*, 461 B.R. 293 (Bankr. D. Del. 2011).

[78]*In re JER/Jameson Mezz Borrower II, LLC*, 461 B.R. 293 (Bankr. D. Del. 2011).

[79]*In re JER/Jameson Mezz Borrower II, LLC*, 461 B.R. 293 (Bankr. D. Del. 2011).

[80]*In re JER/Jameson Mezz Borrower II, LLC*, 461 B.R. 293 (Bankr. D. Del. 2011).

[81]*In re JER/Jameson Mezz Borrower II, LLC*, 461 B.R. 293 (Bankr. D. Del. 2011).

which amounted to a 9% equity cushion. The court held that that this was insufficient to create adequate protection on its own.[82]

The Jameson Debtors argued that the measure of equity cushion should be the difference between the value of the collateral and the moving creditor's claim as a percentage of the moving creditor's claim.[83] The court disagreed, holding that the measure of equity cushion is the difference between the value of the collateral and the moving creditor's claim as a percentage of the value of the collateral. The court further held that the Jameson Debtors' claims of excess cash were not helpful because the Jameson Debtors were not offering the Jameson Secured Creditors any portion of that cash. Further, the court agreed with the Secured Creditors' contention that, over time, the excess cash would be insufficient to cover the costs of the case.[84] Therefore, the court granted the Jameson Secured Creditors' motion to lift the stay.[85]

In re Samshi Homes is another case where the court addressed a declining equity cushion.[86] In September 2010, Samshi Homes LLC ("Samshi"), a Houston developer of townhome developments, filed a voluntary petition under Chapter 11 of the Bankruptcy Code.[87] Prior to its filing, the debtor had financed its activities with equity invested by its principal, Vinay Karna ("Karna"), as well as debt borrowed from Texas Community Bank ("TCB") and secured by the properties. Earlier in the bankruptcy case, TCB twice consented to Samshi's use of its cash collateral to finance ongoing operations. Specifically, Karna testified that cash collateral had been used to continue construction on the properties. However, approximately one year after the filing, TCB refused to consent to further use of cash collateral and filed a motion for relief from the automatic stay.[88]

In explaining its decision to deny further use of cash collateral, the court noted that Samshi's equity cushion at filing, using

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[82]*In re JER/Jameson Mezz Borrower II, LLC*, 461 B.R. 293 (Bankr. D. Del. 2011).

[83]*In re JER/Jameson Mezz Borrower II, LLC*, 461 B.R. 293 (Bankr. D. Del. 2011).

[84]*In re JER/Jameson Mezz Borrower II, LLC*, 461 B.R. 293 (Bankr. D. Del. 2011).

[85]*In re JER/Jameson Mezz Borrower II, LLC*, 461 B.R. 293 (Bankr. D. Del. 2011).

[86]*In re Samshi Homes, LLC*, 2011 WL 3903054 (Bankr. S.D. Tex. 2011).

[87]*In re Samshi Homes, LLC*, 2011 WL 3903054, *1 (Bankr. S.D. Tex. 2011).

[88]*In re Samshi Homes, LLC*, 2011 WL 3903054, *1 (Bankr. S.D. Tex. 2011).

Karna's valuation of the properties, was $375,694.51 and, at the time of consideration of the motion, due to postpetition interest and tax claims, the equity cushion had been reduced to $17,432.48.[89] Although the court did not provide calculations of equity cushion percentages, the equity cushion was 15% of the value of TCB's claim as of the petition date and was subsequently reduced to less than 1%.[90] The court noted that, even "if an equity cushion continues to exist to protect TCB's interest in the property, such cushion is rapidly eroding. . . ."[91] Because of its dwindling equity cushion, the court granted TCB's motion to lift the stay.[92] However, *Samshi Homes* raises the question of what the court would have done if the equity cushion was eroding but was still at a level greater than 20% of the value of the underlying security interest.

2. *Steady Equity Cushion*

Where the value of collateral is not eroding, as the court found in *In re Young*, courts have been more reluctant to grant secured creditors relief from the stay.[93] In *In re Young*, the secured creditor of Chapter 11 debtors moved to lift the automatic stay for lack of adequate protection where the court found that it only had a 10.9% equity cushion in its collateral.[94] The creditor argued that it was entitled to adequate protection because (i) interest would accrue on its collateral if it were to foreclose its lien, thereby eroding the equity cushion, (ii) the creditor would incur additional legal fees to recover on its claim, (iii) property taxes were accruing and not being paid, (iv) if the creditor acquired the collateral at a foreclosure sale and resold the property, the sale proceeds would be reduced by the costs of the sale and (v) a sale by the creditor would have been perceived as a fire sale and, therefore, yielded a lower price.[95]

In *In re Young*, the court held that the value of the collateral was steady (neither increasing nor decreasing), that the debtors had improperly used postpetition rents subject to the creditor's lien and that the debtors were not paying postpetition property

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[89] *In re Samshi Homes, LLC*, 2011 WL 3903054, *3 (Bankr. S.D. Tex. 2011).

[90] *In re Samshi Homes, LLC*, 2011 WL 3903054, *3 (Bankr. S.D. Tex. 2011).

[91] *In re Samshi Homes, LLC*, 2011 WL 3903054, *4 (Bankr. S.D. Tex. 2011).

[92] *In re Samshi Homes, LLC*, 2011 WL 3903054, *1 (Bankr. S.D. Tex. 2011).

[93] *In re Young*, 2011 WL 3799245 (Bankr. D. N.M. 2011).

[94] *In re Young*, 2011 Bankr. LEXIS 3300, at *18–19.

[95] *In re Young*, 2011 Bankr. LEXIS 3300, at *19.

taxes.[96] The court held that the secured creditor was entitled to adequate protection for the improper use of rent payments and for the non-payment of property taxes.[97] However, the court held that the secured creditor was not entitled to adequate protection to compensate it for the erosion of its equity cushion as a result of the accrual of postpetition interest in accordance with the Supreme Court's 1988 holding in *Timbers of Inwood Forest* that the payment of adequate protection for postpetition interest would be contrary to Section 506(b) of the Bankruptcy Code.[98] Furthermore, the court held that the secured creditor was not entitled to adequate protection to compensate it for the erosion of its equity cushion caused by the accrual of postpetition attorney's fees under the same rationale.[99]

3. *Value Of Equity Cushion May Not Be Determinative*

A substantial equity cushion in collateral may not be sufficient adequate protection without certain limitations and conditions on the use of the collateral. In *In re Podzemny*, the Chapter 11 debtor sought court authority to use a substantial amount of cash collateral to (a) develop farmland for which it had obtained the water rights, (b) plant, cultivate and harvest a corn crop on the newly-acquired land and (c) acquire cattle for the land.[100] Podzemny, the debtor, owed its primary creditor $27 million.[101] Although the collateral value was not firmly established, the parties agreed that the debtor had equity in the collateral. The debtor estimated that the loan-to-value ratio was 52.52% and the secured creditor estimated 60 to 70%.[102] The debtor sought the use of $12 million of the cash collateral to cultivate its existing farmland and to acquire new cattle and farmland.[103] The debtor's secured creditor objected on the basis that the development of newly acquired farmland was outside the ordinary course of business and would

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[96]In re Young, 2011 Bankr. LEXIS 3300, at *26.

[97]In re Young, 2011 Bankr. LEXIS 3300, at *26.

[98]In re Young, 2011 Bankr. LEXIS 3300, at *27–32 (citing *United Sav. Ass'n of Texas v. Timbers of Inwood Forest Associates, Ltd.*, 484 U.S. 365, 369–82, 108 S. Ct. 626, 98 L. Ed. 2d 740, 16 Bankr. Ct. Dec. (CRR) 1369, 17 Collier Bankr. Cas. 2d (MB) 1368, Bankr. L. Rep. (CCH) P 72113 (1988).

[99]In re Young, 2011 Bankr. LEXIS 3300, at *27–32.

[100]*In re Podzemny*, 2011 WL 576591 (Bankr. D. N.M. 2011).

[101]*In re Podzemny*, 2011 Bankr. LEXIS 567, at *6.

[102]*In re Podzemny*, 2011 Bankr. LEXIS 567, at *6.

[103]*In re Podzemny*, 2011 Bankr. LEXIS 567, at *1.

not leave it adequately protected.[104] The court found that using cash for a new business venture was not ordinary course for this particular debtor.[105] However, given the substantial equity cushion for the debtor's creditors, the court held that the new venture was a valid exercise of the debtor's business judgment.[106]

The court further held that a 30% equity cushion—the minimum cushion based on the creditor's calculation—was enough adequate protection for the creditor, as long as certain other conditions and restrictions on the use of cash collateral were met as a form of additional adequate protection.[107] These conditions included (i) an acknowledgment of the amount of the secured creditor's indebtedness and its lien position, (ii) replacement liens, (iii) periodic cash payments in the amount of interest accrual, (iv) price protection on the cattle and corn to limit market risks, (v) operating within a budget to control expenses, (vi) reporting requirements and access to inspections, (vii) the debtor's obtaining of written bids from vendors for the purchase and installation of necessary equipment before expending any funds to develop the land in time to plant crops by a certain time, (viii) a requirement that the debtor forward contract his corn crop and cattle acquisitions consistent with the requirements in prior cash collateral orders, (ix) a requirement to sell certain cattle as feeder cattle by a specific date and (x) a requirement that the debtor "exercise prudent ranch and grazing management practices so as not to over-graze the wheat pasture."[108] *In re Podzemny* shows that, even with a substantial equity cushion, a debtor may be required to provide additional forms of adequate protection.

B. Future Value of Unfinished Projects as Adequate Protection

Recently, several courts have considered how a debtor with an unfinished real estate project pledged as collateral may provide adequate protection to its secured creditors. In such cases, courts have generally found that continuing construction on an unfinished project does not, in itself, provide adequate protection.[109] Instead, courts have generally required such improvements be

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[104] *In re Podzemny*, 2011 Bankr. LEXIS 567, at *15.

[105] *In re Podzemny*, 2011 Bankr. LEXIS 567, at *21.

[106] *In re Podzemny*, 2011 Bankr. LEXIS 567, at *22–27.

[107] *In re Podzemny*, 2011 Bankr. LEXIS 567, at *26–29.

[108] *In re Podzemny*, 2011 Bankr. LEXIS 567, at *25–33.

[109] *In re Swedeland,* 16 F.3d at 566.

made "in conjunction with the debtor's providing additional collateral beyond contemplated improvements."[110] *In re Marcus Lee Associates*, *In re DB Capital Holdings* and *In re Philadelphia Rittenhouse Developer, L.P.* reinforce that continued construction does not necessarily provide adequate protection, while *In re* 207 *Redwood Street*, *In re Lagoon Breeze Development Corp.* and *In re Moritz Walk* indicate that finishing a project may actually provide enough benefit to adequately protect a secured creditor, particularly when outside financing is provided.[111] Although, as discussed herein, courts have faced this issue in the context of unfinished construction, it is possible that adequate protection for the use of any unfinished collateral, such as inventory, could be analyzed the same way.

1. *Speculative Value Does Not Provide Adequate Protection*

As in 2010's *In re Pacific Lifestyle Homes* case, in which unfinished construction was held to not increase the present value of property for adequate protection purposes, several courts have highlighted the insufficiency of the speculative value of unfinished construction.[112]

In *In re Marcus Lee Associates*, the court refused to allow the value of unfinished construction to satisfy the debtor's ("Marcus Lee") burden of adequate protection.[113] There, Marcus Lee had begun developing property in Pennsylvania which was pledged to a secured creditor.[114] In order to continue to develop the property postpetition, Marcus Lee sought authority to use cash collateral. For most of a year postpetition, Marcus Lee was allowed use cash collateral by consent of its secured creditor.[115] Once the creditor withdrew its consent, the court held that Marcus Lee had a

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[110] *In re Swedeland,* 16 F.3d at 566.

[111] *In re Marcus Lee Assocs.*, 2011 U.S. Dist. LEXIS 5372 (E.D. Pa. Jan. 20, 2011); *In re DB Capital Holdings, LLC*, 454 B.R. 804, 808 (Bankr. D. Colo. 2011); *In re Philadelphia Rittenhouse Developer, L.P.*, 2011 Bankr. LEXIS 1930 (Bankr. E.D. Pa. May 25, 2011); *In re 207 Redwood Street LLC*, 2011 WL 3799767 (Bankr. D. Md. 2011); *In re Lagoon Breeze Dev. Corp.*, 2011 Bankr. LEXIS 981, at *3 (Bankr. S.D. Cal. Mar. 14, 2011); *In re Walk*, 2011 WL 830533 (Bankr. S.D. Tex. 2011).

[112] *In re Pacific Lifestyle Homes, Inc.*, 2009 WL 688908 (Bankr. W.D. Wash. 2009).

[113] *In re Marcus Lee Assocs.*, 2011 U.S. Dist. LEXIS 5372 (E.D. Pa. Jan. 20, 2011).

[114] *In re Marcus Lee*, 2011 U.S. Dist. LEXIS 5372, at *2.

[115] *In re Marcus Lee*, 2011 U.S. Dist. LEXIS 5372, at *2.

renewed burden to demonstrate adequate protection under sections 363(c)(2) and (e) of the Bankruptcy Code.[116] The district court observed that the bankruptcy court had found that any increase in the value of the property in development from completion of the project was purely speculative.[117] Therefore, the bankruptcy court had held that the debtor "failed to provide a non-speculative basis" for adequate protection of its creditors.[118] Thus, the district court affirmed the bankruptcy court's ruling that the secured creditor was not adequately protected.[119]

In *In re DB Capital Holdings*, a condominium developer in Aspen—DB Capital Holdings, LLC—had begun to default on its development loans in June 2009.[120] In early 2010, its lenders initiated state court proceedings against it.[121] Shortly thereafter an involuntary proceeding was filed against the DB Capital parent and its subsidiaries filed voluntary petitions.[122] The debtors filed a motion for approval of debtor-in-possession ("DIP") financing, which they claimed was necessary for completion of their condominium project.[123] In response, a secured creditor holding security interests in the uncompleted project sought relief from the automatic stay to continue to pursue its non-bankruptcy remedies.[124] The parties had stipulated that the lender was undersecured and, therefore, there was no equity cushion to provide such adequate protection.[125] The debtor offered to provide adequate protection through (i) a one-time payment from funds reserved in a state court action, (ii) recurring payments from the DIP financing and (iii) hiring a third party to resume sales and

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[116] *In re Marcus Lee*, 2011 U.S. Dist. LEXIS 5372, at *3.

[117] *In re Marcus Lee*, 2011 U.S. Dist. LEXIS 5372, at *3.

[118] *In re Marcus Lee Associates, L.P.*, Case No. 09-11037, "Statement of Reasons in Support of Order Denying Motion of the Debtor for Reconsideration of the Court's Order of December 29, 2009 Denying Continued Use of Cash Collateral and Granting Stay Relief to Wachovia Bank", at *4 [Dkt. No. 248] (Jan. 8, 2010).

[119] *In re Marcus Lee*, 2011 U.S. Dist. LEXIS 5372, at *1–2.

[120] *In re DB Capital Holdings, LLC*, 454 B.R. 804, 808 (Bankr. D. Colo. 2011).

[121] *In re DB Capital,* 454 B.R. at 808.

[122] *In re DB Capital,* 454 B.R. at 809.

[123] *In re DB Capital,* 454 B.R. at 810.

[124] *In re DB Capital,* 454 B.R. at 816.

[125] *In re DB Capital,* 454 B.R. at 817.

marketing of the unfinished project.[126] The court noted that, even if it were to approve the DIP financing, the project would not be completed, nor would payments be made to the secured creditor under a plan for years.[127] Further, the court held that the debtors had ample time to propose a plan but had failed to do so. The court held that "the previous cost overruns of the [uncompleted project], coupled with the fact that the debtors must rely on high cost, super-priority financing to finish the [uncompleted project], support a finding [that] the Debtors' assertions of repayment of [the secured creditor] are at best extremely speculative."[128] Therefore, the court held that the secured creditor was not adequately protected by the uncompleted project.[129]

In *In re Philadelphia Rittenhouse Developer*, the debtor had mostly finished construction of a condominium development in downtown Philadelphia prior to filing for Chapter 11 protection.[130] Leading up to its filing, the debtor and its undersecured senior lender had been embroiled in contentious state court litigation over defaults and the debtor's ability to make payments.[131] As a receiver was about to be appointed, the debtor filed its bankruptcy petition.[132]

The debtor's secured creditor filed a motion either to dismiss the debtor's Chapter 11 case or to lift the automatic stay. The debtor filed a motion for authority to use cash collateral.[133] The debtor argued that its secured creditor was adequately protected by its proposed plan of reorganization, which called for the use of rents and proceeds of condominium sales to fund operations.[134] In exchange for this use of the secured creditor's collateral, the debtor proposed to pay a portion of those proceeds to the lender while using the remaining proceeds to fund ongoing operations.[135] The court found that this was not the indubitable equivalent of

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[126] *In re DB Capital,* 454 B.R. at 816–17.

[127] *In re DB Capital,* 454 B.R. at 818.

[128] *In re DB Capital,* 454 B.R. at 818.

[129] *In re DB Capital,* 454 B.R. at 818.

[130] *In re Phila. Rittenhouse Developer, L.P.*, 2011 Bankr. LEXIS 1930, at *8 (Bankr. E.D. Pa. May 25, 2011).

[131] *In re Phila. Rittenhouse*, 2011 Bankr. LEXIS 1930, at *8–12.

[132] *In re Phila. Rittenhouse*, 2011 Bankr. LEXIS 1930, at *13.

[133] *In re Phila. Rittenhouse*, 2011 Bankr. LEXIS 1930, at *45.

[134] *In re Phila. Rittenhouse*, 2011 Bankr. LEXIS 1930, at *53.

[135] *In re Phila. Rittenhouse*, 2011 Bankr. LEXIS 1930, at *63–4.

the creditor's claims.[136] The court held that "continued construction and improvements to a property do not alone constitute adequate protection."[137] Therefore, the court held that relief from the automatic stay was warranted for the creditor.[138]

2. *The Value In An Almost Complete Project May Provide Adequate Protection*

In contrast to these cases, if the court finds that the value of a construction project is certain enough (e.g. nearly complete construction being separately financed), the project may provide adequate protection. For example, in *In re 207 Redwood Street*, the bankruptcy court addressed a motion by a secured creditor in a single asset real estate debtor's Chapter 11 case under section 362 to lift the automatic stay on the basis that it was not adequately protected.[139] The secured creditor argued that the debtor's sole asset, its real estate property, had been sold at a tax sale and that the debtor needed over $300,000 to redeem the property including accrued interest. Further, the secured creditor pointed out that the debtor was not making current tax payments, had no employees, no work had been done on the property for two years and no payments had been made to the secured creditor. The debtor admitted that the value of the property may have been less than the secured creditor's claim. However, the debtor also asserted that it had funding in place to complete repairs and renovations on the property to be able to have it in condition to open as a hotel within six months of confirmation of a reorganization plan.[140] The renovation project was 90% complete and the court accepted the debtor's produced testimony that it would take roughly $800,000 to complete the project.[141] Because the debtor had $3.5 million of financing in place, the court held that the debtor had enough funds to complete the project, make the necessary repairs, redeem the property from the tax sale and

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[136] *In re Phila. Rittenhouse*, 2011 Bankr. LEXIS 1930, at *65.

[137] *In re Phila. Rittenhouse*, 2011 Bankr. LEXIS 1930, at *68 (citing *In re Swedeland Development Group, Inc.*, 16 F.3d 552, 25 Bankr. Ct. Dec. (CRR) 486, 30 Collier Bankr. Cas. 2d (MB) 1034, Bankr. L. Rep. (CCH) P 75803 (3d Cir. 1994)).

[138] *In re Phila. Rittenhouse*, 2011 Bankr. LEXIS 1930, at *68–69.

[139] *In re 207 Redwood Street LLC*, 2011 WL 3799767, *1 (Bankr. D. Md. 2011).

[140] *In re 207 Redwood Street LLC*, 2011 WL 3799767, *1 (Bankr. D. Md. 2011).

[141] *In re 207 Redwood Street LLC*, 2011 WL 3799767, *2 (Bankr. D. Md. 2011).

pay taxes.[142] Perhaps significantly, the court held that the passive partner in the debtor who had taken the initiative to complete the project had reputable credentials and had put together a feasible business plan. Given that it had determined that the debtor had enough cash on hand to complete the project, the court then held that the secured creditor was adequately protected. It stated:

> This Property appears to be very close to becoming an income-producing hotel and the Debtor ought to be given an opportunity to see that vision through. The [secured creditor] will become increasingly protected based on the expectation that the value of the Property will continue to grow as the Debtor improves the condition of the Property.[143]

Therefore, the court denied the secured creditor's request for relief from the automatic stay.[144] This case shows that, even with a minimal equity cushion, a court may find that a secured creditor is adequately protected by, in part, the potential value of a completed project.

Similarly, in *In re Lagoon Breeze*, the debtor was a real estate developer. The debtor was building a seven-unit condominium, intending to sell all seven units upon completion.[145] The debtor sought a postpetition priming loan to finance completion of construction. The debtor's prepetition secured lender argued that it was not adequately protected. Based on evidence presented, the court determined that completion of the condominiums would increase their value by $4 million "under any conceivable scenario supported by the evidence."[146] Thus the court determined that the value of the secured lender's collateral, which was the amount to be adequately protected, could be calculated by subtracting $4 million from the ultimate completed value of the project, whatever that turned out to be.[147] The court then found, "that the Bank's deficiency claim would be eliminated under any conceivable scenario with a cushion" even after allowing the prim-

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[142] *In re 207 Redwood Street LLC*, 2011 WL 3799767, *6 (Bankr. D. Md. 2011).

[143] *In re 207 Redwood Street LLC*, 2011 WL 3799767, *6 (Bankr. D. Md. 2011).

[144] *In re 207 Redwood Street LLC*, 2011 WL 3799767, *6 (Bankr. D. Md. 2011).

[145] *In re Lagoon Breeze Dev. Corp.*, 2011 Bankr. LEXIS 981, at *3 (Bankr. S.D. Cal. Mar. 14, 2011).

[146] *In re Lagoon Breeze*, 2011 Bankr. LEXIS 981, at *3.

[147] *In re Lagoon Breeze*, 2011 Bankr. LEXIS 981, at *4–5.

ing loan.[148] Therefore, the court granted the debtor's motion for approval of financing.[149]

C. Replacement Liens in Future Rents

As discussed in section I.C.2 above, the court in *In re Buttermilk Towne Center* held that a floating lien on rents must be adequately protected, without regard to whether the value of the underlying collateral was declining.[150]

In *In re Smithfield Crossing*, Smithfield Crossing, LLC ("Smithfield") was a single asset real estate debtor leasing retail shopping space.[151] Smithfield had borrowed $5.1 million from Branch Banking and Trust Company ("BB&T") for a purchase of property and construction costs.[152] Smithfield defaulted on the loan and related assignment of rents and deed of trust.[153] BB&T initiated proceedings to exercise remedies and recovery on the loan.[154] Subsequently, BB&T assigned its interests to Rialto Real Estate Fund, LP ("Rialto").[155] After Rialto filed a complaint in North Carolina Superior Court, Smithfield filed its bankruptcy petition.[156] In response, Rialto sought relief from the automatic stay because, among other things, it was not being adequately protected.[157] The court found that there was no equity in the property and, therefore, Rialto was undersecured.[158]

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[148] *In re Lagoon Breeze*, 2011 Bankr. LEXIS 981, at *6. However, after finding that the lender was adequately protected, the court, due to the de minimis cushion, proceeded to grant the lender's additional requests for non-monetary adequate protection, including limiting the amount of time to close the new loan, carefully constraining the use of proceeds, requiring proof of insurance and allowing no unapproved changes to the " 'sales and marketing' budget." *In re Lagoon Breeze*, 2011 Bankr. LEXIS 981, at *7. Finally, the court required periodic status conferences and reporting to ensure continuing adequate protection. *In re Lagoon Breeze*, 2011 Bankr. LEXIS 981, at *8.

[149] *In re Lagoon Breeze*, 2011 Bankr. LEXIS 981, at *7.

[150] *In re Buttermilk Towne Center, LLC*, 442 B.R. 558, 54 Bankr. Ct. Dec. (CRR) 13, 64 Collier Bankr. Cas. 2d (MB) 1771 (B.A.P. 6th Cir. 2010).

[151] *In re Smithville Crossing, LLC*, 442 B.R. 558, 2011 Bankr. LEXIS 4605, at *1 (Bankr. E.D.N.C. Sept. 28, 2011).

[152] *In re Smithville Crossing*, 2011 Bankr. LEXIS 4605, at *3.

[153] *In re Smithville Crossing*, 2011 Bankr. LEXIS 4605, at *3–4.

[154] *In re Smithville Crossing*, 2011 Bankr. LEXIS 4605, at *3–4.

[155] *In re Smithville Crossing*, 2011 Bankr. LEXIS 4605, at *5.

[156] *In re Smithville Crossing*, 2011 Bankr. LEXIS 4605, at *5.

[157] *In re Smithville Crossing*, 2011 Bankr. LEXIS 4605, at *21.

[158] *In re Smithville Crossing*, 2011 Bankr. LEXIS 4605, at *21–22.

The court noted that there are times when lenders' cash collateral may be used in the absence of adequate protection.[159] This "exception" is authorized under section 506(c) of the Bankruptcy Code.[160] The court observed that "[g]enerally, a debtor may use cash collateral to reasonable maintain the property."[161] Therefore, the court allowed Smithfield to use Rialto's cash collateral for the maintenance of the property.[162]

With respect to Smithfield's request to use Rialto's cash collateral to pay administrative expenses and make plan distributions, Smithfield argued that Rialto was adequately protected due to the grant of replacement liens on accruing rents.[163] The court disagreed, holding that "a security interest in postpetition rents must be adequately protected in its own right."[164] The court noted that section 552(a) of the Bankruptcy Code cuts off a secured creditor's security interest in collateral accruing postpetition but that section 552(b) excludes rents from this provision.[165] With respect to Smithfield's argument that Rialto was adequately protected by replacement liens in postpetition rents, the court stated that "[v]irtually every case addressing the issue has held that that proffer of a replacement lien on post-petition rents is illusory by virtue of § 552(b) of the Bankruptcy Code."[166] The court held that, because Smithfield was not permitted to use Rialto's cash collateral, Rialto's security interest was not declining in

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[159]*In re Smithville Crossing*, 2011 Bankr. LEXIS 4605, at *32.

[160]*In re Smithville Crossing*, 2011 Bankr. LEXIS 4605, at *27.

[161]*In re Smithville Crossing*, 2011 Bankr. LEXIS 4605, at *27 (citing *In re River Oaks Ltd. Partnership*, 166 B.R. 94, 98, 31 Collier Bankr. Cas. 2d (MB) 654 (E.D. Mich. 1994)).

[162]*In re Smithville Crossing*, 2011 Bankr. LEXIS 4605, at *28–30.

[163]*In re Smithville Crossing*, 2011 Bankr. LEXIS 4605, at *25–26.

[164]*In re Smithville Crossing*, 2011 Bankr. LEXIS 4605, at *29 (citing *In re Griswold Bldg., LLC*, 420 B.R. 666, 699 (Bankr. E.D. Mich. 2009)).

[165]*In re Smithville Crossing*, 2011 Bankr. LEXIS 4605, at *30–31 (citing 11 U.S.C. § 552(a) & (b)).

[166]*In re Smithville Crossing*, 2011 Bankr. LEXIS 4605, at *31 (citing *In re Buttermilk Towne Center, LLC*, 442 B.R. 558, 54 Bankr. Ct. Dec. (CRR) 13, 64 Collier Bankr. Cas. 2d (MB) 1771 (B.A.P. 6th Cir. 2010); *In re Griswold Bldg., LLC*, 420 B.R. 666 (Bankr. E.D. Mich. 2009); *In re River Oaks Ltd. Partnership*, 166 B.R. 94, 31 Collier Bankr. Cas. 2d (MB) 654 (E.D. Mich. 1994); *In re Union-Go Dairy Leasing, LLC*, 2010 WL 1848485 (Bankr. S.D. Ind. 2010).

value.[167] Therefore, the court denied Rialto's motion to lift the automatic stay.[168]

D. Other Recent Attempts to Provide Adequate Protection

As discussed above, courts have indicated that adequate protection may at times be bolstered by requiring additional duties and activities of debtor.[169] Courts, however, have also been quick to identify and reject various debtor proposals that do not suffice—for instance, where (a) the debtor's proposed activities are no different than its current activities, (b) payments to the secured creditor would be likely to be decreased by the use of cash collateral or (c) maintenance of the property would cost more than the value generated by the property.[170]

1. *A Plan of Reorganization as Adequate Protection*

In *In re Hickory Ridge*, a secured bank lender sought relief from the automatic stay to allow it to exercise state law remedies regarding tracts of land.[171] At the same time, the debtor, Wagner ("Wagner"), sought to convert its involuntary Chapter 7 case to a case under Chapter 11.[172] The bankruptcy court initially found that Wagner did not demonstrate adequate protection of its secured creditor's interests.[173] On appeal, the district court agreed that Wagner clearly did not offer to provide adequate protection in the form of cash or replacement liens.[174] Instead, Wagner testified that he could provide the indubitable equivalent of the secured lender's claims in the form of a proposed plan of reorga-

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[167] *In re Smithville Crossing*, 2011 Bankr. LEXIS 4605, at *36.

[168] *In re Smithville Crossing*, 2011 Bankr. LEXIS 4605, at *36.

[169] *See, e.g.*, *In re Lagoon Breeze Dev. Corp.*, 2011 Bankr. LEXIS 981, at *3 (Bankr. S.D. Cal. Mar. 14, 2011); *In re Podzemny*, 2011 WL 576591 (Bankr. D. N.M. 2011).

[170] *See, e.g.*, *People v. Farnetti*, 2011 WL 2816670 (Cal. App. 2d Dist. 2011), unpublished/noncitable; *In re Phila. Rittenhouse Developer, L.P., 54 Bankr. Ct. Dec. (LRP) 206*, 2011 Bankr. LEXIS 1930 (Bankr. E.D. Pa. May 25, 2011); *In re Grand Island Liquor Mart*, 2011 WL 739593 (Bankr. D. Neb. 2011).

In re Harbour East Development, Ltd., 66 Collier Bankr. Cas. 2d (MB) 1808, 2011 WL 6097063, *1 (Bankr. S.D. Fla. 2011).

[171] *In re Hickory Ridge*, 2010 U.S. Dist. LEXIS 84720, at *1–2.

[172] *In re Hickory Ridge*, 2010 U.S. Dist. LEXIS 84720, at *1–2.

[173] *In re Hickory Ridge*, 2010 U.S. Dist. LEXIS 84720, at *2.

[174] *In re Hickory Ridge*, 2010 U.S. Dist. LEXIS 84720, at *6.

nization if the case was converted to one under Chapter 11.[175] Without determining whether the proposed plan of reorganization could be considered adequate protection, the court held that Wagner's plan would not adequately protect the secured creditors' interest because the plan would not accomplish anything more than the Chapter 7 trustee had already attempted.[176]

In *In re Moritz Walk*, the debtor was a developer of a parcel of real property.[177] The debtor's largest secured creditor moved to lift the automatic stay.[178] Relying on the evidence presented, the court found that the value of the property was between the amount owed to the secured creditor and the higher appraised value provided by the debtor.[179] On this basis, the court found that the debtor must have had some equity in the property.[180] However, because the evidence presented also demonstrated that the property value was eroding, the court was concerned about continuing adequate protection.[181] The court continued the stay contingent on the debtor pursuing its plan of reorganization—by preparing the plan and corresponding disclosure statement promptly. In continuing the effectiveness of the stay, the court gave the debtor six weeks to prepare its plan and disclosure statement, without allowing the debtor unfettered leeway in order to protect the secured lender's interests as well.[182]

2. *Partial Payment of Proceeds May Not Provide Adequate Protection of Cash Collateral*

As previously seen in *In re Buttermilk Towne Center*,[183] which was decided in 2010 and addressed the insufficiency of payment of future rents to the holder of a lien on all assets, several courts in 2011 held that other partial payments of proceeds were also not sufficient to provide adequate protection of cash collateral.

As discussed in Section II.B.1 above, in *In re Philadelphia Rittenhouse Developer*, the debtor proposed to pay a portion of the

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[175] *In re Hickory Ridge*, 2010 U.S. Dist. LEXIS 84720, at *6.

[176] *In re Hickory Ridge*, 2010 U.S. Dist. LEXIS 84720, at *7.

[177] *In re Walk*, 2011 WL 830533 (Bankr. S.D. Tex. 2011).

[178] *In re Moritz Walk*, 2011 Bankr. LEXIS 811, at *1.

[179] *In re Moritz Walk*, 2011 Bankr. LEXIS 811, at *6.

[180] *In re Moritz Walk*, 2011 Bankr. LEXIS 811, at *6.

[181] *In re Moritz Walk*, 2011 Bankr. LEXIS 811, at *7.

[182] *In re Moritz Walk*, 2011 Bankr. LEXIS 811, at *7.

[183] *In re Buttermilk Towne Center, LLC*, 442 B.R. 558, 54 Bankr. Ct. Dec. (CRR) 13, 64 Collier Bankr. Cas. 2d (MB) 1771 (B.A.P. 6th Cir. 2010).

proceeds of sales of collateral to its secured lender and to keep the remainder to fund on-going operations.[184] The court found that such partial payment was insufficient to adequately protect its secured lender.[185]

In *In re Grand Island Liquor Mart*, the debtors owned two retail stores which had provided their inventory, accounts, fixtures and equipment as collateral on a secured loan.[186] Their monthly bank payments became too high for them to afford and they filed for Chapter 11. The debtors sought authority to use cash collateral, offering to provide monthly cash payments, sales and expense reports and a physical inventory on a regular basis as adequate protection to their secured creditors.[187] The court evaluated the business's gross receipts, its profit margin as compared to expenditures, the wholesale and retail values of inventory and prospects for success.[188] The court determined that, without any "backup" collateral, the monthly payments offered were insufficient to provide adequate protection, even if combined with the reporting and inspection rights offered.[189] Thus, the court denied the debtors' request for the use of cash collateral.[190]

3. *Replacement Liens on New Investments May Not Provide Adequate Protection*

The use of cash collateral to fund new endeavors may be insufficient to adequately protect a secured creditor. In *In re Harbour East Development, Ltd.*, Harbour East Development, Ltd. ("Harbour East") developed and built a condominium complex

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[184] *In re Phila. Rittenhouse*, 2011 Bankr. LEXIS 1930, at *63–4.

[185] *In re Phila. Rittenhouse*, 2011 Bankr. LEXIS 1930, at *67. For this reason and for other incurable defects, the *Philadelphia Rittenhouse* court found that the debtor's plan of reorganization could not be confirmed. *In re Phila. Rittenhouse*, 2011 Bankr. LEXIS 1930, at *69.

[186] *In re Grand Island Liquor Mart*, 2011 WL 739593, *1 (Bankr. D. Neb. 2011).

[187] *In re Grand Island Liquor Mart*, 2011 WL 739593, *1 (Bankr. D. Neb. 2011).

[188] *In re Grand Island Liquor Mart*, 2011 WL 739593, *2 (Bankr. D. Neb. 2011).

[189] *In re Grand Island Liquor Mart*, 2011 WL 739593, *2 (Bankr. D. Neb. 2011).

[190] *In re Grand Island Liquor Mart*, 2011 WL 739593, *3 (Bankr. D. Neb. 2011).

("Cielo") in North Bay Village, Florida.[191] Harbour East financed the construction with a $16.9 million construction loan from Northern Trust Bank, secured by the Cielo properties. When this loan matured in 2009, Harbour East was unable to pay. Shortly thereafter, with the debtor in default, Northern Trust Bank sold its interest to NBV and NBV then initiated foreclosure proceedings on the Cielo properties. In April 2010, the day before a hearing for the appointment of a receiver, Harbour East filed a voluntary Chapter 11 petition.[192]

During the bankruptcy case, NBV consented to seven consecutive cash collateral orders to allow Harbour East to continue to operate.[193] However, in August 2011, NBV objected to Harbour East's request for the use of $119,000 of cash collateral "for the build out of additional units and similar expenses."[194] Harbour East argued that NBV was adequately protected by a replacement lien on future rental income from the new units and on furniture and appliances installed in the units.[195] The court held that NVB's cash collateral could not be used to fund capital improvement without NBV's consent or a replacement lien on unencumbered assets "that affords NBV dollar-for-dollar protection for the diminishment in its cash collateral."[196] The court found that the expenditures were not guaranteed to enhance the collateral property dollar-for-dollar and, thus, NBC was not adequately protected by the replacement liens offered by Harbour East.[197] The court stated that "[t]he possibility that the Debtor's

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[191] *In re Harbour East Development, Ltd.*, 66 Collier Bankr. Cas. 2d (MB) 1808, 2011 WL 6097063, *1 (Bankr. S.D. Fla. 2011).

[192] *In re Harbour East Development, Ltd.*, 66 Collier Bankr. Cas. 2d (MB) 1808, 2011 WL 6097063, *1 (Bankr. S.D. Fla. 2011).

[193] *In re Harbour East Development, Ltd.*, 66 Collier Bankr. Cas. 2d (MB) 1808, 2011 WL 6097063, *2 (Bankr. S.D. Fla. 2011).

[194] *In re Harbour East Development, Ltd.*, 66 Collier Bankr. Cas. 2d (MB) 1808, 2011 WL 6097063, *2 (Bankr. S.D. Fla. 2011).

[195] *In re Harbour East Development, Ltd.*, 66 Collier Bankr. Cas. 2d (MB) 1808, 2011 WL 6097063, *3 (Bankr. S.D. Fla. 2011).

[196] *In re Harbour East Development, Ltd.*, 66 Collier Bankr. Cas. 2d (MB) 1808, 2011 WL 6097063, *4 (Bankr. S.D. Fla. 2011) (citing *In re Fontainebleau,* 434 B.R. at 727).

[197] *In re Harbour East Development, Ltd.*, 66 Collier Bankr. Cas. 2d (MB) 1808, 2011 WL 6097063, *4 (Bankr. S.D. Fla. 2011).

rental program may perform as projected does not justify shifting the risk of success or failure from the Debtor to NBV."[198]

The court in *In re Podzemny*, discussed in section II.A.3 above, made a similar determination.[199] While the court found that using cash for a new business venture was within the debtor's business judgment, it also held that the expenditures were not ordinary course and thus entitled the secured lender to adequate protection.[200] To that end, the court enforced a heightened level of adequate protection, apparently due to the greater risk to the secured lender's collateral.[201]

4. *Payment of Senior Claims as Adequate Protection*

In *In re The Lodge at Big Sky, LLC*, Jeffrey Quackenbush ("Quackenbush") was the managing member of The Lodge at Big Sky, Inc. ("Lodge") and The Lodge at Big Sky Management Company, LLC ("Management"), each of which as a single member limited liability company.[202] Through Lodge, Quackenbush purchased real estate in Big Sky, Montana which he operated as a hotel with 90 separate condominium units.[203] A year after purchasing the real estate, Quackenbush formed Management which took over operations of the condominium units and collected rental income.[204] Although Management retained the hotel income and was responsible for the general expenses of running the hotel, Lodge remained liable for real estate taxes and debt service on the units. Lodge and Management filed for Chapter 11 together. As of the petition date, Lodge claimed approximately $3.5 million in assets and $11.5 million debt, most of which was owed to First Financial Bank, N.A. ("First Financial"), which had a security interest in Lodge's condominium units. Lodge also owed over $380,000 in property taxes as of its petition date. Management reported approximately $567,000 in assets and

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[198] *In re Harbour East Development, Ltd.*, 66 Collier Bankr. Cas. 2d (MB) 1808, 2011 WL 6097063, *4 (Bankr. S.D. Fla. 2011) (citing *In re Swedeland,* 16 F.3d at 557).

[199] *In re Podzemny*, 2011 Bankr. LEXIS 567.

[200] *In re Podzemny*, 2011 Bankr. LEXIS 567, at *21.

[201] *In re Podzemny*, 2011 Bankr. LEXIS 567, at *26–29.

[202] *In re The Lodge at Big Sky, LLC*, 454 B.R. 138, 140 (Bankr. D. Mont. 2011).

[203] *In re The Lodge at Big Sky*, 454 B.R. at 140.

[204] *In re The Lodge at Big Sky,* 454 B.R. at 141.

$120,000 of debt.[205] The bankruptcy court determined that the business functions of Lodge and Management were "hopelessly intertwined" and, therefore, substantively consolidated their cases.[206]

In response to First Financial's motion seeking adequate protection, the court held that, while an equity cushion is a common form of adequate protection, Lodge had no equity in its condominium units.[207] Therefore, the court held that First Financial was entitled to the adequate protection it requested and ordered that Lodge make immediate payment of its past due property taxes.[208] The remedy in *The Lodge at Big Sky* was tailored to First Financial's request but raises the question whether the payment of claims with priority over those of the creditor seeking adequate protection should constitute adequate protection for that creditor.[209]

III. Conclusion

As evidenced by recent case law, adequate protection as described in section 361 of the Bankruptcy Code spawns a great deal of litigation over nuanced issues. This article has addressed topics including: (i) sufficiency and adequacy of equity cushions, (ii) whether completion of unfinished projects serving as security can provide adequate protection, (iii) whether replacement liens in future rents or future value of an unfinished project can provide adequate protection and (iv) additional forms of adequate protection. These topics, and likely other as-yet unreported issues, are susceptible to differences of opinion and should engender substantial debate and controversy in the coming years.

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[205] *In re The Lodge at Big Sky,* 454 B.R. at 141.

[206] *In re The Lodge at Big Sky,* 454 B.R. at 143.

[207] *In re The Lodge at Big Sky,* 454 B.R. at 144–5.

[208] *In re The Lodge at Big Sky,* 454 B.R. at 145.

[209] See *Matter of Mulcahy*, 5 B.R. 558, 563–64 (Bankr. D. Conn. 1980) (holding that secured creditor was adequately protected because there was an equity cushion in the collateral and because the debtor was making payments on liens senior to those of the secured creditor seeking relief from the automatic stay).