

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF:)
)
FARNAM ASSOCIATES LIMITED)
PARTNERSHIP,) CASE NO. BK91-80845
) CH. 11
DEBTOR(S)) Filing No. 97, 100

MEMORANDUM

Hearing was held on Motion to Dismiss and Resistance to Motion to Dismiss and Request for Hearing of Andersen Construction Company of Council Bluffs, Inc. Appearances: Janice Woolley for the debtor, Jerry Jensen for the UST, Neil Danberg and Frank Schepers for PMC, Tom Saladino for Eileen Ratigan, and Douglas Lash for Andersen Construction Co. This memorandum contains findings of fact and conclusions of law required by Fed. Bankr. R. 7052 and Fed. R. Civ. P. 52. This is a core proceeding as defined by 28 U.S.C. § 157(b)(2)(A).

Background

This Chapter 11 case was filed on April 16, 1991. The case involves a single asset residential apartment building.

Shortly after the case was filed, on April 26, 1991, the debtor and Patrician Mortgage Company, its mortgage lender, entered into a "Stipulation" by which the debtor was permitted to use cash collateral. Patrician was and is secured by a deed of trust on the real property and a security interest in the rents generated by the apartment complex. By virtue of the Stipulation, the debtor was permitted to use the monthly rents to the extent necessary to pay specific operating expenses. The net rents were then to be turned over to Patrician and, pursuant to paragraph 4(c) of the Stipulation, the funds received by Patrician "shall be applied by Patrician to principal and interest due under the note."

Notice of the Stipulation was provided to the appropriate parties, including Andersen Construction Co. Of Council Bluffs, Inc., (Andersen).¹

¹Andersen is a lien creditor whose claim results from services and materials provided to the debtor while

On May 21, 1991, after having received no objection to the Stipulation, an order was entered approving the Stipulation.

Thereafter, on September 4, 1991, Andersen filed a motion requesting dismissal or conversion and requested a determination of the applicability of the Stipulation to certain tax increment financing funds that were to be received by the debtor. A hearing on that motion was held on October 7, 1991, and, as part of the evidence received at the hearing, the court admitted an affidavit of the president of a general partner of the debtor. In that affidavit, the president, Mr. Kooper, testified, in part, that the Stipulation specifically provided that Patrician would apply the excess funds to interest and principal due under the note.

Following the hearing, an order was entered denying Andersen's motion. Andersen did not appeal this order.

From the beginning of the case until now, the debtor has paid the net rents to Patrician and Patrician has applied the net rents as authorized under the Stipulation and order approving the Stipulation.

In the summer of 1997, Patrician and the debtor determined that no consensual plan would be able to be presented and the debtor would not be able to obtain confirmation of a non-consensual plan. Patrician then moved to dismiss the case under 11 U.S.C. § 1112(b)(1), (2) and (3).

The debtor did not resist the dismissal but Andersen did object. Andersen asserts that Patrician was an undersecured creditor on the petition date and, therefore, Patrician did not have the right to interest on its claim during the pendency of the case.² Accordingly, Andersen takes the

rehabilitating the apartment complex. Throughout most of this case, the debtor, Andersen, and Patrician have been litigating the extent, validity and priority of the Andersen lien claim and such claim has ultimately been determined to be subordinate to the claim of Patrician secured by its deed of trust.

²Section 506(b) of the Bankruptcy Code allows the holder of a secured claim interest on its claim only to the extent

position that any monies received by Patrician from the debtor during the pendency of the case, whether referred to as "adequate protection" or otherwise, should have been applied to the outstanding principal balance of the Patrician claim, thereby reducing that balance by a significant amount. If the money received by Patrician is applied to the principal, the now outstanding principal balance is less than the value of the collateral, causing the debtor to have equity in the collateral, the proceeds of which could be used to pay Andersen, a lienholder second in priority to Patrician. On that basis, Andersen requested permission to file a liquidating plan.

After a hearing on the motion to dismiss and objection, an order was entered that deferred ruling on the motion. Since, at the time of the hearing, there was no plan on file which placed into contest the propriety of the prior order which approved the Stipulation and allowed the application of net rents to principal and interest under the note, the issue was not ripe for determination. Each party was given a period of time to file a plan and disclosure statement which plan was to include, not only a provision for dealing with the claims, but was to be supported by evidence of the value of the collateral. There has not been a determination of the value of the collateral on the petition date or on any date thereafter.

Both parties filed liquidating plans. The Andersen plan assumes, based upon an appraisal, that the value of the collateral is now \$6,030,000.00 and was, on petition date, \$4,960,000.00.

The Patrician plan also provides for liquidation, but values the collateral as of this date at \$8,515,000.00. On the petition date, the claim of Patrician was \$8,810,900.00 and in September of 1997 when the motion to dismiss was argued, after application of a net amount of approximately \$4,500,000.00 to interest and principal, the claim remained at \$8,565,869.00.

The question of the appropriate treatment and application of the net rents received by Patrician during the life of the

that the holder's collateral value exceeds the amount of the claim.

case is now at issue. A hearing was held on both disclosure statements and objections thereto. It became apparent at the hearing that there was no reason to go forward with the disclosure statements and plans without first having a determination of the effect of the order approving the Stipulation which allowed the application of net rents to principal and interest due under the note. If that order is determined to be final and binding on the parties, notwithstanding Andersen's argument under 11 U.S.C. § 506(b), then, since both parties acknowledge that the value of the collateral is less than the current outstanding principal balance on the Patrician note, liquidating the collateral will not benefit any claimants other than Patrician and no plan should be approved and the case should be dismissed.

If, on the other hand, it is ultimately determined that the provisions of 11 U.S.C. § 506(b) are mandatory and that no stipulation approved by court order can vary the rights of the debtor and creditors with regard to payment of interest on undersecured claims, the Andersen liquidation plan, in concept, is viable, because the principal amount of Patrician's claim will have been reduced to approximately \$4,300,00.00 and the lowest value assumed by the parties for the collateral at this time is over \$6 million. In other words, there would be equity for the Andersen lien.

Findings of Fact

Although Andersen has now raised the issue of the appropriateness of the application of rent collateral to interest and principal due under the note, the first time Andersen raised this issue was in response to a motion to dismiss which was filed more than six years after the case began and the Stipulation was approved. Andersen did not object to the Stipulation when it was originally circulated and did not appeal the order approving the Stipulation. Several months after the Stipulation was approved, Andersen did challenge the right of the debtor and Patrician to treat tax increment financing payments as collateral of Patrician and subject to the Stipulation. When Andersen's motion concerning that issue was denied, Andersen did not appeal nor ask for reconsideration based upon the supposed invalidity of the Stipulation and the order approving it.

Patrician relied upon the terms of the Stipulation and would be significantly prejudiced by a retroactive change

which would require it to apply all of the rents to principal, and none to interest. Patrician is a limited partnership which has used the net rents to pay interest to its investors. If the Stipulation had not been approved, Patrician would have taken immediate steps to end the bankruptcy or obtain relief from the automatic stay. Patrician had absolutely no reason to acquiesce in the continuation of the Chapter 11 case if it were not assured by the order approving the Stipulation that the debtor's obligation to Patrician would be properly serviced, during the relatively short period of time that the parties expected it would take to either obtain a consensual plan or determine the priority of liens.

During the case, over \$400,000.00 in tax increment financing benefits and over \$60,000.00 per month have been received by Patrician and applied as provided for in the Stipulation approved by court order after notice and hearing.

Issue

Is the order approving the Stipulation and the application of net rents to principal and interest binding on the parties to this case?

Question of Law

The issue concerning the binding effect of the order approving the Stipulation which allowed the application of net rents to principal and interest due under the note can be determined as a matter of law.

Decision

The order approving the Stipulation which permitted Patrician to apply the net rents to interest and principal due under the note was a final, appealable order. It was not appealed and should not be altered at this late date to the prejudice of Patrician. It is binding on the parties. Since the disclosure statement and plan as proposed by Andersen relies upon the assumption that the Stipulation and order approving it are not binding, the disclosure statement cannot be approved and the plan cannot go forward to confirmation. Patrician does not actually desire to liquidate its collateral in this bankruptcy proceeding and it has filed a motion to dismiss which shall be granted by separate order.

Discussion and Conclusions of Law

A. Final Order

Both the order that approved the Stipulation and the order that denied the motion filed by Andersen to limit the applicability of the Stipulation with regard to tax increment financing funds were final. That is, they ended the litigation concerning the use of cash collateral. After those orders were entered, this court had nothing further to do with regard to the implementation of those two orders. They are, therefore, "res judicata" with regard to the matters which were dealt with in the orders.

As the Eighth Circuit has held:

"[F]inality for bankruptcy purposes is a complex subject and courts deciding appealability questions must take into account the peculiar needs of the bankruptcy process." In re Koch, 109 F.3d 1285, 1287 (8th Cir 1997) (quotations and alterations omitted). To determine the finality of an order in a bankruptcy proceeding, we consider "the extent to which (1) the order leaves the bankruptcy court nothing to do but execute the order; (2) delay in obtaining review would prevent the aggrieved party from obtaining effective relief; and (3) a later reversal on that issue would require recommencement of the entire proceeding." In re Apex Oil Co., 884 F.2d 343, 347 (8th Cir. 1989). This is a more liberal standard of finality than is generally applied to nonbankruptcy proceedings. See Currell v Taylor, 963 F.2d 166, 167 (8th Cir. 1992) (per curiam).

Yukon Energy Corp. v. Brandon Inv., Inc. (In re Yukon Energy Corp.), 138 F.3d 1254, 1258 (8th Cir. 1998).

There is no question that Andersen was well aware of the purpose of the Stipulation and the manner in which it would be implemented. Approximately \$60,000 a month in net rents (which is part of the collateral package held by Patrician) have been paid to Patrician to be applied on the interest and principal of the note since the middle of 1991. In addition,

more than \$400,000 in tax increment payments have been paid to Patrician pursuant to the terms of the cash collateral order.

Patrician had the right to depend upon the finality of the order approving the application of funds. Patrician did not have to wait until the end of the case to see if an order entered in the first few months of the case and the acts which it took thereafter to implement the Stipulation would once again be approved by the court. The Eleventh Circuit Court of Appeals in the case of Martin Brothers Toolmakers, Inc. v. Indus. Dev. Bd. Of Huntsville (In re Martin Bros. Toolmakers, Inc.), 796 F.2d 1435 (11th Cir. 1986), determined that: "Finality of bankruptcy orders cannot be limited to the last order concluding the bankruptcy case as a whole...." Id. at 1437-1438. In the Ninth Circuit, it is clear that an order dealing with the disposition of cash collateral is a final, appealable order. Wattson Pacific Ventures v. Valley Fed. Sav. & Loan (In re Safeguard Self-storage Trust), 2 F.3d 967 (9th Cir. 1993). The Tenth Circuit has ruled similarly in the case of MBank Dallas, N.A. v. O'Connor (In re O'Connor), 808 F.2d 1393 (10th Cir. 1987).

B. Doctrine of Intervening Rights

Since there is no Eighth Circuit Court of Appeals case on the issue of the finality of orders providing for the disposition of cash collateral, it is possible that, in this circuit, such orders could be considered non-final and subject to alteration under the appropriate circumstances late in the case. However, even if that possibility exists in general, the doctrine of intervening rights should protect this order from alteration. The doctrine of intervening rights is an equitable limitation upon the court. The Fifth Circuit Court of Appeals in the case of Continental Airlines, Inc. v. Air Line Pilots Ass'n. (In re Continental Airlines Corp.), 907 F.2d 1500 (5th Cir. 1990), when considering the bankruptcy court's authority to modify an order which approved a settlement, stated:

A bankruptcy court's decision to approve or disapprove a settlement is reviewed under an abused discretion standard. (Citations omitted). Thus, the question now is not a matter of interpretation, because the bankruptcy court is ordinarily free to modify its own non-final orders in the absence of intervening

rights that may have vested in reliance on such orders.

Id. at 1520 (emphasis supplied).

In that case, the bankruptcy court had modified its original settlement order and the modification was stricken because Continental, its creditors and others had acted in reliance upon the settlement in approving Continental's plan of reorganization. Payments had been made under the agreement and other litigation had been settled pursuant to the agreement. The court went on to state:

We are persuaded that, because of the actions taken in reliance on the order approving settlement, the district court correctly held that the bankruptcy court should not have set aside the order approving settlement in order to interpret and enforce said order or the settlement itself....Although the bankruptcy court is, of course, free to interpret and enforce the order approving settlement, any modification of that order at this late date would be an abuse of discretion. The settlement, as originally approved by the bankruptcy court and the order approving settlement, has been implemented during the four years since it was approved. Compelling interests of fairness and finality demand that the order approving settlement be enforced according to its terms without any modification.

Id. at 1522.

In the Eighth Circuit, the doctrine of intervening rights has been recognized in Mulligan v. Fed. Land Bank, 129 F.2d 438 (8th Cir. 1942); see also In re Peyton Realty Co., 148 F.2d 771 (3rd Cir. 1945).

Bankruptcy courts, as courts of equity, have the power to reconsider, modify, or vacate their previous orders, so long as no intervening rights have become vested in reliance upon the order. See In re Lenox, 902 F.2d 737, 739-740 (9th Cir. 1990); accord In re Mettlen, 174 B.R. 822 (D. Kan. 1994). In this case, Patrician acted in reliance on the order and paid

out the funds received to its investors as interest on their investments. Its right to do so vested when the order became non-appealable. The order may not now be altered to the detriment of Patrician.

Conclusion

The order approving the stipulation which allowed the application of net rents to interest and principal due under the note is binding on the parties and shall not, at this late date, be altered. The plan and disclosure statement submitted by Andersen which relied upon such potential alteration, is moot. The motion to dismiss this case filed by Patrician and acquiesced in by the debtors is granted.

Separate journal entry shall be entered.

DATED: July 30, 1998.

BY THE COURT:

/s/ Timothy J. Mahoney
Timothy J. Mahoney
Chief Judge

Copies faxed by the Court to:

LASH, DOUGLAS	345-8853
SALADINO, THOMAS	390-2866
WOOLLEY, JANICE	330-3909
DANBERG, NEIL B.	930-1701
SCHEPERS, FRANK	397-8450

Copies mailed by the Court to:

United States Trustee

Movant (*) is responsible for giving notice of this journal entry to all other parties (that are not listed above) if required by rule or statute.

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF:)	
)	
FARNAM ASSOCIATES LIMITED)	
PARTNERSHIP,)	CASE NO. BK91-80845
<u>DEBTOR(S)</u>)	CH. 11
)	Filing No. 97, 100
Plaintiff(s))	
vs.)	<u>JOURNAL ENTRY</u>
)	DATE: July 30, 1998
<u>Defendant(s)</u>)	HEARING DATE:

Before a United States Bankruptcy Judge for the District of Nebraska regarding Motion to Dismiss and Resistance to Motion to Dismiss and Request for Hearing.

APPEARANCES

Janice Woolley, Attorney for debtor
Jerry Jensen, Attorney for UST
Neil Danberg and Frank Schepers, Attorney for PMC
Tom Saladino, Attorney for Eileen Ratigan
Douglas Lash, Attorney for Andersen Construction Co.

IT IS ORDERED:

The order approving the stipulation which allowed the application of net rents to interest and principal due under the note is binding on the parties and shall not, at this late date, be altered. The plan and disclosure statement submitted by Andersen which relied upon such potential alteration, is moot. The motion to dismiss this case filed by Patrician and acquiesced in by the debtors is granted. See memorandum entered this date.

BY THE COURT:

/s/ Timothy J. Mahoney
Timothy J. Mahoney
Chief Judge

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