United States Bankruptcy Court
Western District of Wisconsin

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In re James Wilson Associates,
a Wisconsin limited partnership, Debtor
Bankruptcy Case No. MM11-90-01515

United States Bankruptcy Court
W.D. Wisconsin

March 21, 1991

Denis P. Bartell, Ross & Stevens, S.C., Madison, WI, for debtor.
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Daniel W. Stolper, Stafford, Rosenbaum, Rieser & Hansen, Madison, WI, for First Nationwide Bank.
Trayton Lathrop, Lathrop & Clark, Madison, WI, for Metropolitan Life Insurance.
Julie A. Plotkin, Murphy & Desmond, S.C., Madison, WI, for JWP Investors.

Robert D. Martin, United States Bankruptcy Judge.

AMENDED MEMORANDUM DECISION

In late 1989 the debtor-in-possession, James Wilson Associates, a Wisconsin Limited Partnership, defaulted on notes to Metropolitan Life Insurance Company ("Met") and First Nationwide Bank ("Bank") (collectively, "Mortgagees"). The notes were secured by properly recorded mortgages and rent assignments on an office building known as James Wilson Plaza (the "property"). Met and the Bank thereafter began foreclosure proceedings in state court, and on May 11, 1990, were successful in having a receiver appointed for the property; the receiver took possession of the property the same day. On May 31, 1990, the debtor filed a chapter 11 petition. After a hearing, on June 13, 1990, this court ordered the receiver to turn over the property to the debtor-in-possession.

On July 16, 1990, at a hearing on the debtor-in-possession's motion to use cash collateral, it was determined that the property was worth "not less than $6,000,000," and that "[t]he rate of decline in protection . . . is fairly rapid," noting that "[i]t has a relatively short life, somewhere under three years if in fact there is a million four available to cover the interest that is accruing on $4,650,000." Use of cash collateral, that is, the rents from the property, was approved for the period of nine months. The order has not been extended and the authority to use cash collateral expires on April 16, 1991.

On November 7, 1990, the attorney for the debtor-in-possession applied for an order approving attorneys fees and expenses in the amount of $36,604.49 and directing their payment from the accumulated rents which constitute cash collateral. Both Met and the Bank object to any payment of attorneys fees and expenses from rents. Met further objects to payment of any fees and expenses relating to negotiations with JWP

Investors.

I.

Met contends that its "assignment was perfected before the filing of this Chapter 11 proceeding, and that such rentals may be used only for the preservation or sale of the property." The Bank contends that "there has been an absolute assignment of the Rents to First Nationwide Bank and the Rents are not property of the estate. Therefore, the Debtor has no right to use the Rents to pay attorneys' fees." Both Met and the Bank are mistaken in their views of the applicable law.

Nature of Mortgagees' Interests. The interests of both mortgagees in the rents of the building were, by the terms of the mortgages and assignments, as well as by the conventions and conduct of the parties, conditional. So long as there was no default by the debtor, use of the rents was solely within the debtor's discretion.(1) Only upon the condition of a default did either of the movants have the right to obtain possession of the rents. This conditional assignment was in each case agreed to as a means of securing an underlying obligation. To suggest that the assignment was absolute and ought to be treated as an outright transfer completed prior to the filing of this bankruptcy case is sophistry and not based upon an analysis of either of the documents reciting the agreements between the parties nor on any applicable law.

An assignment that would require direct payment of rents to or for the benefit of the assignee from the date of the assignment could be said to be "absolute." Short of that, however, the use of the word absolute is at best ambiguous, particularly if some act or event in the future is to trigger the rights of the assignee. The Wisconsin courts have not addressed the difference, if any, between an "absolute assignment" and a non-absolute assignment. However, the court in In re Harbour Town Associates, Ltd. explained that "[t]o be an absolute assignment the parties must intend that the assignment vest rights to rents in the assignee automatically upon default without requiring the assignee to take any additional steps." In re Harbour Town Associates, Ltd., 99 BR 823, 824-25 (Bankr MD Tenn 1989) (citation omitted). In the present case, the Bank's "absolute assignment" gave it the right to the rents from the office building not immediately upon the debtor's default, but only after the Bank took the additional step of sending the debtor a written notice that an "event of default" had occurred. Thus, even under a generous construction of an "absolute assignment," the Bank's agreement is simply a pledge of collateral security.(2) Throughout this memorandum decision the mortgagees' assignments will be treated as security interests, defined by 11 USC § 101(45).

Perfection. The initial inquiry, suggested by prior cases,(3) is whether the mortgagee's security interest in the rents is perfected. This is a question which can only be answered by resort to the law of Wisconsin. "Property interests are created and defined by state law." Butner v United States, 440 US 48, 54 (1979).(4) A Wisconsin mortgagee, in addition to recording its mortgage with the register of deeds, must do one of the following in order to perfect its interest prior to the filing of the bankruptcy petition:

(1) obtain possession by a peaceable yielding up of possession;

(2) obtain possession by petition for and appointment of a receiver; or

(3) experience the happening of an event clearly expressed in the security agreement as being an event of perfection.

See Matter of Gotta, 47 BR 198, 203 (Bankr WD Wis 1985), citing Wuorinen v City Federal Savings & Loan Association, 52 Wis2d 722, 191 NW2d 27 (1971); Dick & Reuteman Co. v Jem Realty Co., 225 Wis 428, 274 NW 416 (1937); First Wisconsin

Trust Co. v Adams, 218 Wis 406, 409-10, 261 NW 16 (1935); Grether v Nick, 193 Wis 503, 512, 213 NW 304, 215 NW 571 (1927); and Lincoln Crest Realty v Standard Apt. Devel., 61 Wis2d 4, 211 NW2d 501 (1973). In the present case, Met and the Bank obtained the appointment of a receiver prior to the debtor's filing in bankruptcy. Thus, under Wisconsin law, their respective rent assignments were perfected pre-petition.

Enforcement. Perfection alone does not permit the mortgagees to take possession of the rents. That right remains dependent upon the occurrence of any conditions stated in the agreements, such as default, notice, and if demand is resisted, the appropriate form of state action to enforce the agreement. That these conditions may also serve under Wisconsin law to perfect the security interest may cause some confusion, but it does not change the way in which the events and rights must be analyzed. Perfection and enforcement remain separate steps in analysis even if under state law they are undertaken simultaneously. Met and the Bank were able to enforce their interests when the receiver was appointed and took possession on May 11, 1990. The mortgagees' right to enforce their security interests by having the receiver collect the rents continued until the filing of the debtor's bankruptcy petition on May 31, 1990.

The filing of the petition automatically stayed the rights of Met and the Bank to enforce their security interest in any rents accruing post-petition. 11 USC § 362(a)(4) (staying "any act to . . . enforce any lien against property of the estate").(5) As was aptly stated in In re Westchase I Associates, L.P., No C-C-90-93-MU, slip op at 9 (WD NC, January 15, 1991):

Perfection of Lincoln's security interest does not equate with enforcement of the perfected assignment, however. . . . [I]n order to collect the rents under the perfected assignment, Lincoln will now have to seek enforcement from the bankruptcy court, just as it initially had sought enforcement through the appointment of a receiver in state court proceedings.

See also In re Raleigh/Spring Forest Apartment Associates, 118 BR 42, 46 (Bankr ED NC 1990) (Under North Carolina law, "[a] properly filed rent assignment may be perfected even though it is not enforceable.").

Post-Petition Rents. The mortgagees have or had interests in two distinct types of rents: those that arose prepetition and were collected by the receiver, and those which arose post-petition and are property of the bankruptcy estate.(6) It is the latter type which are the subject of this proceeding. Because they perfected their interests in the rents prior to the filing of the debtor's petition, the mortgagees' interests in post-petition rents are also perfected, pursuant to 11 USC § 552(b), which provides:

Except as provided in sections 363, 506(c), 522, 544, 545, 547, and 548 of this title, 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.

Comments in the Congressional Record caution that "[a]lthough this section grants a secured party a security interest in proceeds, product, offspring, rents, or profits, the section is explicitly subject to other sections of title 11. For example, the trustee or debtor in possession may use, sell, or lease proceeds, product, offspring, rents, or profits under section 363." 124 Cong Rec H 11097 (Sept. 28, 1978). Thus, the security

interests of Met and the Bank in the post-petition rents from the property are expressly made subject to the rights of the trustee (here, debtor-in-possession), under 11 USC § 363.

Cash Collateral and Adequate Protection. 11 USC § 363(a) defines "cash collateral" as :

cash, negotiable instruments, documents of title, securities, deposit accounts, or other cash equivalents whenever acquired in which the estate and an entity other than the estate have an interest 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, whether existing before or after the commencement of a case under this title.

(emphasis supplied).

Pursuant to Sections 552(b) and 363(a), the rents from the property constitute cash collateral in which Met and the Bank each have an interest. Both have previously objected generally to the debtor-in-possession's use of the rents. Those objections were overruled and the use of cash collateral was approved upon a finding that the mortgagees were adequately protected. They now renew their objection on a narrower scope, objecting only to the application to pay attorneys fees and expenses.(7)

11 USC § 363(c)(2) provides:

The trustee may not use, sell, or lease cash collateral under paragraph (1) of this subsection unless--

(A) each entity that has an interest in such cash collateral consents; or

(B) the court, after notice and a hearing, authorizes such use, sale, or lease in accordance with the provisions of this section.

"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 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)." In re Dotz, MM11-90-01864, slip op at 6 (Bankr WD Wis, January 24, 1991). Section 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.(8)

On July 16, 1990 this court determined that Met and the Bank were adequately protected without the receipt of the post-petition rents, and accordingly granted the debtor-in-possession's motion to use cash collateral. Neither Met nor the Bank has presented the court with any evidence that would suggest that the $1,400,000 equity cushion has been totally dissipated as of this date and time. Absent such changed circumstances, the court has no reason to modify its prior ruling with respect to the debtor-in-possession's use of cash collateral. The specific use to which the debtor-in-possession now seeks to put the rents is one recognized as appropriate even to the extent that it is afforded a priority over other claims by 11 USC §§ 503 and 507(a)(1). Accordingly, the objections of Met and the Bank to the payment of attorneys fees and

expenses from the post-petition rents of the property must be denied.

II.

Met further objects to allowance of attorneys fees relating to negotiation with JWP Investors, stating that it is improper to negotiate "to give a preference" and to negotiate "for a speculative purchase," and that "Counsel have not met their burden [under 11 USC § 330(a)][(9)] of showing that these services were for the benefit of the bankruptcy estate."

If Met believes that JWP Investors has received a preferential transfer which the debtor-in-possession has failed to attempt to recover, Met can move for the appointment of a trustee. The mere existence of the alleged preference is not a basis for denial of the attorneys fees and expenses of counsel for the debtor-in-possession.

With respect to Met's allegation of "negotiation for a speculative purchase," the debtor-in-possession states that "in exchange for $285,000.00, the debtor has negotiated the elimination of $2,000,000.00 of [JWP Investors'] claims, plus the acquisition of all equity of JWP in the real estate, appraised at $600,000.00 or more." In the absence of such an accord, the debtor-in-possession's prospects for a successful reorganization would be marginal at best. Counsel for the debtor-in-possession have performed actual and necessary services within the meaning of Section 330(a) and the fees and expenses related to JWP Investors should be allowed.

END NOTES:

1. The terms of Met's assignment of rents provide:

[T]he undersigned James Wilson Associates . . . does hereby sell, assign, transfer and set over unto Metropolitan Life Insurance Company . . . all of the rents, issues, profits and income whatsoever arising from or which may be had under any leases or tenancies . . .

. . .

It is understood and agreed that the undersigned shall be entitled to collect and retain the rents, issues and profits of and from the . . . real estate unless and until they shall default . . . In the event of default and the continuance thereof for a period of thirty days, the assignee [Met] shall be entitled to . . . collect the rents, issues, profits and income . . .

The terms of the Bank's assignment of rents provide:

Assignor [James Wilson Associates] . . . does hereby transfer, assign and convey . . . to Assignee [Bank] all of Assignor's right, title and interest which Assignor, as Lessor, has or may have in and to: . . . all rents, income and profits which may now or hereafter be or become due or owing under the leases . . .

. . .

This Assignment is absolute and is effective immediately, but until notice is sent to the Assignor in writing that an Event of Default . . . has occurred . . . Assignor may receive, collect and enjoy the rents, income and profits accruing from the Premises.

2. The Bank's further contention that perfection of a security interest in rents transforms a collateral assignment of rents into an absolute assignment of rents is without foundation in the law and is therefore rejected.

3. See, Butner v United States, 440 US 48 (1985); Matter of Gotta, 47 BR 198 (Bankr WD Wis 1985). If the mortgagee's security interest is unperfected, the "strong arm" powers under 11 USC § 544(a) may be exercised by the trustee to avoid the mortgagee's security interest, thereby making the property available for the payment of general creditors' claims without resort to the treatment prescribed for collateral under 11 USC § 363.

4. In Butner, the United States Supreme Court stated 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." Butner, 440 US at 56. Despite this language, the holding in Butner was much narrower. "The 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." Matter of Gotta, 47 BR 298, 201 (Bankr WD Wis 1985).

5. The Bank, relying on In re 163rd Street Mini Storage, Inc., 113 BR 87 (Bankr SD Fla 1990), asserts that by virtue of its "absolute assignment," the rents are its own and therefore are not property of the estate. However, the court in 163rd Street Mini Storage based its ruling on a Florida statute which it interpreted as creating "an absolute transfer of ownership interests in the rents" upon a mortgagor's default. The decision in 163rd Street Mini Storage is directly at odds with In re One Fourth Street North, Ltd., 103 BR 320, 321 (Bankr MD Fla 1989), in which the court determined that that statute "was not meant to create an outright or absolute transfer of ownership interest in rents where none existed before. On the contrary, it was intended only to create a more simplified or expeditious mechanism for the perfection of the right to sequester rents to be applied to the indebtedness secured by the mortgage and was intended to be nothing more than additional security." Regardless of the interpretation placed upon the Florida statute, the Bank's security interest is defined not by Florida law, but by Wisconsin law, and Wisconsin possesses no statute similar to that relied upon by the court in 163rd Street Mini Storage. 163rd Street Mini Storage is accordingly inapplicable to the present case, and provides no support for the Bank's contention. Furthermore, the rents are not the Bank's "own" as a consequence of language in its assignment stating that "[t]his Assignment is absolute and is effective immediately." As has been previously discussed, the rents are collateral security only and in that capacity they qualify as property of the estate.

6. 11 USC § 541(a)(6) provides:

(a) The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:

(6) Proceeds, product, offspring, rents, or profits of or from property of the estate, except such as are earnings from services performed by an individual debtor after the commencement of the case.

7. Met, citing 11 USC § 506(c), argues that administrative expenses which do not benefit a secured creditor may not be charged against the secured creditor. However, as noted by the debtor-in-possession, "[t]he fact that expenses are not recoverable by a trustee under §506(c) has no bearing on the use of cash collateral under §363."

8. The means by which a trustee may provide adequate protection of an entity's interest in property are enumerated in 11 USC § 361.

9. Section 330(a) provides:

After notice to any parties in interest and to the United States trustee and a hearing, and subject to sections 326, 328, and 329 of this title, the court may award to a trustee, to an examiner, to a professional person employed under section 327 or 1103 of this title, or to the debtor's attorney--

(1) reasonable compensation for actual, necessary services rendered by such trustee, examiner, professional person, or attorney, as the case may be, and by any paraprofessional persons employed by such trustee, professional person, or attorney, as the case may be, based on the nature, the extent, and the value of such services, the time spent on such services, and the cost of comparable services other than in a case under this title; and

(2) reimbursement for actual, necessary expenses.