United States Bankruptcy Court
Western District of Wisconsin

Cite as: [Unpublished]

In re Linda Rae Dotz, Debtor
Bankruptcy Case No. MM11-90-01864

United States Bankruptcy Court
W.D. Wisconsin

January 4, 1991

Richard B. Jacobson, Borns, Macaulay & Jacobson, Madison, WI, for debtor.
Karen A. Mercer, Cross, Jenks, Mercer and Maffei, Baraboo, WI, for First National Bank of Columbus.

Robert D. Martin, United States Bankruptcy Judge.

MEMORANDUM DECISION

On July 3, 1990 the debtor, Linda Rae Dotz, filed her petition under chapter 11 of the Bankruptcy Code. At the time of filing, she was the defendant and third-party plaintiff in an action commenced by the First National Bank of Columbus ("Bank") to foreclose its mortgage, which secures both a 76-acre parcel of farmland known as the "Middle 80," and the debtor's residence. The Middle 80 is currently under lease to a third person. On October 9, 1990, in conjunction with the Bank's motion for relief from the automatic stay, I found that the Middle 80 was worth $112,500.00, and the residence was worth at least $76,000.00.

As of the July 3, 1990 petition date, the amount due under the note and mortgage was $118,246.93. In addition, the Bank has incurred approximately $15,000.00 in disbursements and attorneys fees related to the state foreclosure proceedings which are claimed under the mortgage note. Interest has accrued from July 3, 1990 at the rate of approximately $33.00 per day.

In addition to the real estate, the debtor mortgaged to the Bank "all privileges, hereditaments, easements and appurtenances, all rents, leases, issues and profits, all awards and payments made as a result of the exercise of the right of eminent domain, and all existing and future improvements and fixtures (all called the "Property")." The mortgage also provides:

Upon the commencement or during the pendency of an action to foreclose this Mortgage, or enforce any other remedies of Lender under it, without regard to the adequacy or inadequacy of the Property as security for the Note, the court may appoint a receiver of the Property (including homestead interest) without bond, and may empower the receiver to take possession of the Property and collect the rents, issues and profits of the Property and exercise such other powers as the court may grant until the confirmation of sale, and may order the rents, issues and profits, when so collected, to be held and applied as the court may direct.

On February 6, 1989 the state court in the foreclosure action appointed Donald W. Adam, a Bank officer, as the receiver of the mortgaged property. Mr. Adam continued to act as the receiver through the time of the October 9, 1990 hearing. As of the July 3, 1990 filing date, the amount in the receivership account totalled approximately $19,414.00. Near the end of July this amount was reduced about $2,000.00 for payment of real estate taxes. As of the October 9, 1990 hearing, the receivership account contained approximately $17,000.00.(1)

At the hearing, the Bank's motion for complete relief from the stay was denied, but the continued stay was conditioned upon the filing of a plan and disclosure statement within 45 days, and the confirmation of a plan within 90 days thereafter.(2) The Bank's motions for an order excusing compliance with 11 USC § 543 and for an order prohibiting use of cash collateral, as well as the debtor's motions for turnover of property and use of cash collateral were reserved and are the subject of this decision. All of these motions relate to the funds contained in the receivership account.(3)

I.

11 USC § 552(b) provides:

Except as provided in sections 363, 506(c), 522, 544, 545, 547, and 548 of this title [11 USCS §§ 363, 506(c), 522, 544, 545, 547 and 548], if the debtor and an entity entered into a security agreement before the commencement of the case and if the security interest created by such security agreement extends to property of the debtor acquired before the commencement of the case and to proceeds, product, offspring, rents, or profits of such property, then such security interest extends to such proceeds, product, offspring, rents, or profits acquired by the estate after the commencement of the case to the extent provided by such security agreement and by applicable nonbankruptcy law, except to any extent that the court, after notice and a hearing and based on the equities of the case, orders otherwise.

The Bank asserts that pursuant to Section 552(b), it has a perfected security interest in the pre- and post-petition rents and profits of the Middle 80, including all sums in the receivership account.

In Butner v United States, 440 US 48, 56 (1979), the United States Supreme Court held that "the federal bankruptcy court should take whatever steps are necessary to ensure that the mortgagee is afforded in federal bankruptcy court the same protection he would have under state law if no bankruptcy had ensued." This court discussed the Butner decision in In re Gotta, 47 BR 198 (Bankr WD Wis 1985), stating that in Butner:

[t]he Supreme Court held only that a bankruptcy court must look to state law to determine a mortgagee's interest. If that interest is perfected under state law, the bankruptcy court must insure that the mortgagee is afforded the same protection in bankruptcy that it would have been under state law if no bankruptcy had ensued.

Gotta, 47 BR at 201.

In Gotta, Wisconsin case law was explained: "Wisconsin law . . . provides that an assignment of rents executed contemporaneously with a mortgage is not a perfected security interest until the mortgagee obtains possession either by a peaceable yielding up of possession or by a petition for and appointment of a receiver." Gotta, 47 BR at 203 (citations omitted; emphasis in original). In the present case, the Bank has satisfied both of the requirements for perfection. It has petitioned for, and obtained, the appointment of a receiver. Its perfected interest in the rents thus extends to rents acquired both pre- and post-petition, "except to any extent that the court, after notice

and a hearing and based on the equities of the case, orders otherwise."

The debtor contends that:

the equities of the case are such that the debtor should be permitted to use this cash collateral under § 363 for a few limited purposes as set out in her motion. Specifically, she needs access to these funds for paying the legal fees of her counsel, as they may be approved by the court, certain expenses of litigation in her third-party action against E. Clark Arnold and Callahan & Arnold, and urgent living expenses.

The following passage from J. Catton Farms, Inc. v First National Bank of Chicago, 779 F2d 1242 (7th Cir 1985), clearly illustrates that the circumstances cited by the debtor are not those in which the equity exception is intended to apply:

> The equity exception is meant for the case where the trustee or debtor in possession uses other assets of the bankrupt estate (assets that would otherwise go to the general creditors) to increase the value of the collateral. See, e.g., In re Village Properties, Ltd., 723 F.2d 441, 444 (5th Cir.1984). Suppose a creditor had a security interest in raw materials worth $1 million, and the debtor invested $100,000 to turn those raw materials into a finished product which he then sold for $1.5 million. The proceeds of this sale (after deducting wages and other administrative expenses) would be added to the secured creditor's collateral unless the court decided that it would be inequitable to do so--as well it might be, since the general creditors were in effect responsible for much or all of the increase in the value of the proceeds over the original collateral.

J. Catton Farms, 779 F2d at 1246-47. In the present case, the debtor has not used other assets of the estate to increase the value of the mortgaged property, and the equity exception of Section 552(b) therefore does not apply.

The rents in the receivership account are the Bank's cash collateral. 11 USC §§ 552(b) and 363(a).[(4)] The debtor now seeks to use that cash collateral and the Bank has filed a motion to prohibit its use. "When a creditor opposes a debtor's proposed use of cash collateral, the guiding inquiry is whether its security interests are 'adequately protected' absent the additional protection that the receipt of the cash collateral would provide." In re Johnson, 47 BR 204, 208 (Bankr WD Wis 1985) (citations omitted). If a creditor is adequately protected without the receipt of the cash collateral, the debtor may be authorized to use the cash collateral under Section 363; if not, the use must be prohibited or conditioned as is necessary to provide the protection. 11 USC § 363(e).[(5)]

The current indebtedness to the Bank secured by the mortgage is in the neighborhood of $139,000.00. The combined value of the residence and the Middle 80 is at least $188,500.00. The Bank's "equity cushion" is thus at least $49,500.00, without the receivership account. Although that cushion is subject to erosion by any decline in the value of the real estate, absent a very dramatic downturn in value (a loss of over one-third the value of the Middle 80 or over one-half the value of the residence, or a combination of the two) within the relatively short time anticipated for the confirmation of a plan, or failing that, the dismissal of this case, the Bank's security interests are adequately protected without the receivership account. The Bank's motion for an order prohibiting the use of cash collateral is therefore denied. Should a sharp decline in value or a serious delay be anticipated, the motion may be brought again.

The debtor's motion to use cash collateral proposes paying the balance of the retainer due to bankruptcy counsel, legal fees and costs arising from the debtor's third-party claim in the foreclosure action, and the debtor's living expenses. The debtor's attempted reorganization will undoubtedly fail if she is unable to pay legal counsel or to pay for her living expenses. The debtor's motion accordingly is granted.

II.

In conjunction with her motion to use cash collateral, the debtor has filed a motion pursuant to 11 USC § 543(b)(1) for turnover of the property in the receivership account. Not surprisingly, the Bank has filed its own motion pursuant to 11 USC § 543(d) for an order excusing compliance with 11 USC §§ 543(a) and (b)(1).[(6)] Section 543(d)(1) provides:

After notice and a hearing, the bankruptcy court--

may excuse compliance with subsection (a), (b), or (c) of this section, if the interests of creditors and, if the debtor is not insolvent, of equity security holders would be better served by permitting a custodian to continue in possession, custody, or control of such property[.]

The Bank's court-appointed receiver, Mr. Adam, qualifies as a custodian. See In re Left Guard of Madison, Inc., 11 BR 238, 240 (Bankr WD Wis 1981) (a court-appointed receiver is a custodian as defined in 11 USC § 101(10)(A)).[(7)]

Because the Bankruptcy Code contemplates turnover, the creditor seeking to be excused from compliance with the turnover provisions of Section 543 bears the burden with respect to all issues relating to that affirmative relief. In re Northgate Terrace Apartments, Ltd., 117 BR 328, 332 (Bankr SD Ohio 1990). The Northgate Terrace court expounded:

> The turnover provisions of 11 U.S.C. § 543 are part of the statutory expression of the Congressional preference that a Chapter 11 debtor be permitted to operate and control its business during the reorganization process. Moreover, that operation is for the benefit of all constituencies and is not solely for the benefit of the lender holding the primary mortgage against the debtor's property. "[G]enerally the basic equities would favor a debtor or debtor in possession. If nothing more, a substantial weight is added to the debtor's burden of attempting to reorganize and promulgate an acceptable plan of reorganization if the debtor cannot have access to all of its assets during its initial breathing spell."
>
> The statute contemplates that property being managed by a receiver will be returned to the representative of the estate upon the commencement of the bankruptcy case by the owner. Excuse from this statutory mandate requires Goldome [the creditor] to show that the interests of all creditors are better served if the Receiver is kept in place. Absent a bad faith filing lacking any possibility of reorganization, the presence of grossly inept management of the Property, or fraudulent behavior, that burden will be hard to sustain.

Northgate Terrace, 117 BR at 332-33, citing In re KCC-FUND V, LTD., 96 BR 237, 239-40 (Bankr WD Mo 1989).

The Northgate Terrace court elaborated upon factors a court might consider when evaluating a Section 543(d) motion:

> In analyzing creditors' interests, the Court will examine the likelihood of a reorganization, the probability that funds required for reorganization will be available, whether there are instances of mismanagement by the debtor, and whether turnover would be injurious to creditors.

Northgate Terrace, 117 BR at 332-33, citing In re Powers Aero Marine Service, 42 BR 540, 544 (Bankr SD Tex 1984).

In the present case, it is difficult to evaluate the likelihood of the debtor's reorganization. Distribution under the debtor's proposed plan depends upon a monetary recovery in her pending third-party malpractice action. That monetary recovery may or may not materialize. Whether creditors will elect to be bound by such a plan is impossible to guess. Whether the plan can be "crammed down" on unconsenting creditors cannot be determined from the present state of the record in this case.

The other criteria are less troublesome. Although the debtor has defaulted on payment of the mortgage note, taxes, and insurance, no specific "instances of mismanagement" have been identified as factors contributing to the debtor's inability to pay down the obligation. There is no evidence that the debtor's filing was made in bad faith, that the debtor has engaged in fraudulent behavior, or that the debtor's management of the property has been grossly inept.

The debtor's secured obligation to the Bank totals approximately $139,000.00, while the debtor's obligations to unsecured creditors total in excess of $7,000.00. In In re Poplar Springs Apartments of Atlanta, Ltd., 103 BR 146, 150 (Bankr SD Ohio 1989), the court, faced with a similar fact scenario, stated: "Although the interest of unsecured creditors must be protected, the overwhelming amount of these debtors' obligations are to Great Western. Therefore, it is primarily Great Western's interests which must be balanced against the debtors' rights." Similarly, it is primarily the Bank's interests which must be balanced against the debtor's rights in our case.

There is little reason to believe that the debtor would not manage the receivership account appropriately (i.e., pay the real estate taxes, maintain the insurance, etc.), for the brief period until the plan of reorganization is confirmed or the case is dismissed or converted. Even in the absence of the receivership account, the Bank's interest is protected by an equity cushion of approximately $49,500.00. Any injury caused by allowing the receivership account to be turned over to the debtor for the limited time anticipated and for the limited purposes described in the debtor's motion would be negligible in degree.

It is in the best interests of all of the creditors for the debtor to replace the receiver, so long as the chapter 11 bankruptcy case is pending, provided that the receiver will be reinstated and the Bank's security interest in the rents deemed continuously perfected if this case is dismissed. Accordingly, the debtor's motion for turnover of the receivership account is granted, and the Bank's motion to excuse compliance with Section 543 is denied. However, because the possibility exists that the debtor may fail to use the rents to pay the taxes and insurance on the property, the Bank's motion to prohibit use of cash collateral is denied without prejudice to its being brought again if circumstances have materially changed.

END NOTES:

1. On November 14, 1990 (and hence after the October 9, 1990 hearing on matters to be considered herein), this court authorized $3,000.00 of the debtor's attorney's fees to be paid from the farm rents already collected and to be collected in the future.

2. On November 23, 1990 the debtor filed her disclosure statement and plan of reorganization. A hearing on the approval of the debtor's disclosure statement is scheduled for January 8, 1991.

3. In addition to the Bank's secured claim, unsecured claims have been filed totalling in excess of $7,000.00.

4. 11 USC § 363(a) provides:

In this section, "cash collateral" means cash, negotiable instruments, documents of title, securities, deposit accounts, or other cash equivalents whenever acquired in which the estate and an entity other than the estate have an interest and includes the proceeds, products, offspring, rents, or profits of property subject to a security interest as provided in section 552(b) of this title [11 USCS § 552(b)], whether existing before or after the commencement of a case under this title [11 USCS §§ 101 et seq.].

5. 11 USC § 363(e) provides:

Notwithstanding any other provision of this section, at any time, 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 trustee, 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. 11 USC § 543(a) provides:

A custodian with knowledge of the commencement of a case under this title [11 USCS §§ 101 et seq.] concerning the debtor may not make any disbursement from, or take any action in the administration of, property of the debtor, proceeds, product, offspring, rents, or profits of such property, or property of the estate, in the possession, custody, or control of such custodian, except such action as is necessary to preserve such property.

11 USC § 543(b)(1) provides:

A custodian shall--

deliver to the trustee any property of the debtor held by or transferred to such custodian, or proceeds, product, offspring, rents, or profits of such property, that is in such custodian's possession, custody, or control on the date that such custodian acquires knowledge of the commencement of the case[.]

7. 11 USC § 101(10)(A) provides:

"custodian" means--

receiver or trustee of any of the property of the debtor, appointed in a case or proceeding not under this title[.]