

In the United States Bankruptcy Court

for the Northern District of Iowa

LARKEN/LICO PROPERTIES
Debtor(s).

Bankruptcy No. 94-10539KC
Chapter 11

ORDER RE: MOTION TO PROHIBIT USE OF CASH COLLATERAL

) Chapter 11 (Involuntary)

On July 26, 1994, the above-captioned matter came on for hearing pursuant to assignment. Present at the hearing were Joseph Peiffer and Linda Merritt representing S & S Partnership and Alpine Bank & Trust Co. ("S & S"), T. Randall Wright and Dan Childers representing Debtor Larken/LICO Properties, and Anita Shodeen representing Central Life Assurance Co. ("Central Life").

STATEMENT OF THE CASE

The matter before the Court is a Motion to Prohibit Use of Cash Collateral filed by S & S. S & S holds first mortgages on three of the four parcels comprising Debtor's hotel property located in Colorado. It also holds a second mortgage on Parcel "C". The mortgages contain assignment of rent provisions. The total debt to S & S is approximately \$1.2 million. Central Life holds a first mortgage on Parcel "C" and second mortgages on the other three parcels. The total debt to Central Life is approximately \$1.1 million. The property was recently appraised at \$1.7 million. An offer to purchase the property is currently pending with a purchase price of \$2.4 million.

Debtor has been operating under a receiver appointed in a Colorado state court action. The receiver has failed to make at least two monthly payments to service the S & S debt. The Holiday Inn franchise under which the hotel was operating has now been terminated. S & S moves for an order prohibiting Debtor from utilizing the hotel revenues which it characterizes as cash collateral. It argues that its secured interest in the property and rents is not adequately protected.

Debtor objects to the motion. It argues that S & S's interest is adequately protected by the substantial equity cushion evidenced by the difference between the debt and the purchase price in the pending sale. Furthermore, Debtor points out that revenues are being reinvested to maintain the property which further protects S & S's security interest.

Central Life also objects to the motion. It agrees with Debtor that S & S's interest is adequately protected. Central Life further asserts that any order proscribing Debtor's use of cash collateral should be limited to the three parcels on which S & S holds first mortgages.

CONCLUSIONS OF LAW

This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(M).

In order to be entitled to adequate protection under 11 U.S.C. § 363(e), S & S must have an interest in the property Debtor proposes to use. The property Debtor proposes to use is the revenue generated from its hotel rooms. Debtor makes a compelling argument that S & S does not have a valid interest in the property because of its failure to file a UCC financing statement to perfect its interest in the hotel revenues. See In re M. Vickers, Ltd., 111 B.R. 332, 337 (D. Colo. 1990) (holding that because hotel rents are personalty, security interest must be perfected by filing an Article 9 financing statement); Bank of Am. Nat'l Trust & Savs. Ass'n v. Denver Hotel Ass'n Ltd. Partnership, 830 P.2d 1138, 1140 (Colo. Ct. of App. 1992) (citing M. Vickers; holding that rights to hotel charges must be perfected through filing a financing statement).

It is further debatable whether the hotel revenues actually constitute cash collateral under § 363. See In re Airport Inn Assoc., Ltd., 132 B.R. 951, 960 (Bankr. D. Colo. 1990) (Melloy, J., sitting by designation) (holding that postpetition security interests, governed by California law, in accounts receivables consisting of hotel room sales are invalid under § 552); In re Investment Hotel Properties, Ltd., 109 B.R. 990, 994 (Bankr. D. Colo. 1990) (holding that security interest, created in Missouri, in postpetition hotel revenues is invalidated by § 552(a) where such revenues are personalty, not realty, under state law).

For purposes of this ruling, the Court assumes *arguendo*, without deciding, that S & S has a valid lien and that hotel revenues constitute cash collateral. The issue is then narrowed to whether the interest of S & S is adequately protected if Debtor is allowed to use the hotel revenues in the operation of its business. Debtor has the burden of establishing that S & S is adequately protected. In re Weiser, Inc., 74 B.R. 111, 115 (Bankr. S.D. Iowa 1986).

The existence of adequate protection is a question of fact. In re Martin, 761 F.2d 472, 474 (8th Cir. 1985). It is a flexible concept designed to insure that the creditor receives the value for which it bargained. Id.

In any given case, the bankruptcy court must necessarily (1) establish the value of the secured creditor's interest, (2) identify the risks to the secured creditor's value resulting from the debtor's request for use of cash collateral, and (3) determine whether the debtor's adequate protection proposal protects value as nearly as is possible against risks to that value consistent with the concept of indubitable equivalence.

Id. at 477.

In the context of rents as cash collateral, courts have acknowledged that adequate protection can be established by the fact that the rents are used to enhance and maintain the value of the real property. In re Atrium Dev. Co., 159 B.R. 464, 471 (Bankr. E.D. Va. 1993). Application of rents to operation and maintenance expenses without diversion to the debtor clearly insures adequate protection. In re 499 W. Warren St. Assoc., Ltd. Partnership, 142 B.R. 53, 56 (Bankr. N.D.N.Y. 1992). Usage of gross rents to maintain the property is a form of adequate protection which preserves the value of the property in which the creditor has a security interest. In re Rollingwood Apartments, Ltd., 133 B.R. 906, 913 (Bankr. S.D. Ohio 1991). Other factors to consider are whether the debtor has equity in the property, whether the property is declining in value and whether the debtor is current on postpetition payments due to the creditor. Atrium Dev. Co., 159 B.R. at 471.

Existence of an equity cushion can be sufficient to provide adequate protection. In re Rancourt, 123 B.R. 143, 152 (Bankr. D.N.H. 1991), stated that a clear showing of an equity cushion sufficient at least to cover debts until plan confirmation adequately protected the creditor as there was no real

danger of the debt not being covered in full. A debtor's use of rents does not mean that the real property is gone. Id. Another court, in considering whether an equity cushion combined with use of rents to pay operating expenses and for renovation provides adequate protection, held that an equity cushion is an acceptable method of adequate protection. In re McCombs Properties VI, Ltd., 88 B.R. 261, 266 (Bankr. C.D. Cal. 1988). Using rent to pay operating expenses and for renovation will eliminate the risk of diminution of value of the real property. Id. at 268.

The parties dispute whether the \$1.7 million appraisal of the property or the \$2.4 million sale price is the proper measure of value to determine the extent of Debtor's equity cushion. The essential question is what is the property worth. It appears that the sale price is fixed. The evidence establishes that the buyers are serious and intend to honor the purchase agreement. Common sense compels this Court to conclude that the property's value is best evidenced by the proposed sale price. See BFP v. Resolution Trust Corp., 114 S. Ct. 1757, 1767 (1994) (holding that in foreclosure sale context, property's value at the time it is sold is the foreclosure sale price itself). Obviously, if the sale should fail to materialize, a reconsideration would be appropriate.

Therefore, with the property valued at \$2.4 million and encumbered by debts to both S & S and Central Life of approximately \$2.3 million, there exists an equity cushion of approximately \$100,000. S & S presents a novel theory for establishing the respective interests of S & S and Central Life by separating out revenues from the hotel rooms located on Parcel C on which Central Life has a first mortgage. The Court is not convinced that such an approach is analytically correct. Nevertheless, without adopting a specific methodology, the Court concludes that S & S's first mortgage on three-fourths of the property would undoubtedly allow it a larger share of any proceeds than that which would be attributable to Central Life's first mortgage on Parcel C. The parties contemplate that the proposed sale of the property will be finalized within two or three months. The equity cushion is sufficient to assure that debts can be covered for at least that short period of time.

A court-appointed receiver is currently operating Debtor's hotel business. The record is devoid of any evidence that the receiver is not applying the hotel revenues to operation and maintenance expenses. This use of the hotel revenues will avoid depreciation of the value of the real property and enhance the chances of the sale being finalized.

The Court concludes that Debtor's proposed use of the hotel revenues combined with the equity cushion evidenced by the sale price provides S & S adequate protection under § 363(e). There is little risk that Debtor's use of the hotel revenues will diminish the value of the real property beyond the existing equity cushion. Use of the revenues to maintain the hotel operations further protects S & S's interest in the hotel property.

WHEREFORE, for the reasons set forth herein, Debtor's use of hotel revenues, combined with the equity cushion, constitutes adequate protection under § 363(e).

FURTHER, for the reasons set forth herein, the Motion to Prohibit Use of Cash Collateral filed by S & S Partnership is DENIED.

SO ORDERED this 2nd day of August, 1994.

Paul J. Kilburg
U.S. Bankruptcy Judge