

UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF

F & P COVALT CO., INC.,

DEBTOR

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CASE NO. BK85-2611

MEMORANDUM OPINION RE USE OF CASH COLLATERAL

Final evidentiary hearing on motion by debtor and debtor-in-possession to permit the use of cash collateral was held on April 28, 1986. Vince Powers of Lincoln, Nebraska, appeared on behalf of the debtor and debtor-in-possession and Terrence Michael of Baird, Holm, McEachen, Pedersen, Hamann & Strasheim of Omaha, Nebraska, appeared on behalf of the secured creditor, Farm Credit Capital Corporation.

Background

Debtor is a family farm corporation which filed its voluntary petition in Chapter 11 on or about November 12, 1985. Debtor's main business for many years has been cattle ranching. Debtor owns or operates approximately 6,000 acres in Box Butte and surrounding counties. Early in 1986 debtor, because it was without funds to purchase the appropriate feed and supplements for the cattle herd, liquidated the cattle herd and now holds a check or checks representing the proceeds of such liquidation. The total amount of the checks being held by the debtor is \$102,767. The parties agree that such proceeds are cash collateral in which the creditor has a valid security interest. Debtor has requested authority to use all of the \$102,767 to purchase a new cow-calf herd and finance the operation of that herd for a three-year period. As adequate protection for the interest of the creditor, the debtor has offered the following:

A. A deed of trust on certain land owned by the debtor or by one of the shareholder/officers of the debtor, such land being identified as "Esther's place". It has a fair market value of \$56,000 with approximately \$1,000 of taxes encumbering it.

B. A lien on all of the cattle purchased and/or born in the future.

C. A payback in three lump-sum annual payments including interest at the rate of 13%.

D. The right of the creditor to request the Bankruptcy Court to terminate the permissive use of the cash collateral upon any deviation from the income and expense projections submitted into evidence at the hearing, upon failure to maintain the herd, or upon failure of the crop.

The creditor's position is that none of the above is the indubitable equivalent of cash in the amount of \$102,767.

#### The Law

The Eighth Circuit has given the Bankruptcy Court specific directions with regard to consideration of a request for the use of cash collateral. See In re Martin, 761 F.2d 472 (8th Cir. 1985). The Martin case requires the Bankruptcy Court to establish the value of the creditor's security interest; identify the risk to the secured creditor's value associated with the purchase, maintenance, feeding, fattening and marketing a cow-calf herd from this date through and including the total period that the creditor will be deprived of its collateral.

Paraphrasing Martin, the Bankruptcy Court must also consider: the experience and practices of the rancher; the profitability of his operation in previous years; the health and reliability of the rancher; the condition of the rancher's machinery and equipment; whether there are encumbrances on the machinery which may subject it to being repossessed before the crop is harvested; the potential encumbrances on the present or future crop which will be used for feed and for revenue generation by the debtor; the availability of crop insurance and the risk of crop failure not covered by crop insurance and the resulting problems with regard to feeding the livestock or generating sufficient revenue to repay the cash collateral on a regular basis; the anticipated fluctuation in the market price of the calves.

Martin further directs that the Bankruptcy Court is to attempt to balance the competing interests of a debtor who proposes to use secured property to contribute to the reorganization plan on the one hand, and the creditor who wishes to retain the value and safety of its security interest on the other. The Bankruptcy Court is required to ultimately decide whether the debtor's adequate protection proposal provides protection to the creditor consistent with the concept of indubitable equivalent. Indubitable equivalent requires "such relief as will result in the realization of value". See In re Sheehan, 38 Bankr. 859, 864 (D. S.D. 1984). If the debtor's proposal provides adequate protection, the request for use of cash collateral should be granted by the Bankruptcy Court. If the debtor's proposal can be modified to provide for adequate protection while still remaining useful to the debtor, the debtor's request should be granted under the modified plan. If

adequate protection cannot be afforded under any circumstances, the debtor's request for use of cash collateral should be denied by the Bankruptcy Court. Martin at 477 and 478.

### Analysis

In this case, the debtor has offered a deed of trust on real estate worth \$55,000 and has offered a lien on cattle which will be purchased for \$55,000 and has offered a repayment schedule which will provide the creditor with the repayment of the collateral being used plus interest at the rate of 13% per year in three lump-sum payments. The first payment is to be in February of 1987.

Pursuant to the direction of the Martin case, the value of the secured creditor's interest in the collateral is \$102,767.

The risk to such value resulting from the debtor's request for use of cash collateral is:

1. The land securing the repayment obligation may decline in value rapidly and/or if the creditor is required to look to the land for liquidation, it may be required to hold the land for several months or years before a buyer can be found.

2. Part or all of the herd could die.

3. The alfalfa crop which the debtor proposes to plant and which will support the feeding of the livestock as well as provide cash revenue from sales of alfalfa may be destroyed by hail, pest infestation or lack of water.

4. The debtor may take possession of the cash collateral, spend it as proposed in its cash-flow statement, but not make appropriate arrangements for electrical power for irrigation systems, fail to make arrangements for custom grazing and custom feeding or "backgrounding" as proposed during the evidentiary hearing.

5. Cattle prices may fluctuate to such a degree that the debtor will be unable to make the annual payments.

The Court is also required to 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 equivalent. In other words, cash is the indubitable equivalent of cash. Cash several months or years down the road may be the indubitable equivalent of cash now if the appropriate interest is paid and if there is little risk to the creditor because the debtor's proposal has a high probability of success.

The evidence before the Court is that the maximum possible loss to the herd due to any type of failure by the debtor would be 30% of the value of the herd. In other words, the creditor should be able to monitor the herd closely enough to enable the creditor to take court action long before significant damage was done to the cow-calf herd. The evidence shows that the land owned by the debtor is declining in value and will continue to so decline at least for the next six months.

The possibility of a loss of the alfalfa crop by hail, drought or pest infestation is speculative. If the debtor maintains good production habits, then such loss will be the result only of an "act of God" and the Court will not speculate upon the likelihood of that.

Without court restrictions, it is possible that the debtor could spend the funds and not obtain the appropriate electrical requirements and not enter into any agreements concerning grazing or feeding as the evidence showed was necessary to make the plan work.

There is always the opportunity for fluctuation in cattle prices, but this debtor has been in the cattle business for many years and is aware of the traditional problems and opportunities in the cattle market.

With regard to the risks to the creditor's security interest listed above, this Court is of the opinion that the risk is not so great that the use of the collateral should be prohibited. However, certain other facts must be considered. The evidence convinces the Court that if the cattle purchase prices are near the projected costs, the calf prices in January and February of 1986 are near the projected figures, the debtor uses good husbandry practices and is not hit by an unfavorable "act of God", the debtor's proposal will work. If it does not work, the creditor will be able to repossess the cattle and liquidate them and foreclose upon the real estate within a short period of time. In addition, if this Court finds that the creditor is adequately protected by this proposal and it turns out later that this creditor is not adequately protected, it will have the opportunity to look to a priority administrative expense which could be paid out of unencumbered funds resulting from the alfalfa crop. The Court realizes that it is not to anticipate failure of the adequate protection proposal nor to anticipate that the creditor can look to some other type of an administrative claim to protect itself, but the Court is aware that if the debtor plants the alfalfa crop this year, and does not grant a lien in that crop to any other creditor, barring an "act of God" the crop will be there for the Court to administer as is necessary later on.

There is evidence before the Court that the debtor has adequate irrigation equipment to raise the proper and necessary crop.

The debtor's president testified that he is 50 years of age and that he and his son can operate the ranch and work off the ranch to supplement the necessary family income. No evidence was presented that either of the proposed workers are in ill health.

The land which is to be used by the debtor and the equipment are encumbered and this does raise the possibility that a secured creditor could obtain relief from the automatic stay, thereby causing the debtor's proposal to be unworkable. The debtor has successfully avoided that situation by convincing the Court at a hearing on a motion for relief from stay that the debtor's land still has equity for the debtor and that it is necessary for an effective reorganization. The Court acknowledges that this creditor or some other may be successful in a future motion for relief from the automatic stay, but the Court will not speculate on the likelihood of such success.

It is the duty of the Court to balance the need of the debtor to use this cash collateral with the need of the creditor to have its collateral protected and to receive the indubitable equivalent of its collateral. In this case, the debtor has thousands of acres of land which he has already proved he has an equity interest in. The land has irrigation equipment. The debtor's business is ranching, that is, raising cattle for sale, and the land is of little value unless it is used for that purpose. The debtor has agreed, in order to stay in the cattle business, to give up an unencumbered asset, land, worth \$55,000. The debtor has further agreed to work for very little money for several years to build up a cow-calf herd which will enable the debtor to operate a going business and service its debt load.

The debt load is significant. The debtor, however, does have the possibility of reorganization. The debtor has proposed adequate protection for the creditor's interest which is sufficient, with some modification.

#### Decision

1. The debtor is granted the right to use \$102,767 in cash collateral.

2. The debtor may not use such cash collateral until and unless the debtor provides to the creditor a written agreement from the company supplying electrical power for the irrigation system in which such power company agrees to provide the necessary electrical power if paid for such power on a timely basis. The agreement cannot require payment of prepetition obligations to the power company. Such agreement must be provided the creditor by May 15, 1986. No cash is to be spent prior to the receipt of the written agreement.



3. By November 15, 1986, and November 15th of each year thereafter, the debtor is to provide written proof to the creditor that the debtor has made custom grazing arrangements and custom backgrounding arrangements which will enable the debtor to meet the cash-flow projections in defendant's Exhibit 1 submitted at the hearing on cash collateral. The written proof must be specific and in detail and in addition thereto, the debtor must provide the specific details in its monthly reports to the Court.

4. The debtor is to provide a full and complete accounting to the creditor of all sales and receipts regarding cows, calves, bulls, hay and alfalfa and all receipts from custom operations.

5. The debtor is to report to the creditor in writing on a monthly basis any decisions made by the debtor concerning carryover of calves from year to year.

6. The debtor is to execute a deed of trust or obtain the signature of the necessary parties on a deed of trust to the land described as "Esther's place", along with a promissory note reflecting the obligation to repay the full amount of the cash collateral plus interest at 13% per year plus the terms of repayment as proposed in the cash-flow statement. The deed of trust shall contain default provisions including failure to pay postpetition land taxes before delinquency; failure to comply with the cash-flow projections concerning monthly expenses; failure to comply with the cash-flow projections with regard to receipts from the sale of calves, alfalfa or custom grazing or backgrounding. If such receipts show a shortfall by 10% or more, the Court may consider such shortfall a default triggering the right of the creditor to foreclose upon the deed of trust; the deed of trust should also contain language to the effect that a default can also be any other matter determined to be such a default by the Bankruptcy Court after a hearing on a motion for relief from the automatic stay.

7. The cash collateral is to be placed in an interest-bearing account and the creditor is to have access to deposit information concerning such account directly from the bank. The debtor is to make all of the necessary arrangements with the bank assuring the creditor that by telephone call it may receive updated information on the account status. The creditor shall have no veto over the use of the funds.

8. The cash collateral is to be used only as shown on the cash-flow projections which are identified as defendant's Exhibit No. 1 used at the cash collateral hearing on April 28, 1986.

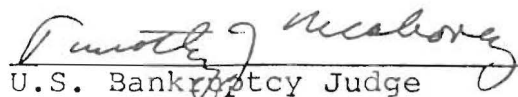
9. The right to use the cash collateral and to keep the purchased and raised cattle and to keep possession of "Esther's place" are subject to review. If this creditor or any other creditor obtain relief from the automatic stay regarding the machinery and equipment necessary for the operation of this ranch,

or obtain relief from the stay regarding land necessary for the operation, the Court, upon hearing concerning the use of cash collateral, may reconsider the continuation of this order.

10. The creditor is not prohibited from filing a motion for relief from the automatic stay concerning any of its collateral.

DATED: April 30, 1986.

BY THE COURT:

  
U.S. Bankruptcy Judge

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