

# In the United States Bankruptcy Court

## for the Northern District of Iowa

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S.O.S. ENTERPRISES, LTD.  
Debtor.

Bankruptcy No. 95-10203KC  
Chapter 11

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### ORDER RE MOTION FOR USE OF CASH COLLATERAL

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On March 23, 1995, the above-captioned matter came on hearing pursuant to assignment on an expedited basis. Present at the hearing were: Dan Childers as Attorney for Debtor and Mr. Terry O'Connell, President of Debtor Corporation; and Steve Pace as Attorney for Creditor Guaranty Bank & Trust Company. Mr. Dan Klenske appeared as a representative of Guaranty Bank & Trust Company. Evidence was presented and the Court took the matter under advisement. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(M).

#### STATEMENT OF THE CASE

The matter before the Court is a motion by Debtor to use cash collateral. This motion was filed March 21, 1995 and requested as an expedited hearing.

The file reflects that Debtor filed the present Chapter 11 Petition on February 8, 1995. Debtor is in the business of printing and placing lettering and other logos on T-shirts and sweatshirts which are then sold through large distributors such as Target, Wal-Mart, and K-Mart. Debtor has relied, since 1987 or 1988, on Guaranty Bank & Trust Company of Cedar Rapids (the "Bank") to provide ongoing financing. The financing originally started in the amount of \$300,000 and has increased gradually over the years until it is now between \$1 million and \$1.1 million.

To protect its loans, the Bank took a general security agreement, a second mortgage on Terry O'Connell's residence, a life insurance policy and an executed personal guarantee which was given without underlying collateral. The general security agreement is on Debtor's business and covers inventory, accounts receivable, and business equipment. It is generally conceded and unchallenged that the Bank's security position in these items is that of a first security interest.

According to the documents presented to the Court, it is the position of Debtor that the present value of inventory is \$1.3 million; the present value of accounts receivable outstanding is \$750,000; and the book value of business equipment is \$200,000 for a total collateral value of \$2.25 million. It is largely uncontested that the debt load at this time is \$1,050,000.

The parties previously agreed to the use of cash collateral. This agreement was incorporated into an interim order entered on February 24, 1995 which expired on March 24, 1995. Apparently, ongoing discussions as to the use of cash collateral were unsuccessful, thereby precipitating Debtor's present application for continued use of cash collateral. The Bank filed a resistance on March 22, 1995. The Bank asserts many of the foregoing facts including the fact that it has a perfected security interest in

virtually all of the property of Debtor as previously set out herein. The Bank asserts that it demands adequate protection from Debtor under 11 U.S.C. § 363(e). It further asserts that the financial statements of Debtor do not show a reasonable projected future profit margin and that the Bank's position is in jeopardy because of Debtor's failure to provide adequate protection. The Bank also asserts that it has filed a Motion for Appointment of a Trustee or, in the alternative, a Conversion to Chapter 7. The Bank raises various allegations which they assert support its Motion for Appointment of a Trustee and that these matters also have an impact upon the issue of adequate protection.

Debtor asserts that the Bank's interest is adequately protected based upon the substantial equity cushion evidenced by the differential between the debt of \$1,050,000 and the value of the secured assets which, through the business, total \$2.25 million. In addition, further security is provided by the second mortgage on Mr. O'Connell's personal residence and the life insurance policy as well as the personal guaranties. Debtor asserts that the accounts receivable, with the exception of certain K-Mart accounts, are being turned over to maintain the accounts receivable in an amount similar to that which presently exists. Additionally, Debtor asserts that the inventory and equipment are not depreciating in value and constitute a constant valuable asset.

### CONCLUSIONS OF LAW

For a creditor to be entitled to adequate protection under 11 U.S.C. § 363(e), a creditor must have an interest in the property which Debtor proposes to use. Here, Debtor proposes to use accounts receivable which are admittedly secured to the Bank in order to generate additional revenues to buy raw goods to continue to generate a marketable product. Therefore, this Court concludes that the Bank does have an interest in the property of the Debtor, particularly accounts receivable, which gives its standing to demand adequate protection for the use of this cash collateral.

The sole issue for the Court's determination in this hearing is, therefore, whether the interest of the Bank is adequately protected if Debtor is allowed to continue to use the accounts receivable in the operation of its business. Debtor has the burden of establishing that the Bank 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. See In re Martin, 761 F.2d 472, 474 (8th Cir. 1985). The concept of adequate protection is flexible and is designed to ensure 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 present case, Debtor asserts that its business is generating a profit, though admittedly small at the present time. Debtor also asserts that the profit margin will increase over the next several months as the beginning months of each calendar year are historically the worst months in terms of generating a net profit. However, Debtor relies primarily upon the existence of an equity cushion as a guarantee of adequate protection. The law is clear that the existence of an adequate equity cushion can be sufficient to provide adequate protection. In In re Rancourt, 123 B.R. 143, 152 (Bankr. D.N.H. 1991), the Court holds that a clear showing of an equity cushion sufficient, at least to cover underlying

obligations until plan confirmation, adequately protects a creditor as there is no real danger of the obligation not being covered in full. Other courts have also held that an adequate equity cushion is an acceptable method of adequate protection. In re McCombs Properties, Ltd., 88 B.R. 261, 266 (Bankr. C.D. Cal. 1988).

In the present case, the Bank argues that there is some uncertainty as to whether the inventory, accounts receivable, and equipment are properly valued based upon inconsistencies in various financial statements. The Bank has expressed concern about various business practices of the Debtor postpetition which bring into question the validity of the property valuation. Ultimately, the Court must determine whether the property pledged as collateral is of sufficient value to provide an adequate equity cushion. While the Bank has raised several significant questions relating to the accounting practices and business practices of Debtor, it appears that many of these issues relate more appropriately to the hearing to be held on the appointment of a Trustee than they do toward the issue of the use of cash collateral and adequate protection.

With minor exceptions, the issues raised by the Bank do not impact on the valuation of the pledged collateral. An issue is raised by the Bank relating to the acquisition of accounts with K-Mart. This may ultimately raise issues as to some loss of collateral in the accounts receivable. However, at this time, based upon the total amount of collateral, this is not sufficiently large to imperil the equity cushion. Viewed in its entirety, Debtor has established that the Bank has been provided assets as security well in excess of the \$1,050,000 which are owed to the Bank. The property on the books of Debtor corporation are in excess of \$2 million in value. While there may exist some variation, as a factual matter, the Court is satisfied that Debtor has established that an equity cushion exists in this case substantially more than is owed to the Bank.

Based on the foregoing, the Court concludes that Debtor's proposed use of accounts receivable as cash collateral is appropriate based upon the substantial equity cushion evidenced by this record. At present, there appears little risk that Debtor's continued use of these accounts receivable will diminish the total value of the secured assets beyond the existing equity cushion. Use of the accounts receivable to maintain Debtor's business as a going concern is necessary, at this time, for reorganization of Debtor's business operations.

**WHEREFORE**, for the reasons set forth herein, Debtor's continued use of accounts receivable, combined with the equity cushion, constitutes adequate protection under 11 U.S.C. § 363.

**FURTHER**, for the reasons set forth herein, the resistance to the use of cash collateral filed by Guaranty Bank & Trust Company is denied.

**FURTHER**, Debtor shall be authorized to continued use of cash collateral under identical terms as those entered in the agreed upon order of February 24, 1995, including numbered paragraphs 1 through 16. In so directing these terms, the Court recognizes, however, that any language in the previous order relating to the Bank's agreement or concurrence is inapplicable based upon this Court's Order.

**SO ORDERED** this 27th day of March, 1995.

Paul J. Kilburg  
U.S. Bankruptcy Judge