

In the United States Bankruptcy Court

for the Northern District of Iowa

MYRON J. KLOUBEC
ELLEN K. KLOUBEC
dba Kloubec Fish Farm
Debtor(s).

Bankruptcy No. 99-02325-C

Chapter 12

ORDER RE MOTION FOR USE OF CASH COLLATERAL AND ADEQUATE PROTECTION OFFER

On January 4, 2000, the above-captioned matter came on for hearing pursuant to assignment. Debtors appeared with Attorney Thomas Fiegen. Farmers State Bank of Walford appeared by Attorney Ray Terpstra. Evidence was presented after which 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

Debtors filed a Motion for Use of Cash Collateral and Adequate Protection Offer on November 30, 1999. Debtors propose to use Farmers State Bank of Walford's cash collateral from postpetition fish sales and collection of prepetition accounts. For adequate protection, they offer to give the Bank a replacement lien in postpetition fish, accounts receivable, contract rights and proceeds. Also, they offer to pay the Bank ten percent of its cash collateral until confirmation, up to \$25,000 annually.

The Bank specifically objects that it does not know the profitability of Debtors' operations, it states that it has not received an accounting from Debtors, and Debtors' projections of sales are internally inconsistent and overstated. The Bank additionally argues that it is not adequately protected considering that the fish remaining in the ponds are not likely to survive this winter.

FINDINGS OF FACT

Debtors own property in Iowa County, Iowa where they raise various species of fish for commercial sale. Debtors are also in the process of expanding a bait sale operation from the same property. Debtors have ponds located on the property where they keep and raise the fish for sale. Debtors have fish at every level of development. Throughout the year they sell fish for human consumption, some as bait fish, and some as sport fish.

On October 10, 1986 and on September 15, 1993, Debtors executed security agreements to secure payment of several notes held by the Farmers State Bank of Walford. These security agreements grant to the Bank an interest in all "cattle, hogs, other livestock and all increase therefrom . . . all grain, feed, crops and products therefrom . . . all implements, machinery, attachments, parts and

replacement, tools and equipment, contract rights, accounts and all proceeds, it being the intention of Debtors to include all personal property now owned or hereafter acquired." This Court, in a hearing held on October 19, 1999 and in an order dated November 15, 1999, determined that the Bank had valid security interests in the fish as well as the personal property and other items listed in the security agreement.

An order was entered in State Court in Johnson County, Iowa on April 23, 1999. This order gave the Bank an immediate right to replevin all pond fish. Debtors filed their Chapter 12 petition the day before the replevin order was to become effective. After the filing of the petition, the Bank learned that Debtors were selling fish commercially. The Bank filed a motion to prevent Debtors from using the proceeds. This was ordered and thereafter, Debtors set up a separate account which now contains approximately \$36,000 in cash. This cash consists of \$4,000 from prepetition accounts receivable and \$32,000 in postpetition sales of fish. As determined by previous orders of this Court, the security agreements cover these proceeds. The proceeds are cash collateral of the Farmers State Bank of Walford. It is this cash that Debtors propose to use to finance their operations into the spring of 2000.

There are serious allegations of bad faith in this case. Myron Kloubec disclaimed an interest in the estate of his grandfather shortly prior to the filing of this Chapter 12 petition. It is alleged that this was a substantial interest and the disclaimer deprives unsecured creditors of the value of this inheritance. Another substantial inheritance is presently in probate. There are allegations that family members and other insiders have received preferences including one that may have been made ten minutes prior to the filing of the Chapter 12 petition. There are allegations that the schedules are incomplete, including jewelry with an undetermined value. Because of these allegations, the Bank has filed a Motion to Dismiss and the U.S. Trustee's Office has filed a Motion to Convert under 11 U.S.C. §1208.

Debtors have listed assets of substantial value which are not covered by Farmers State Bank of Walford's security interest. These include real estate and motor vehicles. Debtors' own liquidation analysis reflects that if Debtors were to liquidate their business, there would be approximately \$63,000 derived for the benefit of creditors. It is argued by the Bank and the U.S. Trustee, however, that if unlisted assets, preferences, the disclaimer of inheritance and other assets were properly included in this analysis, the amount available for unsecured creditors could approximate \$250,000 or more. Interestingly, Debtors plan proposes to pay unsecured creditors \$10,000 per year for three years for a total of \$30,000.

The documentation of Debtors business has been sparse. The Department of Natural Resources seized many of Debtors' records. These records are now being returned to Debtors. Nevertheless, Debtors have not filed a tax return for calendar year 1998. Many of the existing records have slowly been made available to the Bank or to the Chapter 12 Trustee or U.S. Trustee. The records which have been presented do not provide a complete picture of the business operations of Debtors. There are no complete accounting records of prepetition or postpetition fish sales. Debtors have provided a projected cash flow analysis for calendar year 2000. Income for calendar year 2000 is based upon three primary categories: fish sales, bait sales, and consulting fees by Myron Kloubec. Total fish sales for calendar year 2000 are projected at approximately \$173,000; bait sales are projected at approximately \$290,000; and consulting fees are projected at approximately \$20,000. There is also listed income from other sales and CRP payments totaling approximately \$24,000. Debtors' projected total income for calendar year 2000 is \$508,000. Debtors' projected costs of goods sold and operating expenses as well as living expenses for calendar year 2000 total approximately \$397,000. Debtors project profit of \$111,456.10.

Debtors sustained a net loss in 1999 of approximately \$8,000. Additionally, the projected expenses for the year 2000 do not include the proposed plan payment of \$10,000 to unsecured creditors. It does not include repayment of any loans. It appears that the projected fish sales have some historical validity though they approximate if not exceed income from the best year of this business. The highest sales were in 1995 with sales of \$236,000. The lowest sales recorded was in 1999. However, the sales related to bait do not have a historical basis. Debtors assert that these sales will increase by projected expansion of the bait route and customer base. Finally, Debtors indicate an additional \$20,000 from consulting fees by Debtor Myron Kloubec. The evidence establishes that Myron Kloubec presently has no consulting contracts with anyone in the fish business.

Debtors indicate that they will repay the use of cash collateral through the sale of fish. They indicate that they need \$30,000 to produce fish which will be sold this late spring and summer. They testified that with the infusion of \$30,000 of cash collateral they will not need additional money after this spring. Debtors, however, have not produced a written budget. Debtor Ellen Kloubec indicated that they have two employees who need to be paid. Additionally, they will use the money appropriately toward business uses into the spring. Debtors testify that they have accumulated bills of \$10,000 over the last three months. It appears from the testimony that it is anticipated that certain of the cash collateral would be used to pay personal expenses of Debtors including life insurance premiums and credit card payments. Absent a written budget, it is impossible to determine with any accuracy how this proposed cash collateral would be utilized.

Debtors state that they will use the sale of fish to cover use of the cash collateral. Debtors testified that December, January and February of each year are their worst months for generating income. Debtors are unable to state how many fish, if any, are left in the ponds at this time. Debtors are unsure how many ponds are open and how many are frozen over. Finally, they are unsure of how many ponds contain fish. They did testify that they have some brood fish with which to regenerate and stock the ponds this year.

CONCLUSIONS OF LAW

The Bankruptcy Code provides that the Trustee or debtor-in-possession after notice and a hearing may "use, sell, or lease, other than the ordinary course of business, property of the estate." 11 U.S.C. §363 (b)(1). However, the use of this property is limited by other provisions of the Code which provide that:

Notwithstanding any other provision of this section, at any time, on request of an entity that has an interest in property used, sold, or leased, or property to be used, sold, or leased, by the trustee, the court, with or without a hearing shall prohibit or condition such use, sale, or lease as is necessary to provide adequate protection of such interest. This subsection also applies to property that is subject to any unexpired lease of personal property (to the exclusion of such property being subject to an order to grant relief from the stay under section 362).

11 U.S.C. §363(e). Section 363 is applicable to Chapter 12 cases pursuant to 11 U.S.C. §1205(b). In re Milleon, 83 B.R. 696, 700 (Bankr. D. Neb. 1988).

Adequate protection is a question of fact. This Circuit has provided that: "The concept of adequate protection was designed to insure that the secured creditor receives the value for which he bargained." In re Martin, 761 F.2d 472, 474 (8th Cir. 1985). Stated differently:

Congress in enacting §363 of the Code gave a special treatment to "cash collateral" for the obvious reason that cash collateral is highly volatile, subject to rapid dissipation and requires special protective safeguards in order to ensure that a holder of a lien on "cash collateral" is not deprived of its collateral through unprotected use by the Debtor.

In re Mickeler, 9 B.R. 121, 123 (Bankr. M.D. Fl. 1981). In order to determine whether proposed adequate protection is satisfactory, the Eighth Circuit has established a three part analysis. It is stated as follows:

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 possible against risks to that value consistent with the concept of indubitable equivalence.

Martin, 761 F.2d at 476-477.

In applying these concepts, the proposed cash collateral which Debtors intend to use is the fund set up in a DIP account postpetition. This has a total value of \$36,000.

Secondly, the Court must identify risks to the secured creditor's value resulting from Debtors' request to use the cash collateral. Debtors have not provided a written budget of projected use of the cash collateral. There is no showing of a needs assessment between now and the spring of 2000. All that is stated is that Debtors have several employees who will need to be compensated. Debtors do not provide an itemized listing of how much salary will be needed. There is no listing of other expenses necessary to run this operation through the winter. In fact, it appears that Debtors propose to use at least a portion of the cash collateral for personal use and personal expenses. Additionally, Debtors' proposal of adequate protection is based upon providing the Bank with a replacement lien in new fish. They propose that ten percent of cash sales, up to \$25,000 per year, will be turned over to the Bank. However, there has been no showing made that fish even exist in the ponds at this time. In fact, Debtors themselves have stated in their resistance to the Bank's motion to modify stay that:

Kloubecs' affirmatively state that they stocked their ponds with \$68,000 of young spawned fish. However, the 1999 drought and remains of dead fish dumped on the banks of Kloubecs' ponds by the Bank's state court receiver reduced the number of fish that survived. Kloubecs' have taken orders for \$20,000 of fish, which proceeds they have deposited into an account bearing DIP savings account pursuant to this Court's direction, pending a decision of whether or not to use cash collateral. Kloubecs estimate, based on a sampling of their ponds, that less than \$6,000 of saleable fish remain in their ponds.

The Court understands that it is the intention of Debtors to restock these ponds in time that marketable fish can be produced. However, the months of December, January and February are historically Debtors worst months based upon Debtors' own testimony. The conditions of 1999 have seriously impaired the ability of Debtors to ensure that fish production in calendar year 2000 will meet these projections. Additionally, there have been allegations made in this case concerning Debtors' financial transactions in this case. These allegations remain unresolved, however, it has been established that Debtors have equity in other assets including farm land which by Debtors' own admission totals in excess of \$60,000. Debtors have not offered adequate protection through additional liens or second mortgages on any property having equity. Instead, Debtors have limited their offer to a lien in new fish whose existence, at best, may be speculative based on the evidence presented.

The concept of adequate protection was designed to recognize the fifth amendment protection of property interests. Adequate protection is "a mechanism ensuring that there will not be a taking of a constitutionally protected property interest without providing an adequate substitute." Milleson, 83 B.R. at 700. In this case, Debtors propose to use up to \$36,000 in cash over the next unspecified period of time for unspecified purposes and without a written budget. To adequately protect this constitutional interest, Debtors propose a substitute lien on fish in ponds whose existence cannot be verified. Alternatively, Debtors have equity in other assets which could support additional liens or mortgages. However, Debtors have not chosen to offer liens or mortgages in those assets. If the Court were to approve Debtors' proposal of adequate protection, Debtors would be free to use up to the total amount of the cash collateral presently in the DIP account for almost any purpose, including the proposed purpose of paying personal obligations, over an unlimited period of time, with no possibility of review since there is no proposed budget against which to measure the appropriateness of the expenditures. Approval of this motion would have the effect of transferring all risk of this venture to the Bank. If the fish offered as protection fail to materialize, the Bank would absorb the loss while Debtors retain their equity. It is the conclusion of this Court that concepts of due process require that adequate protection be applied more stringently than the terms proposed by Debtors in this case.

WHEREFORE, for all the reasons set forth herein, Debtors' Motion to Use Cash Collateral and Adequate Protection Offer is DENIED.

SO ORDERED this 11th day of January, 2000.

Paul J. Kilburg
Chief Bankruptcy Judge