North Dakota Law Review

Volume 63 | Number 3 Article 3

1987

Bankruptcy - Chapter 11 Reorganization - Determining the Starting Date of Adequate Protection Payments for Opportunity Cost and Expanding the Contribution Exception to the Absolute Priority Rule

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BANKRUPTCY - CHAPTER 11 REORGANIZATION — DETERMINING THE STARTING DATE OF ADEQUATE PROTECTION PAYMENTS FOR OPPORTUNITY COST AND EXPANDING THE CONTRIBUTION EXCEPTION TO THE ABSOLUTE PRIORITY RULE

The United States Supreme Court has granted a petition for a writ of certiorari in Alhers v. Norwest Bank (In re Ahlers), 794 F. 2d 388 (8th Cir. 1986), cert. granted, 55 U.S.L.W. 3852 (U.S. June 23, 1987) (No. 86-958). The Court has indicated that it will review the absolute priority issue, which is discussed at length in this Comment.

On November 16, 1984, Norwest Bank of Worthington (Norwest) initiated a replevin action against James and Mary Ahlers in a Minnesota state court.[1] The Ahlers had entered into several financing agreements with Norwest and, in return, had given Norwest a first mortgage on their farm machinery and equipment as collateral.[2] When the Ahlers were unable to make payments on the loans, Norwest initiated the replevin action to recover possession of the Ahlers' farm machinery and equipment.[3]

1. Ahlers v. Norwest Bank (*In re* Ahlers), 794 F.2d 388, 392 (8th Cir. 1986), *cert. granted,* 55 U.S.L.W. 3852 (U.S. June 23, 1987) (No. 86-958).

2. *Id.* James and Mary Ahlers managed a grain and livestock operation on approximately 840 acres of farmland in Nobles County, Minnesota. *Id.* They owned 560 acres of land and rented 280 acres. *Id.* The Ahlers financed the operation through four financing agreements with Federal Land bank, which were executed between December 1965 and January 1982. *Id.* They gave a first mortgage on the 560 acres of farmland they owned to Federal Land Bank as security for the loans. *Id.* The Ahlers also obtained financing through several financing agreements with Norwest Bank of Worthington (Norwest), which were executed between May 1982 and April 1984. *Id.* at 392. They gave Norwest a second mortgage on the farmland, and a first mortgage on the machinery and equipment, crops, livestock, and other farm proceeds. *Id.*

3. *Id.*

Two weeks later, the Ahlers filed a petition in the bankruptcy court for reorganization pursuant to chapter 11 of the Bankruptcy Code.[4] The petition included a plan for restructuring the debt and for payment of that restructured debt.[5] In addition, the petition automatically stayed the replevin proceedings.[6]

Norwest filed motions for relief from the stay and for adequate protection in order to protect itself from the value lost because it was not able to immediately take possession of the collateral, sell it, and reinvest the proceeds.[7] The Federal Land Bank of St. Paul

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4. *Id.* at 393. The United States Bankruptcy Code is codified in title 11 of the United States Code. 11 U.S.C. §§ 101-151326 (1982 & Supp. III 1985). Chapter 11 of title 11 codifies reorganization pursuant to the United States Bankruptcy Code. 11 U.S.C. §§ 1101-1174 (1982 & Supp. III 1985). As of November 30, 1984, the Ahlers owed Federal Land Bank $540,118 and Norwest $450,468 in principal and accrued interest. *Ahlers,* 794 F.2d app. at 412. The Ahlers also owed $35,791 to John Deere Credit Corporation, secured by a combine, $3337 to the Community Credit Corporation, secured by a grain bin, and $2900 to General Motors, secured by an automobile. *Id.* at 392.

5. *Ahlers,* 794 F.2d at 393; *see* 11 U.S.C. § 1123 (1982 & Supp. III 1985) (plan shall be filed for the treatment of the debtor's debts).

6. *Ahlers,* 794 F.2d at 393; *see* 11 U.S.C. § 362(a) (1982 & Supp. III 1985). Subsection 362(a) provides, in relevant part:

> [A] petition filed under. . . this title. . . operates as a stay, applicable to all entities, of—
> (1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title;
> (2) the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title;
> (3) any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate;
> (4) any act to create, perfect, or enforce any lien against property of the estate;
> (5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title;
> (6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title;
> (7) the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor; and
> (8) the commencement or continuation of a proceeding before the United States Tax Court concerning the debtor.

Id. The purpose of the automatic stay is to protect debtors and creditors. *See* H.R. REP. No. 595, 95th Cong., 2d Sess. 340 [hereinafter HOUSE REPORT], *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5963, 6296-97. For a discussion of how the automatic stay protects creditors and debtors, see *infra* note 20 and accompanying text.

7. *Ahlers,* 794 F.2d at 393. A court may grant relief from the automatic stay pursuant to § 362(d) of the Bankruptcy Code. *See* 11 U.S.C. § 362(d) (1982 & Supp. III 1985). Subsection 362(d) provides:

> (d) On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay —
> (1) for cause, including the lack of adequate protection of an interest in property of such party in interest; or
> (2) with respect to a stay of an act against property under subsection (a) of this section, if —

(Federal Land Bank), which held a first mortgage on the Ahlers' farmland, filed similar motions for relief.[8] The bankruptcy court stated that Norwest and Federal Land Bank, as undersecured creditors, were entitled to adequate protection as compensation for the delay in repossession and foreclosure during the interim between the filing of the petition for reorganization and the confirmation of the plan.[9] The court then determined that the creditors were entitled to adequate protection in the form of monthly payments of interest on the current value of the collateral.[10] The court stated that the Ahlers had to make these

(A) the debtor does not have any equity in such property; and
(B) such property is not necessary to an effective reorganization.

Id. Alternatively, a court may require the debtor to provide adequate protection to creditors pursuant to § 361 of the Bankruptcy Code. *See* 11 U.S.C. § 361 (1982 & Supp. III 1985). Section 361 provides, in relevant part:

> When adequate protection is required under . . . this title of an interest of an entity in property, such adequate protection may be provided by —
> (1) requiring the trustee to make a cash payment or periodic cash payments to such entity, to the extent that the stay under . . . this title, use, sale, or lease under . . . this title, or any grant of a lien under . . . this title 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 such stay, use, sale, lease, or grant results in a decrease in the value of such entity's interest in such property; or
> (3) granting such other relief, other than entitling such entity to compensation allowable under . . . this title as an administrative expense, as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property.

Id. In *Ahlers* the court of appeals stated that adequate protection payments are designed to place the secured creditor in essentially the same position it would have been in, absent the debtor's bankruptcy filing. 794 F.2d at 395; *see* HOUSE REPORT, *supra* note 6 at 339, 1978 U.S. CODE CONG. & ADMIN. NEWS at 6295. For a discussion of adequate protection, see *infra* notes 21-48 and accompanying text.

8. *Ahlers,* 794 F.2d at 393. In addition to the Federal Land Bank's first mortgage on the Ahlers' real property, Norwest had a second mortgage on the property. *Id.* at 392. Prior to the filing of the bankruptcy petition, neither Federal Land Bank nor Norwest had started foreclosure proceedings on the Ahlers' real property. Brief of the States of Arkansas, Iowa, Minnesota, Missouri, Nebraska, North Dakota and South Dakota in Opposition to the Petition for Rehearing and Suggestion for Rehearing En Banc at X, Ahlers v. Norwest Bank (*In re* Ahlers), 794 F.2d 388 (8th Cir. 1986), *cert. granted,* 55 U.S.L.W. 3852 (U.S. June 23, 1987) (No. 86-958) [hereinafter Brief of the States].

9. *Ahlers,* 794 F.2d at 392-93, (citing *In re* Ahlers, No. 3-84-2206, slip op. at 5 (Bankr. Minn. Mar. 15, 1985)). Norwest and Federal Land Bank were undersecured creditors because their claims against the Ahlers exceeded the value of collateral held by the creditors as security for the debt. *See id.* They were secured to the extent of the value of the collateral. *See* 11 U.S.C. § 506(a) (1982) (creditor has a secured claim for the value of the collateral and an unsecured claim to the extent that their claim exceeds the value of the collateral). They were unsecured to the extent that their claims exceeded the value of the collateral. *See id.* The bankruptcy court determined that Norwest and Federal Land Bank were entitled to adequate protection of the secured portion of the claims against the debtors. *Ahlers,* 794 F.2d at 395.

10. *Ahlers,* 794 F.2d at 393. Subsection 361(1) of the Bankruptcy Code establishes that adequate protection may be provided in the form of periodic cash payments. 11 U.S.C. § 361(1) (1982 & Supp. III 1985). For the text of § 361(1), see *supra* note 7. In determining that the creditors were entitled to adequate protection in the form of interest on the value of the collateral, the court reasoned that a secured creditor bargains for the right to take possession of the collateral and sell it in the event the debtor defaults. *Ahlers,* 794 F.2d at 395 (citing Crocker Nat'l Bank v. American Mariner Indus., Inc. (*In re* American Mariner Indus., Inc.), 734 F.2d 426, 435 (9th Cir. 1984)).

monthly payments in order to maintain the automatic stay.[11] Furthermore, the court determined that Norwest and Federal Land Bank were entitled to adequate protection payments as of the date they filed for adequate protection.[12] The court then concluded that the Ahlers did not have sufficient funds to provide monthly adequate protection payments and granted the creditors' motions for relief from the stay.[13]

The Ahlers appealed this order to the United States District Court for the District of Minnesota and the district court affirmed the bankruptcy court's decision.[14] The Ahlers then appealed the federal district court's order to the Court of Appeals for the Eighth Circuit.[15] The Ahlers contended that the bankruptcy court erred in granting Norwest and Federal Land Bank relief from the automatic stay.[16] The court of appeals reversed the district court and *held* that the starting date of adequate protection payments should not begin until the date the creditor, absent bankruptcy filing, could have taken possession of the collateral pursuant to state law, sold it to a third party, and reinvested the proceeds.[17] In addition, the court

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Adequate protection payments in the form of interest compensate the creditor to the extent that the automatic stay has prevented him or her exercising his bargained for repossession rights. *Id.*

11. *Ahlers,* 794 F.2d at 393; *see* 11 U.S.C. § 362(d)(1) (1982 & Supp. III 1985) (court shall grant relief from the automatic stay for cause, including the lack of adequate protection). For the text of § 362(d)(1), see *supra* note 7.

12. *Ahlers,* 794 F.2d at 395.

13. *Id.* at 395. In determining whether the Ahlers had sufficient funds to make adequate protection payments, the bankruptcy court determined that a lien on the following year's crops could not constitute adequate protection. *Id.* Since the debtors could not otherwise provide the monthly payments, the court granted the creditors' motions for relief from the automatic stay. *See id.*

14. *Id.* at 393. In addition to reviewing the bankruptcy court's order for relief from the stay, the district court reviewed the Ahlers' reorganization plan. *Id.* The court concluded that, because the plan had no reasonable prospect of success, it was unfeasible. *Id.* Therefore, the court denied confirmation of the Ahlers' reorganization plan. *Id.*

15. *Id.* Prior to appealing the federal district court's order, the Ahlers removed Norwest's replevin action from the state district court to the bankruptcy court. *Id.* Both parties stipulated that the replevin action was a core proceeding, which could be heard and determined by the bankruptcy court. *Id.; see* 28 U.S.C. § 157(c)(2) (Supp. III 1985) (upon consent of parties the district court may refer proceedings to bankruptcy judge). Norwest then filed a motion with the bankruptcy court for prejudgment seizure of the Ahlers' property. *Ahlers,* 794 F.2d at 393; *see* MINN. STAT. ANN. § 565.23 (West Supp. 1987) (court may order prejudgment seizure upon demonstration of probability of success on merits by claimant). Thereafter, the bankruptcy court granted Norwest's motion for prejudgment seizure. *Ahlers,* 794 F.2d at 394. The United States District Court for the District of Minnesota affirmed this order, as well as the order lifting the stay. *Id.* The Ahlers appealed both these orders to the Court of Appeals for the Eighth Circuit. *Id.*

16. *Ahlers,* 794 F.2d at 393-94. In addition to contending that the bankruptcy court erred in granting the creditors relief from the stay, the Ahlers contended that the Minnesota replevin statute was unconstitutional and that the bankruptcy court did not have jurisdiction to rule on Norwest's motion for prejudgment seizure pursuant to that statute. *Id.; see* MINN. STAT. ANN. § 565.23 (West Supp. 1987) (allowing a creditor to initiate a replevin action when a debtor fails to pay money on an obligation). The Court of Appeals for the Eighth Circuit, without discussion, held that the bankruptcy court should not permit the prejudgment seizure of equipment and machinery necessary to carry out the reorganization plan, even if the creditors offer to post a bond. *Ahlers,* 794 F.2d at 392.

17. *Ahlers,* 794 F.2d at 395. The court of appeals noted that the bankruptcy court, in determining the starting date for adequate protection payments, should "take account of the usual time and expense involved in repossession and sale of collateral." *Id.* (quoting Crocker Nat'l Bank v.

held that the debtor farmer's experience, knowledge, skills, and labor were a valuable contribution to the reorganization *and* that the debtor could participate in the reorganization plan to the extent of his or her contribution, even though more senior claims were not fully satisfied.[18] *Ahlers v. Norwest Bank (In re Ahlers)*, 794 F.2d 388 (8th Cir. 1986), *cert. granted,* 55 U.S.L.W. 3852 (U.S. June 23, 1987) (No. 86-958).

A petition for reorganization pursuant to chapter 11 of the United States Bankruptcy Code operates as an automatic stay of all creditors' actions to enforce their liens against the debtor's property.[19] The purpose of the automatic stay is to relieve the debtor of the financial pressures that drove the debtor into bankruptcy and to permit the debtor time to prepare a repayment or reorganization plan.[20] The Bankruptcy Code counterbalances these debtor relief provisions by providing creditors with certain rights, including the secured creditor's right to adequate protection of its interest in the debtor's property during the bankruptcy proceedings.[21] Moreover, the Bankruptcy Code protects the creditor's right to adequate protection by providing that a creditor will be granted relief from the automatic stay if the creditor's interest in property is not adequately protected.[22]

Secured creditors have sought to protect various interests pursuant to their adequate protection rights.[23] One of these

American Mariner Indus., Inc. (*In re* American Mariner Indus., Inc.), 734 F.2d 426, 435 n.12 (9th Cir. 1984)). The court reasoned that a creditor should not be compensated for a lost opportunity until it has actually experienced that loss. *See id.*

18. *Id.* at 402-03. The court applied an exception to the "absolute priority" rule in allowing the debtors, by contributing labor and management, to retain a property interest pursuant to the reorganization plan even though the plan failed to fully provide for the more senior unsecured creditors claims. *Id.* at 401-02; *see* 11 U.S.C. § 1129(b)(2)(B) (1982 & Supp. III 1985) (requiring that unsecured creditors claims be fully satisfied before holders of ownership interests may retain any property pursuant to the reorganization plan). For a discussion of the absolute priority rule, see *infra* notes 50-84 and accompanying text.

19. *See* 11 U.S.C. § 362(a) (1982 & Supp. III 1985) (petition for reorganization automatically stays all creditors' proceedings to enforce their liens). For the text of § 362(a), see *supra* note 6.

20. *See* HOUSE REPORT, *supra* note 6 at 340, 1978 U.S. CODE CONG. & ADMIN. NEWS at 6296-97. In addition to protecting the debtor, the automatic stay protects creditors from each other by preventing one creditor from rushing to enforce its claims to the detriment of the other creditors. *Id.* 1978 U.S. CODE CONG. & ADMIN. NEWS at 6297.

21. *See* 11 U.S.C. § 361 (1982 & Supp. III 1985) (ways to provide adequate protection). For the text of § 361, see *supra* note 7. Although adequate protection is not specifically defined in the Bankruptcy Code, the purpose of adequate protection is to preserve the creditor's bargained for value during the interim between the bankruptcy filing and confirmation of the reorganization plan. *See* HOUSE REPORT, *supra* note 6 at 339-40, 1978 U.S. CODE CONG. & ADMIN. NEWS at 6295-96.

22. 11 U.S.C. § 362(d)(1) (1982) (relief from the automatic stay shall be granted for cause, including lack of adequate protection). For the text of § 362(d)(1), see *supra* note 7. In addition to providing relief from the automatic stay, courts can adequately protect creditors by requiring debtors to make periodic payments to creditors, by giving creditors additional liens on the debtor's property, or by providing creditors with other relief that will result in the creditors receiving the "indubitable equivalent" of their interest in the debtor's property. 11 U.S.C. § 361. For the text of § 361, see *supra* note 7.

23. *See* Anderson, *Adequate Protection of Opportunity Cost After* In re *Briggs, 19* CREIGHTON L. REV. 765, 767 (1985-86) (a creditor's adequate protection right may protect the creditor's interest in

interests is the creditor's opportunity costs, which is the creditor's loss caused by the delay in repossession created by the automatic stay.[24] Adequate protection of this interest is based on the theory that a secured creditor bargains for the right to take possession of the collateral and sell it in the event that the debtor defaults.[25] Because the automatic stay prevents the creditor from immediately repossessing the collateral and selling it, the creditor loses the value it would receive if it was allowed to liquidate the collateral and reinvest the proceeds.[26] Thus, creditors assert that to the extent they are damaged by being prevented from exercising their foreclosure rights, they are entitled to adequate protection.[27]

A number of courts have ordered protection of creditors' opportunity costs.[28] In *Crocker National Bank v. American Mariner Industries*[29] the creditor, Crocker National Bank, had a perfected security interest in the debtor's machinery, equipment, and tools.[30]

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property from the sale, use, or lease of the property by the debtor); *see, e.g.*, Martin v. United States (*In re* Martin), 761 F.2d 472, 476-77 (8th Cir. 1985) (requiring the value of the secured creditor's interest be adequately protected from the risks to that value resulting from the debtor's use of the collateral). A court may also require a debtor to provide adequate protection for the holder of an existing lien from subsequent liens of equal or greater seniority. Anderson, *supra* at 767-68; *see, e.g.*, Owens-Corning Fiberglass Corp. v. Center Wholesale, Inc. (*In re* Center Wholesale, Inc.), 759 F.2d 1440, 1450 (9th Cir. 1985) (permitting debtor to incur debt secured by a senior lien on encumbered property only if adequate protection is provided to the existing secured creditor). In addition, adequate protection may be granted during the automatic stay to protect against a decline in value of the creditor's collateral. Anderson, *supra* at 768-69; *see, e.g.*, Pistole v. Mellor (*In re* Mellor), 734 F.2d 1396, 1400 (9th Cir. 1984) (allowing debtor's equity in estate as adequate protection against decline in value of the creditor's collateral).

24. *See* Anderson, *supra* note 23 at 769; *see, e.g.*, Crocker Nat'l Bank v. American Mariner Indus., Inc. (*In re* American Mariner Indus., Inc.), 734 F.2d 426, 435 (9th Cir. 1984) (creditor is entitled to compensation for the delay in exercising its foreclosure rights); Republic Bank Houston v. Bear Creek Ministorage, Inc. (*In re* Bear Creek Ministorage), 49 Bankr. 454, 457 (Bankr. S.D. Tex. 1985) (secured creditors right to foreclosure entitled to adequate protection). *But see* Gen. Elec. Mortgage Corp. v. South Village, Inc. (*In re* South Village, Inc.), 25 Bankr. 987, 1002 (Bankr. D. Utah 1982) (debtor not entitled to adequate protection for delay in enforcing its foreclosure rights).

25. *See* Anderson, *supra* note 23, at 769. Adequate protection of creditor's opportunity costs is based on the proposition that a secured creditor has an interest in the secured property over and above the availability of that property for debt repayment. *Id.* The secured property represents capital investment by the secured creditor. *Id.* When a debtor defaults on a loan, the creditor's investment yields no return. *Id.* The secured creditor has an interest in taking his investment out of the secured property by selling the property, reinvesting the proceeds, and receiving interest on the new investment. *Id.* Since the automatic stay prevents the sale, the creditor is prevented from asserting this interest. *Id.* To the extent the creditor is harmed by the delay, the debtor must provide adequate protection. *Id.*

26. *See id.*

27. *Id.* at 769.

28. *See, e.g.*, Grundy Nat'l Bank v. Tandem Mining Corp., 754 F.2d 1436, 1440-41 (4th Cir. 1985) (creditor entitled to adequate protection for the delay in exercising its foreclosure rights); *In re* Pulliam, 54 Bankr. 624, 625 (Bankr. W.D. Mo. 1985) (same); *In re* Wolsky, 53 Bankr. 751, 755 (Bankr. D.N.D. 1985) (same); *In re* Deeter, 53 Bankr. 623, 627 (Bankr. N.D. Ind. 1985) (same); *In re* Cash Currency Exch., Inc., 52 Bankr. 577, 580 (Bankr. N.D. Ill. 1985) (same); *In re* Bear Creek Ministorage, Inc., 49 Bankr. 454, 456-57 (Bankr. S.D. Tex. 1985) (same); *In re* Lilyerd, 49 Bankr. 109, 117 (Bankr. D. Minn. 1985) (same); *In re* Cassavaugh, 44 Bankr. 726, 729 (Bankr. W.D. Mo. 1984) (same); *In re* Nordyke, 43 Bankr. 856, 861 (Bankr. D. Ore. 1984) (same).

29. 734 F.2d 426 (9th Cir. 1984).

30. Crocker Nat'l Bank v. American Mariner Indus., Inc. (*In re* American Mariner Indus., Inc.), 734 F.2d 426, 427 (9th Cir. 1984). In 1978, Crocker National Bank made a loan to American

When the debtor filed a petition for reorganization, the automatic stay prevented the creditor from repossessing the collateral, liquidating it, and reinvesting the proceeds.[31] The creditor contended that, because of the delay in repossession, it was entitled to adequate protection payments equal to the return it would have received if it could have liquidated the collateral and reinvested the proceeds.[32] The Court of Appeals for the Ninth Circuit concluded that it must protect the creditor against this delay since the secured creditor's bargain, the right to sell the collateral, was limited by the automatic stay.[33] The court reasoned that it must try to compensate the secured creditor for this loss in order that the secured creditor obtain "in value essentially what he bargained for."[34] Therefore, the court determined that Crocker National Bank was entitled to compensation for the delay in enforcing its rights during the interim between the filing of the petition for reorganization and the confirmation of the plan.[35]

Although a number of courts have allowed protection of creditors' opportunity costs, some courts have adopted a restrictive

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Mariner secured by a perfected security interest in virtually all of the debtor's assets. *Id.* at 427. At the time of the debtor's bankruptcy filing, American Mariner's debt to Crocker was approximately $370,000, secured by collateral worth $110,000. *Id.*

31. *Id.* at 431. American Mariner's filing for reorganization prevented Crocker National Bank from foreclosing on American Mariner's assets. *Id.; see* 11 U.S.C. § 362(a) (1982 & Supp. III 1985) (bankruptcy filing operates as stay of all lien enforcement action). For the text of § 362(a), see *supra* note 6.

32. *American Mariner,* 734 F.2d at 427-28.

33. *Id.* The United States Bankruptcy Court for the Central District of California had rejected Crocker National Bank's contention that it was entitled to adequate protection to compensate it for the delay in repossession. Crocker Nat'l Bank v. American Mariner Indus., Inc. (*In re* American Mariner Indus., Inc.), 10 Bankr. 711, 712 (Bankr., C.D. Cal. 1981). In making its determination, the court noted that the Bankruptcy Code specifically provides interest to a secured creditor to the extent that the collateral has a value greater than the amount of its claim. *Id.* at 712; *see* 11 U.S.C. § 506(b) (Supp. III 1985). The court reasoned, by negative implication, that Congress did not intend for an undersecured creditor to receive interest on its claim. *American Mariner,* 10 Bankr. at 712. In reviewing the bankruptcy court's decision, the United States Bankruptcy Appellate Panel of the Ninth Circuit disagreed with the bankruptcy court's negative implication analysis, but affirmed the bankruptcy court's denial of adequate protection for the present value of the undersecured creditor's collateral. Crocker Nat'l Bank v. American Mariner Indus., Inc. (*In re* American Mariner Indus., Inc.), 27 Bankr. 1004, 1009 (Bankr. 9th Cir. 1983). The appellate panel concluded that, since the bankruptcy court had protected the collateral against depreciation, the value of the creditor's collateral was adequately protected. *Id.* at 1010. In appealing the appellate panel's decision to the United States Court of Appeals for the Ninth Circuit, Crocker National Bank contended that the focus of adequate protection was the value of its interest in the collateral, rather than merely the value of the collateral. *American Mariner,* 734 F.2d at 429. The creditor asserted that the present value of that interest must be adequately protected. *Id.* The court of appeals determined that a secured creditor's right to take possession of and sell collateral on a debtor's default constitutes an interest in property. *Id.* at 435. In concluding that this interest must be protected, the court stated that Crocker National Bank was entitled to compensation as adequate protection for the delay in enforcing the creditor's foreclosure rights during the automatic stay. *Id.*

34. *American Mariner,* 734 F.2d at 431 (citing HOUSE REPORT, *supra* note 6 at 339, 1978 U.S. CODE CONG. & ADMIN. NEWS at 6295 (purpose of adequate protection is to insure that a secured creditor receives in value essentially what he bargains for)).

35. *Id.* at 435.

view of adequate protection of opportunity costs.[36] In *Lend Lease, Inc. v. Briggs Transportation Co.*[37] the debtor, Briggs Transportation, filed a petition for reorganization pursuant to chapter 11 of the Bankruptcy Code.[38] At the time of the debtor's filing, two creditors, General Motors Acceptance Corporation (GMAC) and Lend Lease, held security interests in the debtor corporation's tandem-axle tractors and trailers.[39] The automatic stay prevented the secured creditors from foreclosing on their collateral.[40] The creditors sought adequate protection to compensate for the delay in enforcing their foreclosure rights.[41] Because Briggs opposed the creditors' claims for adequate protection of their lost opportunity costs, the Bankruptcy Court for the District of Minnesota heard the issue and determined that a debtor, as a matter of law, need not pay adequate protection of opportunity costs.[42]

Pursuant to the creditors' appeal, the United States District Court for the District of Minnesota reviewed the bankruptcy court's decision and concluded that the creditors were entitled, as a matter of law, to adequate protection as compensation for the delay in enforcing their foreclosure rights.[43] However, the Court of Appeals for the Eighth Circuit reversed the district court's order after it determined that a creditor is not always entitled to

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36. *See, e.g.*, Lend Lease, Inc. v. Briggs Transp. Co. (*In re* Briggs Transp. Co.), 780 F.2d 1339, 1350 (8th Cir. 1985) (adequate protection of opportunity costs question of fact to be determined by bankruptcy judge); United States v. Peach State Distrib. Co. (*In re* Peach State Distrib. Co.), 58 Bankr. 873, 876 (Bankr. N.D. Ga. 1986) (same).

37. 780 F.2d 1339 (8th Cir. 1985).

38. Lend Lease, Inc. v. Briggs Transp. Co. (*In re* Briggs Transp. Co.), 780 F.2d 1339, 1340-41 (8th Cir. 1985); *see* 11 U.S.C. §§ 1101-1174 (1982 & Supp. III 1985) (codifying reorganization pursuant to the Bankruptcy Code).

39. *Briggs*, 780 F.2d at 1341. At the time Briggs Transportation filed for bankruptcy, General Motors Acceptance held a perfected security interest in fifty tandem-axle tractors purchased by Briggs Transportation. *Id.* at 1340-41. Lend Lease held a perfected security interest in 100 trailers pursuant to a secured lease / purchase agreement with Briggs Transportation. *Id.*

40. *Id; see* 11 U.S.C. § 362(a) (1982 & Supp. III 1985) (petition for reorganization operates as a stay of all lien enforcement actions). For the text of § 362(a), see *supra* note 6.

41. *Briggs*, 780 F.2d at 1341.

42. Lend Lease, Inc., v. Briggs Transp. Co. (*In re* Briggs Transp. Co.), 35 Bankr. 210, 216-17 (Bankr. D. Minn. 1983). In determining that a creditor is not entitled to adequate protection of opportunity cost, the bankruptcy court construed adequate protection pursuant to the automatic stay as an interim measure of protection to the creditor. *Id.* The court reasoned that adequate protection of opportunity cost would result in compensation, rather than protection, for the creditor. *See id.* at 216. Therefore, the court concluded that adequate protection did not entail the payment of lost opportunity cost. *See id.* at 217.

43. *Briggs*, 780 F.2d at 1341. The United States District Court for the District of Minnesota interpreted the Court of Appeal's for the Ninth Circuit adequate protection analysis in *American Mariner*, which was filed after the bankruptcy court's decision. *Id.* The district court reasoned that, when the secured creditor was prevented by the automatic stay from enforcing its foreclosure rights against the collateral, the debtor and its unsecured creditors received a windfall because they were still benefiting from the use of the secured creditor's money. *Id.* at 1350; *see American Mariner*, 734 F.2d at 435. Therefore, the district court reversed the bankruptcy court's ruling and determined that creditors were entitled to adequate protection of opportunity costs as a matter of law. *Briggs*, 780 F.2d at 1341.

compensation for the delay in enforcing its foreclosure rights caused by the automatic stay.[44] The court concluded that, although adequate protection requires the court to protect the secured creditor's claim by compensating the creditor for any loss of value of the collateral, what constitutes adequate protection in a particular case is a question of fact best left to the discretion of the bankruptcy judge.[45] The court stated that adequate protection of opportunity cost should be provided only when the bankruptcy court believes adequate protection of opportunity cost is an essential part of the secured creditor's bargain.[46] The court of appeals noted several factors to be considered by the bankruptcy court in its adequate protection determination, including whether the creditor's claim is oversecured or undersecured, the quality of the collateral, the length of the stay, the stability of the collateral, the probability of the reorganization's success, and whether taxes and other payments are being paid by the debtor.[47] The court remanded the case to the bankruptcy court for determination of whether GMAC and Lend Lease, in negotiating their loans with Briggs, had considered compensation for foreclosure delays as part of their bargains.[48]

The secured creditor's value in the collateral is preserved through adequate protection prior to confirmation of the reorganization plan.[49] The reorganization plan is a proposal to the bankruptcy court for restructuring the debt of the debtor and for payment of that restructured debt.[50] The proposal divides claims or interests in the debtor's property into classes and specifies the treatment of each class.[51] Classes may be composed of secured creditors, unsecured creditors, or ownership interests in the

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44. *Briggs,* 780 F.2d at 1350-51. The court, after examining the statutory language and legislative history of the adequate protection provisions, noted that bankruptcy courts should retain a large amount of flexibility in adequate protection determinations. *Id.* at 1348. The court believed that the most reasonable approach to the question of what interests should be adequately protected was to refrain from shaping a rigid rule, and allow adequate protection questions to be determined on a case-by-case basis. *See id.*

45. *Id.* at 1351.

46. *Id.* at 1349. The court stated that what constitutes the creditor's bargain is based on factors which reveal the creditor's reasonable expectations pursuant to extending credit to the debtor. *Id.* For a nonexclusive list of factors to be used by the bankruptcy court in determining the creditor's reasonable expectations, see *infra* text accompanying note 47.

47. *Briggs,* 780 F.2d at 1349-50.

48. *See id.* at 1351.

49. *See American Mariner,* 734 F.2d at 435 (creditor entitled to compensation for the delay in enforcing its rights during the interim between the petition and the confirmation of the plan). For a discussion of adequate protection, see *supra* notes 21-48 and accompanying text.

50. *See* 11 U.S.C. § 1123 (1982 & Supp. III 1985) (plan shall be filed for the treatment of the debtor's debts).

51. *See id.* § 1123(a) (plan shall designate classes of claims and classes of interests and shall specify treatment of any class).

property.[52] The secured creditor's rights are superior to the unsecured creditor's rights, and the unsecured creditor's rights are superior to the holders of ownership interests.[53] Upon the debtor's filing of the plan, the bankruptcy court will hold a hearing on the confirmation of the plan.[54]

A bankruptcy court will confirm the debtor's reorganization plan if certain requirements are met.[55] An important requirement is that classes of creditors whose interests are impaired must consent to the plan.[56] However, even if there is a dissenting class of impaired creditors, the court must confirm the plan if it finds that the plan does not discriminate unfairly and is fair and equitable with respect to the dissenting class of impaired creditors.[57] The standards for determining whether the plan is fair and equitable vary depending upon whether the dissenting class is composed of secured creditors, unsecured creditors, or holders of ownership interests.[58]

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52. Pachulski, *The Cram Down and Valuation Under Chapter 11 of the Bankruptcy Code,* 58 N.C.L. REV. 925, 929 (1980); *see* 11 U.S.C. § 1129(b) (2) (1982 & Supp. III 1985) (identifying fair and equitable standards for secured creditors, unsecured creditors, and holders of ownership interests). For the text of § 1129(b) (2), see *infra* note 58.

53. *See* Louisville Trust Co. v. Louisville Ry., 174 U.S. 674, 684 (1899). Prior to codification of the Bankruptcy Code, the Supreme Court established that creditor's interests are a property right, to which the creditor is entitled to be paid before the holders of ownership interests retain any property. *Id.*

54. 11 U.S.C. § 1128 (1982) (bankruptcy court shall hold hearing on confirmation of plan).

55. *See* 11 U.S.C. § 1129(a) (1982 & Supp. III 1985) (listing general prerequisites to confirmation of a plan).

56. *Id.* § 1129 (a) (8) (court shall confirm a plan only if each class has accepted the plan or is not impaired under the plan). A class of claims is usually impaired if the plan alters the legal, equitable, and contractual rights to which a holder of a claim is entitled. 11 U.S.C. § 1124 (1982 & Supp. III 1985) (defining when a class of claims is impaired and providing exceptions to the definition of impairment). Thus, a class is impaired if the plan does not provide for the full satisfaction of claims within a class. *See id.*

57. 11 U.S.C. § 1129(b) (1) (1982 & Supp. III 1985) (court may confirm the reorganization plan notwithstanding dissenting impaired creditors if plan does not unfairly discriminate, and is fair and equitable, with respect to each class). The statutory provisions that allow a plan to be affirmed over the opposition of a dissenting class are commonly referred to as the "cram down" provisions. Pachulski, *supra* note 52, at 927.

58. *See* 11 U.S.C. § 1129(b) (2) (1982 & Supp. III 1985). Subsection 1129 (b) (2) provides as follows:

> For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements:
>
> (A) With respect to a class of secured claims, the plan provides—
>
> (i) (I) that the holders of such claims retain the liens securing such claims, whether the property subject to such liens is retained by the debtor or transferred to another entity, to the extent of the allowed amount of such claims; and
>
> (II) that each holder of a claim of such class receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interests, in the estate's interest in such property;
>
> (ii) for the sale, subject to section 363(k) of this title, of any property that is subject to the liens securing such claims, free and clear of such liens, with such liens to attach to the proceeds of such sale, and the treatment of such liens on proceeds under clause (i) or (iii) of this subparagraph; or

The reorganization plan will be confirmed notwithstanding the dissent of a class of secured creditors if one of three requirements is satisfied.[59] First, the plan must provide that the creditors retain a lien on the collateral securing the amount of their allowed claims, and that they receive deferred cash payments equal to the present value of the collateral.[60] Alternatively, the plan must propose to sell the collateral and transfer the dissenting secured parties' liens to the sale proceeds.[61] As another alternative, the plan must provide that the dissenting secured creditors receive the "indubitable equivalent" of their claims.[62]

With respect to a dissenting class of holders of ownership interests, the reorganization plan must be confirmed if one of two standards is satisfied.[63] First, the plan must provide that each holder of an ownership interest receive or retain property equal to the allowed amount of its interest.[64] Alternatively, the plan must provide that the holders of subordinate interests do not receive or retain any property under the plan.[65]

(iii) for the realization by such holders of the indubitable equivalent of such claims.

(B) With respect to a class of unsecured claims—

(i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan or account of such junior claim or interest any property.

(C) With respect to a class or interest—

(i) the plan provides that each holder of an interest of such class receive or retain on account of such interest property of a value, as of the effective date of the plan, equal to the greatest of the allowed amount of any fixed liquidation preference to which such holder is entitled, any fixed redemption price to which such holder is entitled, or the value of such interest; or

(ii) the holder of any interest that is junior to the interests of such class will not receive or retain under the plan on account of such junior interest any property.

Id.

59. *Id.* § 1129(b)(2)(A). For the text of § 1129(b)(2)(A), see *supra* note 58.

60. 11 U.S.C. § 1129(b)(2)(A)(i). For the text of § 1129(b)(2)(A)(i), see *supra* note 58. *See also* Pachulski, *supra* note 52, at 946 ("adequately collaterized secured creditor" entitled to present value equal to the full amount of its allowed claim). The result required pursuant to § 1129(b)(2)(A)(i) depends upon whether a secured creditor is adequately collateralized. *See* Pachulski, *supra* note 52 at 946. For a detailed discussion of § 1129(b)(2)(A)(i), see *id.* at 946-48.

61. 11 U.S.C. § 1129(b)(2)(A)(ii). For the text of § 1129(b)(2)(A)(ii), see *supra* note 58.

62. 11 U.S.C. § 1129(b)(2)(A)(iii). For the text of § 1129(b)(2)(A)(iii), see *supra* note 58. The dissenting secured creditors will receive the "indubitable equivalent" of their claims if, for example, the debtor abandons the collateral to the secured creditor or gives the creditor a lien on similar collateral. Pachulski, *supra* note 52 at 949. Thus, this "indubitable equivalent" requirement could be met by a reorganization plan providing for the sale of a secured creditor's collateral free from liens, with a secured creditor's lien being transferred to other property owned by the debtor. *Id.*

63. *See* 11 U.S.C. § 1129(b)(2)(C). For the text of § 1129(b)(2)(C), see *supra* note 58. Ownership interests include the interests of partners in a partnership, the interests of a sole proprietor in a proprietorship, or the interests of stockholders in a corporation. 5 COLLIER ON BANKRUPTCY ¶ 1129.03 at 1129-40 (15th ed. 1987).

64. 11 U.S.C. § 1129(b)(2)(C)(i). For the text of § 1129(b)(2)(C)(i), see *supra* note 58.

65. 11 U.S.C. § 1129(b)(2)(C)(ii). For the text of § 1129(b)(2)(C)(ii), see *supra* note 58. *But see*

The fair and equitable standards with respect to a dissenting class of unsecured creditors are similar to those for holders of ownership interests.[66] First, the plan must provide that each unsecured creditor receive or retain property equal to the allowed amount of its claim.[67] Alternatively, the plan may provide that the unsecured creditors receive little or no property or participation in the plan, as long as holders of subordinate claims, such as holders of ownership interests, do not receive or retain any property under the plan.[68] Thus, a dissenting class of unsecured creditors must be provided for in full before any junior class can receive or retain any property under the reorganization plan.[69]

The "fair and equitable" provisions of the Bankruptcy Code apply a relaxed version of the absolute priority rule to determine the rights of unsecured creditors and holders of ownership interests.[70] Pursuant to the "absolute priority" rule, a class must be fully satisfied before any subordinate class may retain any interest in the debtor's property, whether or not the class dissents.[71] The Bankruptcy Code, on the other hand, permits senior classes that accept the plan to give up value to subordinate classes, provided no dissenting senior class receives less than the full amount of its claim.[72]

In *Case v. Los Angeles Lumber Products Co.*,[73] however, the United States Supreme Court noted an exception to the absolute priority rule, allowing stockholders who provided new capital into the reorganization plan to retain an ownership interest in the debtor corporation, even though dissenting unsecured creditors received less than their allowed claims.[74] In *Case* the debtor was a

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Ahlers v. Norwest Bank (*In re* Ahlers), 794 F.2d 388, 401 (8th Cir. 1986) (retention of ownership interest by debtors did not prevent a reorganization plan from being "fair and equitable" pursuant to § 1129(b) (2) (B) (ii)); Official Creditors' Comm. v. Potter Material Serv. (*In re* Potter Material Serv.), 781 F.2d 99, 101 (7th Cir. 1984) (stockholder could retain ownership interest even though senior claims were not satisfied in full if the stockholder invests new capital in the corporation).

66. *See* 11 U.S.C. § 1129(b) (2) (B). For the text of § 1129(b) (2) (B), see *supra* note 58.

67. 11 U.S.C. § 1129(b) (2) (B) (i). For the text of § 1129(b) (2) (B) (i), see *supra* note 58.

68. 11 U.S.C. § 1129(b) (2) (B) (ii). For the text of § 1129(b) (2) (B) (ii), see *supra* note 58.

69. *See* 11 U.S.C. § 1129(b) (2) (B) (ii). For the text of § 1129(b) (2) (B) (ii), see *supra* note 58.

70. Klee, *All You Ever Wanted To Know About Cram Down Under the New Bankruptcy Code,* 53 AM. BANKR. L. J. 133, 143 (1979) (tests regarding unsecured claims and ownership interests apply relaxed version of traditional absolute priority rule).

71. *Id.* at 143 n. 81; *See also* Northern Pac. Ry. v. Boyd, 228 U.S. 482, 508 (1913) (creditors must be paid before stockholders could retain property for any reason whatsoever).

72. *See* 5 COLLIER ON BANKRUPTCY ¶ 1129.03 at 1129-56. It is important to note that the "absolute priority" rule of the Bankruptcy Code applies only when an impaired class of unsecured claims or ownership interests does not accept the plan. *Id.*

73. 308 U.S. 106 (1939).

74. Case v. Los Angeles Lumber Products Co., 308 U.S. 106, 121 (1939). The Court reasoned that it is often necessary to obtain new capital for the successful reorganization of a corporation. *See id.* (citing Kansas City Terminal Ry. Co. v. Central Union Trust Co., 271 U.S. 445, 455 (1926)). Thus, the Court concluded that stockholders must be allowed to retain an interest in the debtor

holding company that owned virtually all of the outstanding shares of the capital of six subsidiaries.[75] Claims by creditors against the debtor were four times greater than the debtor's assets.[76] The insolvent debtor corporation filed a reorganization plan, which proposed that the stockholders retain twenty-three percent of the value of the enterprise.[77] The creditors objected to the plan because it did not provide for full satisfaction of their claims and yet allowed the stockholders, whose interests were subordinate to the creditor's claims, to retain an interest in the debtor corporation.[78]

In considering the proposed reorganization plan, the Court stressed that securing new money was essential to the success of the plan.[79] The Court stated that when new money is needed and the old stockholders make a fresh contribution, receiving in return an ownership interest in the debtor corporation, creditors may not object to the plan.[80] The Court emphasized that the stockholders' retained interest must be based on a contribution in money or money's worth, in order to assure that the creditor's priority right would not be diluted by inadequate stockholder contributions.[81] The contribution offered in *Case* was the stockholders' financial standing and influence in the community, and the continuity of management.[82] The Court determined that, on the facts of the

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corporation, or they would not be willing to contribute the new capital that the debtor corporation requires. *See id.*

75. *Id.* at 109. Of the six subsidiary corporations in which the debtor held stock, only one had assets of substantial value. *Id.*

76. *Id.* at 119. The debtor's assets were worth approximately $900,000 while claims against the debtor totaled approximately $3,800,000. *Id.* Thus, even if all of the debtor's assets were turned over to the creditors, less than 25% of the creditor's claims would be satisfied. *Id.*

77. *Id.* The debtor's liabilities consisted of first lien mortgage bonds secured by a trust indenture covering the assets of one subsidiary, and the stock of the other subsidiaries. *Id.* at 109. Pursuant to the reorganization plan, 1,000,000 shares of stock would be issued. *Id.* at 111. The bondholders were to receive some of the stock at a rate of 250 shares for each $1000 bond. *Id.* Stock was also to be issued to prior stockholders free of charge. *Id.*

78. *Id.* at 112. Some of the bondholders objected to the plan on the basis that it was not "fair and equitable" to bondholders, because the plan did not provide for full satisfaction of their claims and yet allowed the stockholders to retain an interest in the corporation. *Id.*; *see* 11 U.S.C. § 1129(b) (1) (1982 & Supp. III 1985) (court may confirm the reorganization plan notwithstanding dissenting impaired creditors if the plan does not unfairly discriminate, and is fair and equitable, with respect to each class).

79. *Case*, 308 U.S. at 121. The court noted that new money was necessary for effective reorganizations to provide the debtor with new working capital and to allow the debtor to pay dissenting creditors. *Id.* at n.15.

80. *Id.* at 121.

81. *Id.* at 122.

82. *Id.* The court determined that the stockholders' ability to provide continuity of management, their financial standing and their influence in the community were too intangible to measure in money's worth. *Id.* In regard to these contributions the court stated: "They have no place in the asset column of the balance sheet of the new company. They reflect merely vague hopes or possibilities. As such, they can not be the basis for issuance of stock to otherwise valueless interests." *Id.* at 122-23. In addition, the court noted that these intangible contributions, if recognized as adequate consideration for the issuance of stock to holders of junior interests, would operate as easy evasions of the absolute priority rule. *Id.* at 122.

case, these contributions could not possibly be translated into money's worth.[83] Therefore, the Court concluded that the stockholders' consideration was insufficient to justify a retained interest pursuant to the contribution exception to the absolute priority rule.[84]

In decisions subsequent to *Case*, courts have recognized that, in certain circumstances, shareholders may participate in the reorganized enterprise.[85] Shareholders' contributions of capital necessary to fund the reorganization plan have been deemed sufficient to allow shareholders to participate in the reorganization of the corporation.[86] Courts have also indicated that the issuance of stock to key personnel involved in the management of an enterprise might not violate the absolute priority rule when the continuation of management is essential to the success of the reorganization.[87] These decisions reflect a practical adjustment of the priority rights of creditors and stockholders.[88]

The Court of Appeals for the Eighth Circuit expanded this exception to the absolute priority rule in *Ahlers v. Norwest Bank*.[89] Prior to discussing the absolute priority rule, however, the court in *Ahlers* analyzed the elements of adequate protection.[90] The Ahlers' filing of a chapter 11 bankruptcy petition resulted in an automatic stay of all creditors' lien actions against the Ahlers' property.[91] Norwest and Federal Land Bank, because their claims against the Ahlers greatly exceeded the value of the Ahlers' land and equipment secured as collateral, were substantially undersecured.[92]

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83. *See id.*

84. *Id.*

85. *See, e.g.*, Buffalo Sav. Bank v. Marston Enter. Inc. (*In re* Marston Enter.), 13 Bankr. 514, 518 (Bankr. E.D.N.Y. 1981) ($300,000 to $400,000 contribution by stockholders to effectuate reorganization plan could be sufficient to allow shareholder participation).

86. *See, e.g.*, Official Creditor's Comm. v. Potter Material Serv., Inc. (*In re* Potter Material Serv. Inc.), 781 F.2d 99, 102 (7th Cir. 1986) (sole shareholder retained interest in exchange for contributing capital and renewing personal guarantee of debtor's note); Brown v. Brown's Indus. Uniforms, Inc. (*In re* Brown's Indus. Uniforms, Inc.), 58 Bankr. 139, 141 (Bankr. N.D. Ill. 1985) (plan confirmed when shareholder contributed personal assets for working capital).

87. *See, e.g.*, Horowitz v. Kaplan, 193 F.2d 64, 75 (1st Cir. 1951), *cert. denied*, 342 U.S. 946 (1952). In *Horowitz*, the First Circuit Court of Appeals upheld the confirmation of a plan of reorganization, which provided two managers with an option to purchase a portion of the common stock of the corporate debtor. *Id.* at 74. The court determined that the two managers' skills were an important assurance of the debtor's future success. *Id.* The court based its findings on the fact that the two managers had agreed by contract to remain in the management positions for a five year period. *Id.*

88. *See* Kansas City Terminal Ry. v. Central Union Trust Co., 271 U.S. 445, 455 (1926) (advocating bankruptcy court's discretion in adjusting the rights of priority).

89. 794 F.2d 388, 401 (8th Cir. 1986), *cert. granted*, 55 U.S.L.W. 3852 (June 23, 1987) (No. 86-958).

90. Ahlers v. Norwest Bank (*In re* Ahlers), 794 F.2d at 393-97 (8th Cir. 1986), *cert. granted*, 55 U.S.L.W. 3852 (June 23, 1987) (No. 86-958).

91. *Id.* at 393; *see* 11 U.S.C. § 362(a) (1982 & Supp. III 1985) (bankruptcy filing operates as stay of all lien enforcement actions). For the text of § 362(a), see *supra* note 6.

92. *Ahlers*, 794 F.2d at 392.

As a result of the automatic stay, the creditors were unable to foreclose on the Ahlers' property so they sought adequate protection.[93]

The first issue the court discussed was the starting date of adequate protection payments for opportunity cost.[94] The bankruptcy court determined that the undersecured creditors were entitled to adequate protection payments as of the date they filed for adequate protection.[95] The court of appeals reversed the bankruptcy court, stating that adequate protection payments should not begin until, pursuant to state law, the secured creditor could have taken possession of the collateral, sold it to a third party, and reinvested the proceeds.[96]

Pursuant to Minnesota law, a creditor must give six weeks published notice prior to a foreclosure sale of a debtor's real property.[97] In addition, the debtor has an exclusive statutory right to redeem the realty for twelve months following the foreclosure sale.[98] During this redemption period, the mortgagor is entitled to possession, rents, and profits of the real estate.[99] Therefore, it is

93. *Id.* at 393; *see* 11 U.S.C. § 361(1) (1982 & Supp. III 1985) (when adequate protection is required it may be provided by periodic payments). For the text of § 361(1), see *supra* note 7. In addition to motioning for adequate protection, the creditors requested relief from the automatic stay. *Ahlers,* 794 F.2d at 393; *see* 11 U.S.C. 362(d)(1) (relief may be granted from the automatic stay for cause, including lack of adequate protection). For the text of § 362(d)(1), see *supra* note 7.

94. *Ahlers,* 794 F.2d at 395. The court of appeals stated that, although a secured creditor should receive adequate protection of its interest during an automatic stay, what constitutes adequate protection depends on the unique facts presented in each individual case. *Id.* at 394. (citing *In re* Briggs, 780 F.2d at 1348 (8th Cir. 1985)). For a discussion of *Briggs,* see *supra* notes 37-48 and accompanying text. The court of appeals then noted that Norwest and Federal Land Bank were entitled to adequate protection of their security interest, and that protection may include compensation, in the form of postpetition interest payments, for the delay in enforcing their foreclosure rights. *Id.* at 395. Therefore the court concluded that the bankruptcy court did not err in requiring the Ahlers to make postpetition payments, and turned to the question of the timing and amount of the adequate protection payments. *Id.*

95. *Id.* The bankruptcy court determined that Federal Land Bank was entitled to adequate protection payments as of January 1, 1985, the date of the Ahlers' postpetition default on the Federal Land Bank loans. *Id.* The bankruptcy court also determined that Norwest was entitled to protection payments as of February 27, 1985, the date of the evidentiary hearing on Norwest's motion for adequate protection. *Id.*

96. *Id.* at 395. The court of appeals noted that before a bankruptcy court determines the time period it would take a creditor to repossess, sell, and reinvest collateral, it must determine the date to which this period would be added. *Id.* The court of appeals determined that if the secured creditor has commenced foreclosure proceedings prior to the filing of the bankruptcy petition, the foreclosure delays should be added to the date foreclosure proceedings were commenced. *Id.* If, however, the secured creditor has not commenced foreclosure proceedings prior to the filing of the bankruptcy petition, the foreclosure delays should be added to the date that the creditor moved for adequate protection in the bankruptcy court. *Id.*

97. *See* MINN. STAT. ANN. § 580.03 (West 1947) (six weeks published notice must be given prior to a foreclosure sale).

98. *See id.* § 580.23(2) (West Supp. 1987) (mortgagor may redeem twelve months after foreclosure sale); *see also id.* § 580.24 (if mortgagor does not redeem within twelve months, the senior creditor having a lien on the mortgaged property may redeem).

99. *See* Johnson v. First Nat'l Bank, 719 F.2d 270, 276 (8th Cir. 1983), *cert. denied,* 465 U.S. 1012, 1013 (1984) (mortgager entitled to retain rights to possession, rents, and property during the redemption period).

extremely unlikely that a third party would purchase the property until after the redemption period.[100] Applying these principles, the court in *Ahlers* noted that Norwest's and Federal Land Bank's rights to foreclose and to reinvest the liquidation proceeds would give them no financial benefit until the land could be resold to a third party, which at the earliest would be one year and six weeks from the date the foreclosure proceedings were commenced.[101] The court concluded that adequate protection payments, with respect to the farmland, should not begin until that day.[102]

The court then considered when adequate protection payments should begin for creditors with an interest in the Ahlers' farm machinery and equipment.[103] The court noted that Minnesota law provides that a creditor, absent bankruptcy filing, is permitted to take possession of farm machinery and equipment secured as collateral without any significant delay.[104] Therefore, the court determined that adequate protection payments, with respect to the Ahlers' farm machinery and equipment, should begin promptly after the secured creditors apply for adequate protection.[105]

The next issue the court discussed was the date that the collateral should be valued for adequate protection purposes.[106]

100. *Ahlers,* 794 F.2d at 396. The court noted that pursuant to reasonable and established marketing techniques, the creditor will purchase the realty at the foreclosure sale and then attempt to resell the property after the redemption period has expired, provided that the debtor has not exercised his or her redemption rights. *Id.*

101. *Id.* The court stated that if foreclosure proceedings had not been commenced prior to the bankruptcy filing, then adequate protection payments would begin one year and six weeks after the adequate protection motion was filed by the creditor. *Id.* For a discussion of the dates from which the redemption period would run for the purpose of adequate protection payments, see *supra* note 96. Norwest and Federal Land Bank had not commenced foreclosure proceedings prior to the date that the Ahlers filed for bankruptcy. Brief of the States, *supra* note 8, at X. Thus, the Ahlers' adequate protection payments would begin one year and six weeks after Norwest and the Federal Land Bank filed their motions for adequate protection. *See Ahlers,* 794 F.2d at 396.

102. *Ahlers,* 794 F.2d at 396.

103. *Id.*

104. *Id.; see* MINN. STAT. ANN. § 565.21 (West Supp. 1987) (claimant can recover possession of personal property prior to final judgment). The court noted that Norwest would be permitted to repossess the Ahlers' farm equipment and machinery unless the Ahlers were dependent on the property to earn a living. *Ahlers,* 794 F.2d at 396; *see* MINN. STAT. ANN. § 565.251 (West Supp. 1987) (debtor can stay the creditor from repossession if the debtor insures the property and makes periodic depreciation payments to the creditor). The court stated that in the event the debtor needed the property for a living, the debtor could only retain the property if he insured it and made periodic payments to the creditor, similar to those required under the Bankruptcy Code. *Ahlers,* 794 F.2d at 396; *see* 11 U.S.C. § 361(1) (1982 & Supp. III 1985). For the text of § 361(1), see *supra* note 7. Therefore, the court concluded that adequate protection payments for farm equipment and machinery should start on application for adequate protection. *Ahlers,* 794 F.2d at 396.

105. *Ahlers,* 794 F.2d at 396. The court added that since secured collateral like livestock and grain in storage may be readily liquidated, adequate protection payments on these items should also begin on the date of application for adequate protection payments. *Id.*

106. *Id.* Congress specifically left open the question of the valuation date of collateral for adequate protection payments. *Id.* at 395; *see* HOUSE REPORT, *supra* note 6 at 339, 1978 U.S. CODE CONG. & ADMIN. NEWS at 6295. The purpose of leaving the determination of valuation open was to permit the bankruptcy court to adapt to varying circumstances and changing modes of financing. *Id.*

The bankruptcy court had determined that the valuation should be fixed as of the date the Ahlers filed for bankruptcy.[107] The court of appeals reversed the bankruptcy court's decision, concluding that the date of valuation should match the starting date of the adequate protection payments.[108] Therefore, the collateral should be valued at the time it could have been sold pursuant to state law.[109]

The court then addressed the timing of the periodic protection payments.[110] The bankruptcy court had required monthly adequate protection payments as a condition to maintaining the automatic stay on all creditor proceedings.[111] The court of appeals, however, reversed the bankruptcy court's decision, determining that the timing of the payments should consider the nature of the debtor's income.[112] A farmer's income is not dependent upon a monthly paycheck, but rather upon the cyclical nature of agriculture.[113] Thus, the court of appeals concluded that adequate protection payments in this particular case should not be due until the Ahlers had harvested their crops and had sold their livestock.[114]

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107. *Ahlers,* 794 F.2d at 396.

108. *See id.* For a discussion of the starting dates for adequate protection payments, see *supra* notes 94-105 and accompanying text. The court stated that the bankruptcy court's determination of the valuation was appropriate with respect to the livestock and grain in storage which, pursuant to state law, could have been sold immediately. *Ahlers,* 794 F.2d at 396; *see* MINN. STAT. ANN. § 565.21 (West Supp. 1987) (creditor possession of personal property prior to final judgment). However, the bankruptcy court's decision was inappropriate with respect to the real property collateral that could not have been sold immediately, since the adequate protection payments would not begin until the collateral could have been sold. *Ahlers,* 794 F.2d at 396; *see* MINN. STAT. ANN. § 580.03 (West 1947) (six weeks published notice must be given prior to foreclosure sale); *id.* § 580.23 (West Supp. 1987) (mortgagor may redeem twelve months after foreclosure sale).

109. *Ahlers,* 794 F.2d at 396. For a discussion of when collateral can be sold pursuant to state law, see *supra* notes 96-104 and accompanying text. The court stated that even if it ignored the bankruptcy court's error of valuing the collateral at the time of the filing of the petition, the court would still remand the issue of valuation to the bankruptcy court because the bankruptcy court had failed to consider the dramatic decline in land values that had occurred in the twelve month period preceeding the filing of the petition. *Ahlers,* 794 F.2d at 396-97.

110. *Ahlers,* 794 F.2d at 397.

111. *Id.; see* 11 U.S.C. § 361(1) (1982 & Supp. III 1985) (when adequate protection is required, adequate protection can be provided by periodic payments). For the text of § 361(1), see *supra* note 7. The adequate protection payments were required in order to compensate Norwest and Federal Land Bank for the delay in exercising their foreclosure rights caused by the automatic stay. *Ahlers,* 794 F.2d at 393.

112. *Ahlers,* 794 F.2d at 397.

113. *Id.* The court noted that a grain farmer's income is not dependent upon a monthly paycheck, but rather upon the harvest of his or her crops at the end of the growing season. *Id.* Similarly, a livestock farmer's income is realized when the livestock is sold. *Id.*

114. *Id.* The court stated that, although adequate protection payments should not be due until harvest is completed and livestock are sold, the adequate protection payments could be accumulated prior to the harvest. *Id.* at 397 n.11.

The court also reviewed whether a lien on growing crops could be sufficient as adequate protection. *Id.* at 397. The court determined that the bankruptcy court erred in ruling that the Ahler's offer of a lien on the next year's crop could not constitute adequate protection. *Id.* The court reaffirmed its holding in a prior decision that a lien on a future crop, to the extent that the crop was otherwise not encumbered, may serve in whole or in part as a basis for providing adequate protection. *Id.; see* Martin v. United States (*In re* Martin), 761 F.2d 472, 476-78 (8th Cir. 1985).

Next, the court examined Norwest's and Federal Land Bank's contentions that any feasible plan submitted by the Ahlers could not be confirmed over the banks' objections.[115] The creditors alleged that, because they were undersecured, any reorganization plan would treat part of their claims as unsecured.[116] The creditors contended that they would object to any reorganization plan because the Ahlers were not financially able to produce a plan that would provide for full payment of the creditors' unsecured claims.[117] Moreover, Norwest and Federal Land Bank argued that the plan could not be confirmed over their objections because the plan would not fully satisfy their unsecured claims and the debtors would retain an interest in the farm by being allowed to continue the farming operation.[118] The creditors maintained that such a plan

115. *Ahlers,* 794 F.2d at 399-400. Prior to reaching the confirmation issues, the court reviewed whether the Ahlers' reorganization plan had a reasonable prospect of success. *Id.* at 397-99. Norwest and Federal Land Bank contended that even if their interests were adequately protected during the automatic stay, they should be granted relief from the stay because the Ahlers' reorganization plan was not feasible. *Id.* at 397. Norwest and Federal Land Bank based their argument on § 362(d)(2) of the Bankruptcy Code, which provides that the automatic stay will be lifted, if the debtor does not have equity in the collateral and the collateral is "not necessary to an effective reorganization." *Id.; see* 11 U.S.C. § 362(d)(2) (1982 & Supp. III 1985). For the text of § 362(d)(2), see *supra* note 7. Norwest and Federal Land Bank argued that the "necessary for an effective reorganization" language of § 362(d)(2) required the Ahlers' to show not only that the property was essential to the reorganization plan, but also that the plan was realistically feasible. *See Ahlers,* 794 F.2d at 397-98.

The district court had reviewed the reorganization plan based on several factors and had found that the plan was utterly unfeasible. *Id.* at 398. The court analyzed the plan, using the factors outlined in *United Properties, Inc. v. Emporium Dept. Stores. Id.; see* United Properties, Inc. v. Emporium Dept. Stores, Inc., 379 F.2d 55, 66-71 (8th Cir. 1967) (outlining the following factors: (1) the ratio of current assets to current liabilities; (2) the debtor's solvency; (3) evidence that the debtor could operate at a profit; (4) the debtor's cash flow; (5) the capability of the debtor's management; and (6) economic conditions affecting the debtor's situation). Based on these factors, the district court determined that the Ahlers' plan was unfeasible because the debtor's current liabilities exceeded his current assets by a substantial margin and the debtor could not, in light of his past experience and current or anticipated farm programs, be expected to operate profitably. *Ahlers,* 794 F.2d at 398. The court of appeals reversed the district court's decision after it determined that the district court failed to value the collateral independent of the bankruptcy court's valuation of the collateral for adequate protection purposes. *Id.* The appeals court stated that for purposes of the feasibility of the reorganization plan, collateral should be valued at the time of confirmation of the plan, and not at the time collateral is valued for adequate protection purposes. *See id.* For a discussion of the time collateral is valued for adequate protection purposes, see *supra* notes 106-09 and accompanying text. The appeals court noted that revaluation is particularly important when, as in the Ahlers' case, the evidence demonstrated that the collateral decreased in value after the adequate protection valuation. *Ahlers,* 794 F.2d at 398. Therefore, the court remanded the issue of valuation to the district court for revaluation of the collateral as of the plan's confirmation date, and ordered the district court to make a new determination of the reorganization plan's feasibility. *See id.*

116. *Ahlers,* 794 F.2d at 399; *see* 11 U.S.C. § 506(a) (1982) (a creditor has a secured claim to the extent of the value of the collateral and an unsecured claim for the amount that his allowed claim exceeds the value of the collateral).

117. *Ahlers,* 794 F.2d at 399; *see* U.S.C. § 1129(a)(8) (1982 & Supp. III 1985) (court will confirm a plan only when a class of creditors has accepted the plan or the class of creditors is not impaired under the plan); *id.* § 1124 (a class of claims is impaired when the plan alters the legal, equitable and contractual rights to which a holder of a claim is entitled).

118. *Ahlers,* 794 F.2d at 399; *see* 11 U.S.C. § 1129(b)(1) (1982 & Supp. III 1985) (court may confirm the reorganization plan notwithstanding dissenting impaired creditors if the plan is fair and equitable with respect to each class); *id.* § 1129(b)(2)(B) (a plan is fair and equitable if, pursuant to the absolute priority rule, unsecured claims are provided for in full before the holder of any junior

would violate the absolute priority rule contained in the Bankruptcy Code's "fair and equitable" provisions.[119] The Ahlers, however, sought to avoid this requirement pursuant to the contribution exception to the absolute priority rule by offering new consideration to the reorganization plan.[120]

The court of appeals addressed for the first time the issue of whether a farmer's efforts in operating and managing his or her farm are a contribution sufficient to allow the debtor farmer to retain an interest in the farm.[121] Relying on the United States Supreme Court's decision in *Case v. Los Angeles Lumber Products Co.*, the court stated that the new contribution must be in money or money's worth.[122] The contribution that the Ahlers offered was the labor and management skills that they possessed as farmers.[123] The court determined that the yearly contribution of the farmer's efforts in operating the farm was measurable in money's worth.[124] Furthermore, acknowledging that the new contribution must be essential to the success of the undertaking, the court stated that a farmer's efforts in operating and managing his or her farm were essential to any farm reorganization.[125] Thus, the court concluded that the Ahlers should be entitled to retain an interest in the farm in return for the labor contribution, even though more senior claims were not provided for in full under the plan.[126]

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claims or interests retains any property owned by the debtor). For the text of § 1129(b)(2)(B), see *supra* note 58. Norwest and Federal Land Bank argued that under any reorganization plan, the Ahlers would retain an ownership interest because they would continue to farm their land. *Ahlers*, 794 F.2d at 401. The creditors maintained that the retention of the ownership interest would violate the absolute priority rule because ownership interests are junior to unsecured claims, and the unsecured claims would not be fully satisfied. *Id.* at 401.

119. *See supra* note 118. For a discussion of the "fair and equitable" provisions of the Bankruptcy Code and the "absolute priority" rule, see *supra* notes 57-72 and accompanying text.

120. *See Ahlers*, 794 F.2d at 401; Case v. Los Angeles Lumber Products Co., 308 U.S. 106, 121 (1939) (an ownership interest may be retained when unsecured claims are not satisfied in full if the holder of the ownership interest makes a fresh contribution to the debtor in money or money's worth). For a discussion of *Case*, see *supra* notes 73-84 and accompanying text.

121. *Ahlers*, 794 F.2d at 402.

122. *Id.* at 401 (citing *Case*, 308 U.S. at 122) (a contribution must be made in money or money's worth to retain an ownership interest when unsecured creditors are not paid in full). For a discussion of *Case*, see *supra* notes 73-84 and accompanying text.

123. *Ahlers*, 794 F.2d at 402.

124. *Id.* The court noted that the Ahlers' skills are something of a value that would disappear if their farm were liquidated. *Id.* Since the value of the Ahlers' skill could not be realized by creditors in the event of liquidation, the court noted that principles of fairness were not violated if the reorganization plan left that value in their hands. *Id.* Furthermore, the court stated that the reorganization value of the Ahlers' farm exceeded its liquidation value. *Id.* Norwest and Federal Land Bank would receive annual payments if the plan was approved and was successful, but they would receive nothing if the plan was rejected and the Ahlers were forced to liquidate their farm. *Id.*

125. *Id.* at 402; *see Case*, 308 U.S. at 121 (the contribution made by the holder of an ownership interest must be necessary to the reorganization for the holder of the ownership interest to retain an interest when senior claim holders have not been satisfied). For a discussion of *Case*, see *supra* notes 73-84 and accompanying text.

126. *Ahlers*, 794 F.2d at 402; *see* 11 U.S.C. § 1129(b)(2)(B)(ii) (1982 & Supp. III 1985) (a plan is fair and equitable if, pursuant to the absolute priority rule, unsecured claims are provided for in full

The court then discussed whether the Ahlers' labor contribution was reasonably equivalent to the ownership interest that they would retain pursuant to the reorganization plan.[127] The court stated that, in determining the worth of the farmer's retained interest in the property, a court must estimate the future worth of the debtor's farm and any potential profits.[128] The court noted that the Ahlers would not realize any value from their retained interest, other than farm operating costs and living expenses, until the reorganization plan was completed, since all profits from the farm operation would be paid to the creditors until the creditors had been paid in full.[129] The court stated that if the value of the Ahlers' yearly contributions of labor, experience, and expertise over the life of the reorganization plan would equal or exceed the value of the retained ownership interest when the plan is completed, then unsecured creditors would have been accorded their full right of priority against the debtors' assets.[130]

In summary, the court in *Ahlers* narrowed the scope of adequate protection of opportunity costs during bankruptcy proceedings.[131] Pursuant to the court's decision, the starting date for adequate protection payments should not begin until the date

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before the holder of any junior claims or interests retains any property under the plan). For the text of § 1129(b)(2)(B)(ii), see *supra* note 58.

127. *Ahlers,* 794 F.2d at 402. The court had to determine whether the Ahlers' labor contribution was reasonably equivalent to the ownership interest he would retain because, pursuant to the contribution exception to the absolute priority rule set forth in *Case,* the contribution must be reasonably equivalent to the ownership interest that is retained. *See Case,* 308 U.S. at 121. For a discussion of the contribution exception in *Case,* see *supra* notes 73-84 and accompanying text.

128. *See Ahlers,* 794 F.2d at 402 (citing *In re* Landau Boat Co., 13 Bankr. 788, 792-93 (Bankr. W.D. Mo. 1981) (the court must make determinations regarding the future of the debtor as reorganized and its possible profits). The court noted that determining the value of the farmer's contribution should not be difficult to determine. *Id.* However, the court viewed the valuation of the farmer's retained interest as a more difficult problem. *Id.*

129. *Ahlers,* 794 F.2d at 403. The court noted that since the Ahlers would not receive any profit or benefit until the plan was complete, their ownership interest did not mature until the plan was finished. *Id.*

130. *Id.* For example, if the bankruptcy court values the farmer's labor, experience, and expertise at $40,000 per year, and the plan provides for living expenses of $12,000 per year, the farmer's contribution for his retained ownership interest would be $28,000 per year. *Id.* at n.17. This $28,000 multiplied by the number of years a reorganization plan spans equals the amount the farmer has paid for his retained ownership interest. *See id.* If this amount exceeds the value of the farmer's retained ownership interest at the time the plan is completed, the unsecured creditors have been afforded their full rights of priority against the debtor. *Id.* at 403.

Moreover, the court noted that a plan may be more profitable than anticipated, and if the holder of the ownership interest receives this profit, the holder may receive more than the value of its contribution. *Id.* The court suggested, in order to avoid this result, that the bankruptcy court should require that the excess profit from the operation of the farm be paid to the unsecured creditors on a pro rata basis until the secured creditors have been paid in full without interest. *Id.* In addition, if any secured property is sold during the life of the plan, and if the unsecured creditors have not been paid in full, the bankruptcy court should require that any amount received in excess of that necessary to pay any secured creditors be shared equitably among the unsecured creditors and the holders of ownership interests, based on their contribution at the time the property is sold. *Id.*

131. *See id.* at 393-97. For a discussion of adequate protection of opportunity costs, see *supra* notes 23-48 and accompanying text.

when the secured creditor, acting pursuant to state law, could have taken possession of the collateral, sold it to a third party, and reinvested the proceeds.[132] In addition, the court expanded the contribution exception to the absolute priority rule to permit a debtor farmer to participate in a reorganization plan in consideration for his or her contribution of experience, knowledge, and labor to the plan.[133]

In his dissent, Judge Gibson contended that the majority ignored the bankruptcy court's discretionary authority and failed to review the bankruptcy court's factual findings under the "clearly erroneous" standard.[134] Gibson also contended that the majority's view that experience, knowledge, and labor is equivalent to capital was contrary to precedent, logic, and fairness.[135] Gibson concluded that this adjustment in the relationship between the debtor farmer and his or her creditors involved policy considerations that should be addressed by Congress rather than the courts.[136]

The *Ahlers* decision redefines the manner in which a creditor's opportunity costs may be adequately protected during the stay in bankruptcy proceedings.[137] In *In re Roberts*[138] the United States Bankruptcy Court for the Eastern District of Michigan reviewed and questioned the *Ahlers* decision.[139] In *Roberts* undersecured

132. *Ahlers,* 794 F.2d at 395. For a discussion of the starting date of adequate protection payments, see *supra* notes 94-105 and accompanying text.

133. *See Ahlers,* 794 F.2d at 399, 403. For a discussion of the contribution exception to the absolute priority rule, see *supra* notes 70-88 and accompanying text.

134. *Ahlers,* 794 F.2d at 404 (Gibson, J., dissenting). Judge Gibson asserted that the majority ignored factual and equitable considerations properly relied upon by the bankruptcy judge in ordering the commencement of adequate protection payments. *Id.*

135. *Id.* at 406. Judge Gibson maintained that the contribution exception to the absolute rule should be narrowly construed to allow a debtor to participate in the reorganization plan only when the debtor makes a fresh capital contribution or its equivalent which is necessary to the reorganization plan. *Id.* In his view, the majority's expansion of the rule to include a contribution of labor was not supported by case law. *Id.* at 407.

Judge Gibson also asserted that the court's reasoning was illogical. *Id.* Judge Gibson contended that a contribution of labor did not provide the same certain protection to the unsecured creditor as did a contribution of capital. *Id.* In addition, Judge Gibson argued that the value of a farmer's experience, knowledge, and labor was too speculative compared to the value of capital. *Id.* Furthermore, Judge Gibson noted that a contribution of capital was made prior to the execution of the plan, whereas the contribution of labor was a promise to perform in the future. *Id.* Finally, Judge Gibson maintained that the expansion of the absolute priority rule to include labor as a sufficient new contribution to allow debtor participation violated the "fair and equitable" requirement of the absolute priority rule. *Id.; see* 11 U.S.C. § 1129(b)(2)(B)(ii) (1982 & Supp. III 1985) (a plan is fair and equitable, if, pursuant to the absolute priority rule, unsecured claims are provided for in full before the holder of any junior claims or interests retains any property under the plan). For the text of § 1129(b)(2)(B)(ii), see *supra* note 58. He reasoned that, because an agreement to contribute labor was not sufficient to allow a debtor to retain an interest under the plan, the plan was not fair and equitable. *Ahlers,* 794 F.2d at 407 (Gibson, J., dissenting).

136. *Ahlers,* 794 F.2d at 408 (Gibson, J., dissenting).

137. *See id.* at 395. The court determined that adequate protection payments should not begin until the date when the creditor could have repossessed and liquidated the collateral. *Id.* For a discussion of the court's analysis of adequate protection, see *supra* notes 90-114 and accompanying text.

138. 63 Bankr. 372 (Bankr. E.D. Mich. 1986).

139. *In re* Roberts, 63 Bankr. 372, 381 (Bankr. E.D. Mich. 1986).

creditors sought adequate protection of their interests in the debtor farmers' real property after the debtors filed for reorganization pursuant to chapter 11 of the Bankruptcy Code.[140] The bankruptcy court disagreed with the *Ahlers* holding that the starting date for adequate protection payments should not begin until the date when the creditor could have taken possession of the property pursuant to state law, sold it to a third party, and reinvested the proceeds.[141] Instead, the bankruptcy court concluded that adequate protection must be provided from the time that the undersecured creditors moved for relief.[142] The court reasoned that if adequate protection is not required until after the date when the creditor could have, absent bankruptcy filing, taken possession of and liquidated the collateral and the debtor fails to make a payment at that time, the creditor would only then be able to institute foreclosure proceedings.[143] This would, in effect, double the time that the creditor must wait to obtain title to the property.[144]

The *Ahlers* decision also expands the contribution exception to the absolute priority rule by allowing a farmer to participate in a reorganization plan by operating his or her farm.[145] In *In re Stegall*[146] the United States Bankruptcy Court for the Central District of Illinois criticized the *Ahlers* decision.[147] In *Stegall* the debtor farmers filed a plan of reorganization pursuant to chapter 11 of the Bankruptcy Code.[148] The debtors sought to retain an equity interest in their farming operation on the strength of a promise to provide labor and services in conducting the farming operation according to the reorganization plan.[149] The bankruptcy court agreed with Judge Gibson, the dissenting judge in *Ahlers*, that the exception created for farmers in *Ahlers* was contrary to the clear

140. *Id.* at 372-75; *see* 11 U.S.C. § 1121(a) (1982) (debtor may file a plan for voluntary reorganization).

141. *Roberts,* 63 Bankr. at 381; *see Ahlers,* 794 F.2d at 395 (adequate protection payments begin when the creditor could take possession of the collateral, sell it, and reinvest the proceeds). For a discussion of the starting date of adequate protection, see *supra* notes 94-105 and accompanying text.

142. *Roberts,* 63 Bankr. at 381.

143. *Id.*

144. *Id.* The bankruptcy court did, however, agree with the *Ahlers* court's determination that the timing of periodic protection payments should be considered in light of the cyclical nature of agriculture. *Id.; see Ahlers,* 794 F.2d at 397 (the court should consider the cyclical nature of agriculture when determining the timing of adequate protection payments). The court noted that farm lenders often receive payments from mortgagors only at those times of the year when the farmers realize income. *Roberts,* 63 Bankr. at 381.

145. *Ahlers,* 794 F.2d at 402. For a discussion of the *Ahlers* court's analysis of a labor contribution exception to the absolute priority rule, see *supra* notes 120-33 and accompanying text.

146. 64 Bankr. 296 (Bankr. C.D. Ill. 1986).

147. *See In re* Stegall, 64 Bankr. 296, 299 (Bankr. C.D. Ill. 1986).

148. *Id.* at 297; *see* 11 U.S.C. § 1121(a) (1982) (debtor may file a plan for a voluntary reorganization).

149. *See Stegall,* 64 Bankr. at 298.

weight of authority, which applied the absolute priority rule to individuals and farmers.[150] In addition, the bankruptcy court supported Judge Gibson's statement that if any changes were to be made, Congress, not the courts, should make the changes.[151]

The effect of the *Ahlers* decision on a debtor's obligation to provide adequate protection, as a condition to maintaining the automatic stay, will vary from state to state since the determination of the starting date for adequate protection payments depends upon the creditor's right to possession of the collateral pursuant to state law.[152] North Dakota has a foreclosure process similar to Minnesota.[153] Since the court in *Ahlers* determined the starting date for adequate protection payments according to Minnesota law, the application of the court's decision to North Dakota law should virtually parallel that interpretation.[154]

The decision in *Ahlers* did not address the application of the labor contribution exception to the absolute priority rule in a non-

150. *Stegall,* 64 Bankr. at 301; *see Ahlers,* 794 F.2d at 407 (Gibson, J., dissenting). The bankruptcy court asserted that the absolute priority rule was not appropriate in agricultural bankruptcies. *Stegall,* 64 Bankr. at 301; *see* 11 U.S.C. § 1129(b)(2)(B)(ii) (1982 & Supp. III 1985) (a plan is fair and equitable if, pursuant to the absolute priority rule, unsecured claims are provided for in full before the holder of any junior claims or interests retains any property under the plan). For the text of § 1129(b)(2)(B)(ii), see *supra* note 58. The court reasoned that the debtor farmer's effort to reorganize is motivated not so much by a desire to retain an interest of value in property, but rather by a desire to remain on the family farm and continue with a way of life. *Stegall,* 64 Bankr. at 300-01 (citing *In re* Witt, 60 Bankr. 556, 560 (Bankr. N.D. Ia. 1986)). The court stated, however, that the absolute priority rule did not contain an exception for farmers. *See id.* Therefore, the court concluded that the debtor farmers could not retain an ownership interest in their farm without fully satisfying the claims of unsecured creditors. *See id.;* 11 U.S.C. § 1129(b)(2)(B)(ii).

151. *Stegall,* 64 Bankr. at 300; *see Ahlers,* 794 F.2d at 408. (Gibson, J., dissenting) (if there is to be a change in the relationship between farmers and their creditors, Congress should make the change).

152. *See Ahlers,* 794 F.2d at 395.

153. *Compare* MINN. STAT. ANN. § 580.03 (West 1947) (six weeks published notice must be given prior to a foreclosure sale) *and* MINN. STAT. ANN. § 580.23(2) (West Supp. 1987) (mortgagor may redeem twelve months after a foreclosure sale) *with* N.D. CENT. CODE § 28-23-04 (1974) (notice of the foreclosure must be published once a week for three consecutive weeks and the last published notice must be at least ten days prior to the sale) *and* N.D. CENT. CODE § 28-24-02 (Supp. 1985) (judgment debtor may redeem twelve months after sale).

154. *Compare Ahlers,* 794 F.2d at 396 (adequate protection payments begin one year and six weeks after the date foreclosure proceedings are started, and if no foreclosure proceedings are commenced prior to the filing of the bankruptcy proceeding the adequate protection payments begin one year and six months after a motion for adequate protection payments) *with In re* Asbridge, 66 Bankr. 894, 900-01 (Bankr. D.N.D. 1986) (adequate protection payments begin one year and three months after the commencement of foreclosure proceedings if no final judgment has been rendered, and if no foreclosure proceedings are initiated adequate protection payments begin one year and three months after the creditors move for adequate protection). In *Asbridge* the court stated that the first step in determining the date that adequate protection payments begin was to determine the date to which foreclosure delays would be added. *Id.* at 900 (citing *Ahlers,* 794 F.2d at 396). The court determined that since the creditors had already obtained a judgment and a sheriff's sale had been scheduled, the date to which the delays should be added was the date the foreclosure sale was scheduled. *Id.* The court then determined the delays associated with foreclosure pursuant to North Dakota law. *See id.* The court noted that foreclosure is started in North Dakota by serving notice of foreclosure at least thirty days prior to commencement of a foreclosure action. *Id.; see* N.D. CENT. CODE § 32-19-20 (1976) (at least thirty days prior to foreclosure proceeding notice shall be served on the title owner). The court then stated that after a summons and complaint were served on the debtor, the debtor had twenty days to answer upon the creditor. *Asbridge,* 66 Bankr. at 900; *see*

agricultural business sector.[155] However, the labor contributions that a farm owner makes to his or her farming operation are similar to those made by entrepreneurs in small businesses.[156] Therefore, the labor contribution exception could reasonably be applied to the reorganization of a small business.

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N.D.R. CIV. P. 12(a) (Supp. 1985) (defendant has twenty days after service of summons to serve an answer upon the plaintiff). Moreover, the court stated that once a creditor obtains a judgment, the creditor must publish notice of the foreclosure for three weeks, with the last publication at least ten days prior to the sale. *Asbridge,* 66 Bankr. at 900; *see* N.D. CENT. CODE § 28-23-04 (1974) (notice of the sale must be published once a week for three consecutive weeks and the last published notice must be given at least ten days prior to the sale). Finally, the court noted that the redemption period in North Dakota was one year. *Asbridge,* 66 Bankr. at 900; *see* N.D. CENT. CODE § 28-24-02 (Supp. 1985) (judgment debtor may redeem twelve months after sale). Thus, the court concluded that the usual delay associated with foreclosure in North Dakota was fifteen months. *Asbridge,* 66 Bankr. at 901.

155. *See Ahlers,* 794 F.2d at 388.

156. *See* Brief of the States at 26, *supra* note 8.

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