

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF

RAYMOND OLSON
JUDITH OLSON,

DEBTORS

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) CASE NO. BK84-1753
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MEMORANDUM OPINION

This matter came before the Court on a Motion for Relief from the Automatic Stay filed by The Prudential Insurance Company of America. It was heard on October 16, 1985. Greg Searson and Ray Fehringer of Kutak, Rock & Campbell of Omaha, Nebraska, represented the moving party. Marion Pruss of Thompson, Crounse, Pieper & Quinn, Omaha, Nebraska, represented the debtors-in-possession.

Facts

The debtors-in-possession are farmers in Burt County, Nebraska, that filed their petition for relief under Chapter 11 of the Bankruptcy Code on September 11, 1984.

Prudential is a holder of a secured claim of approximately \$863,000 including principal and interest on the date of the hearing. The secured claim is represented by a promissory note and a mortgage on 900 acres of real estate in Burt County, Nebraska. On the date of the filing of the petition for relief the parties agree that the real estate which is collateral for the Prudential claim was worth more than the claim. Therefore, the moving party is entitled to accruing interest post-petition pursuant to §506(b) of the Bankruptcy Code.

The parties agreed that approximately \$22,000 in unpaid real estate taxes and accruing interest are a lien ahead of the claim of the moving party. The two factual issues to be determined are:

1. What is the value of the land at the time of the hearing?
2. Is the offer of adequate protection made by the debtors-in-possession sufficient?

The evidence presented by the moving party concerning the value of the land was presented by the testimony of an appraiser, Stephen England, and testimony of an employee of Prudential, George Janning.

Mr. England is a qualified appraiser with several years' experience. He appraised the property approximately one month prior to the hearing. He arrived at his appraisal valuation by visiting the area, visiting the A.S.C.S. Office, visiting county offices and discussing cash rents with two individual cash-rent tenants in the area. He seemed to have a good understanding of the type of soil, location and the improvements. He was unable to obtain good comparable sales information to be used in a market data approach to the appraisal. The reason he was unable to obtain what he considered to be good comparables is that the land owned by the Olsons is "bottom land" and almost all of the comparable sales in the Burt County area in the past several months have been "hill land". Therefore, although he presented various other sales as comparables, he did not feel that the market approach was an appropriate approach.

Instead, he believed that the income approach was the best way to determine present value of the Olson land. To determine the value based upon the income approach, he obtained information on cash rents in the area and estimated a capitalization rate between 7 and 8%. Based upon his income approach it was his opinion that the fair market value of the land at the time of the hearing was \$712,000 including bins and irrigation equipment. In addition, he admitted that the cash flow from a hunting lease on the property could be capitalized if it were a long-term lease. If it was capitalized, then it would add approximately \$52,000 to the value.

He estimated that the land was declining in value at approximately 1% per month with nothing in the future that he could foresee which would stop the decline. Mr. George Janning, an employee of the moving party, was also qualified as an appraiser. He testified that he believed the land prices in general had deteriorated approximately 25% in the past twelve months and anticipated a future decline of 15% within the next twelve months. He estimated the fair market value of the Olson property at the current time at \$700,000 to \$750,000.

The appraiser for the Olsons, Clyde Maddocks, is an employee of Farmers National Company, and has had many years' experience in farm management and farm appraisals. He appraised the Olson land in October of 1984 for the Tecumseh First National Bank, another creditor in this case. The October appraisal was for only a portion of the land and he, therefore, appraised the balance of the land in January, 1985, for the same creditor. In order to determine the valuation he used the same basic procedure visiting the courthouse and obtaining tax information, A.S.C.S. information and photographs, looked for comparable sales and adjusted the sales information for the quality of the land, the improvements and the productivity of the soils. He used all three types of approaches to determining the value, that is the income approach, the cost approach and the market data approach. In contrast with Mr. England's approach, Mr. Maddocks believed that

the comparable sales or market data approach is the best approach at this time. He felt that there was insufficient information available in the area with regard to cash rents and that the capitalization rate to be used was basically speculation.

He felt that he was able to take the sales in the area in 1984 and make the appropriate adjustments concerning soil types and improvements as well as evidence of the decline in the market value of land in general since the date of each of the sales and give an opinion as to value in October of 1984 and January of 1985 and the value as of the date of the hearing.

His opinion is that land values in the Burt County area have declined approximately 2% per month since the October, 1984, and January, 1985, appraisals. He based the percentage of decline in value upon Federal Reserve information, Nebraska Department of Agriculture information and his experience with farm sales as an employee of Farmers National Company.

Based upon the market value approach and the decline since the earlier appraisals, it is his opinion that the value of the 900 acres of land owned by the Olsons is \$900,000 as of the date of hearing. However, the \$900,000 value represents a sales price which would require considerable time and negotiation by a sales agent. The real estate commission on such a sale would be approximately 5% or \$45,000.

Mr. Maddocks had the opportunity to view the land, visit with the debtors-in-possession, personally inspect the home located upon the land, and provide an appraisal for a totally disinterested third party. He did all of that at approximately the time that the bankruptcy case was filed. His appraisal is, therefore, the best evidence of the value at the time it was originally written, that is, October of 1984 and January of 1985. His method of determining the decline since the dates of those appraisals is acceptable and is not much different from the estimates of decline in value which were provided by Prudential's appraisers. Mr. Maddocks and the appraisers for Prudential agree that the future decline will probably be approximately 1% per month.

Therefore, the only difference between the appraisals, and admittedly it is a big difference, is the amount they start out with. Mr. Maddocks started out with a value in excess of \$1,000,000 and after adjusting for the decline in the past twelve months finds that the value is \$900,000 less a sales commission. This Court believes that such valuation is reasonable and more likely to be accurate than the valuation presented by the representatives of Prudential.

The second factual issue is whether or not the offer of adequate protection made by the debtors-in-possession is sufficient. Mr. Olson testified on behalf of the offer concerning his crops, the condition of the crops and actual sample yields for the 1985 crop year. He also testified concerning a contract to sell white corn at 50 cents per bushel above the Chicago Board of Trade May future on yellow corn. Evidence was admitted which showed that the Chicago Board of Trade

May future on yellow corn was \$2.39 per bushel at the time of the hearing. He estimated that the total value of the 1985 corn and bean crop is \$291,000. In addition, he has income from hunting leases of approximately \$15,000 per year. From the total estimated income of \$306,000 he estimates expenses for crop and living of approximately \$108,000. He would pay from the 1985 crop two years' of back taxes in the amount of \$22,000. He would pay First National Bank of Tecumseh \$60,000 in principal payments on pre-petition operating debt. He would make equipment payments of approximately \$10,000. Although he would have \$20,000 attorney fees he would defer those fees and pay Prudential \$100,000 as adequate protection payments.

The \$100,000 offer to Prudential would be payable \$20,000 in December of 1985 and \$80,000 in June of 1986 after the sale of the corn pursuant to the white corn contract which is tied into the May futures on the Chicago Board of Trade.

In addition to the cash payment, the debtors-in-possession offer Prudential a lien on the 1985 corn crop subject only to a \$60,000 lien of the First National Bank of Tecumseh for the cost of putting in and taking out the 1985 crop. Further, the debtors-in-possession offer Prudential a lien to the extent of \$70,500 in the 1986 crop.

Prudential believes that the offer is inadequate. Prudential points out that interest is accruing at the rate of \$5,769 per month and that the undisputed testimony is that the value of the land is declining at 1% per month. Prudential argues that if the Court accepts \$900,000 as the value of the land and accepts 1% per month as the decline, the land value is declining at the rate of \$9,000 per month. This amount plus the amount of interest accruing per month is approximately \$15,000 per month which needs to be protected.

The evidence concerning the value of the 1985 crop and the total income and expenses estimated by the debtor-in-possession is accepted. The debtors should have approximately \$306,000 in 1985 income from the crop and the hunting lease. They will have approximately the same amount of expense if the offer of a \$100,000 payment to Prudential is accepted.

The offer of adequate protection is not sufficient.

Conclusions of Law

Prudential has moved for relief from the automatic stay under §362(d)(1) and (d)(2). That section states:

(d) on request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under sub-section (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay--

(1) for cause, including the lack of adequate

protection of an interest in the property of such party in interest; or

(2) with respect to a stay of an act against property under sub-section (a) of this section, if--

(A) the debtor does not have an equity in such property; and

(B) such property is not necessary to an effective reorganization.

The evidence from the debtors-in-possession is that the real estate is used in the production of grain and is the only business the debtor-in-possession maintains. It is necessary to an effective reorganization. If the Court uses the value of \$900,000 as the fair market value, without the reduction for the commission, the debtor-in-possession has equity as of the date of the hearing because the Prudential claim is \$863,000 and the taxes are \$22,000. However, if the Court concludes that the commission should be deducted from the supposed value of the land, the debtor does not have equity in such property.

The evidence of the appraiser for the debtor is that the value of \$900,000 can be obtained only by representation by an agent, advertising and negotiation of a sale. Therefore, a commission would be earned and must be deducted from the \$900,000 sale price value. Accordingly, the value of the land for the purpose of this hearing is \$855,000. Since the claim of Prudential is \$863,000 and the delinquent taxes plus accrued interest are approximately \$22,000, it is clear that there is no equity. Based upon the evidence that the value of the land will decline 1% per month in the next twelve months, it is clear that the interest of the creditor must be protected.

Section 361 of the Bankruptcy Code provides examples of adequate protection of an interest of an equity in property. These include providing that the debtor-in-possession make a cash payment or periodic cash payments to the creditor to protect the creditor from a decrease in the value of its interest in the property; providing an additional lien; or granting other relief which will give the creditor the "indubitable equivalent" of the creditor's interest in such property.

In the context of a motion for relief from the automatic stay, the 9th Circuit, in the case of In Re American Mariner Industries, Inc., 734 F.2d 426, at 435 ruled that the interest of the creditor which was to be adequately protected was the value for which the creditor bargained.

In 1985 the 8th Circuit in the case of In Re Martin, 761 F.2d 472 (8th Cir. 1985) discussed the concept of adequate protection in the context of the use of cash collateral under §363 of the Bankruptcy Code. In that context the 8th Circuit agreed with the American Mariner Court that adequate protection was designed to insure that the secured creditor received the value for which he bargained. Id. at 474.

The 8th Circuit then analyzes the meaning of adequate protection in the context of the undubitable equivalent language set forth in 11 U.S.C. §361(3). It directs the Bankruptcy Court to:

- (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 the 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 equivalent. Id. at 476-77.

The United States District Court for the District of Nebraska in the case of In Re Vekco, Inc., BK83-1864, CV 84-0-562 (unpublished opinion filed October 3, 1985) the District Court applied the same three criteria as established in Martin to a case in which the issue was confirmability of a Chapter 11 plan. Although the question before the District Court did not concern the use of cash collateral, the District Court stated that since the Bankruptcy Court had failed to identify and consider the risks to the creditor's value by the operation of the plan and the Bankruptcy Court's failure to ascertain that the adequate protection proposal and the proposed plan protect the creditor's value consistent with the concept of indubitable equivalent, the plan could not be confirmed.

It is, therefore, the opinion of this Court that when considering the adequacy or sufficiency of an adequate protection proposal, it must first establish the value of the secured creditor's interest; second, identify the risks to the secured creditor's value resulting from the debtor's request for use of cash collateral, if that is the request, or, in the case of a motion for relief from the automatic stay, the court must identify the risks to the secured creditor's value if the relief is not granted; and, determine whether the debtor's adequate protection proposal protects the creditor's value as nearly as possible against risks to that value consistent with the concept of indubitable equivalent. In Re American Mariner Industries, Inc., 734 F.2d 426 (9th Cir. 1984); In Re Martin, 761 F.2d 472 (8th Cir. 1985); In Re Vekco, Inc., unpublished opinion in the United States District Court for the District of Nebraska, BK83-1864, CV 84-0-562, (1985).

With the above concepts in mind, the Court's analysis is as follows:

The value of Prudential's claim is \$863,284, principal and accrued interest.

The value of the collateral is \$855,000.

The difference between the value of the claim and the value of the collateral as of the date of hearing is \$8,284. From October 16, 1985, to June 16, 1986, the land will decline in value 1% per month from \$855,000. That decline is \$8,550 per month for 8 months or a total decline of \$68,400. Interest on the claim accrues in the amount of \$5,769 for the 8 months between October 16, 1985, and June 16, 1986. This total interest accrual is \$46,152.

Adding together the difference between the value of the collateral and the claim, the decline in value between now and June and the interest accruing between now and June, the total is \$122,836.

These calculations assume that no payment would be made between now and June and the full \$100,000 would be paid on June 16th. If that were the case, it appears that the creditor would be approximately \$22,836 short of its "indubitable equivalent" on June 16, 1986. However, a \$20,000 payment is being made in December which reduces the amount of underpayment in June by a small amount.

As additional adequate protection the debtors offer a lien on the 1986 crop in the amount of \$70,500. Speculating on the value, if any, of the 1986 crop in October of 1985, when the 1985 crop is not even out of the ground, is not something that this Court is inclined to do. Therefore, the offer of a lien on the 1986 crop to the extent of \$70,500 is disregarded. Perhaps if the question comes up again during the crop year 1986, such an offer should be considered.

The offer of the debtors-in-possession comes very close to the "indubitable equivalent" which is required under §361(3). However, it is approximately \$23,000 short. This does not necessarily require the Court to sustain the motion for relief as filed. The cases cited specifically authorize the Court to create a flexible analysis of adequate protection. Because of the estimates involved in determining the values of the land, the estimates involved in determining the decline in value between now and June of 1986, and the estimates involved in determining the value of the crop, this Court believes that an adequate protection proposal that comes within \$23,000 of being the "indubitable equivalent" of the amount the creditor has the right to expect, should be rewarded with the opportunity to amend its offer to conform to the terms of this decision. Therefore, the debtors-in-possession are granted until November 15, 1985, to amend their proposal for adequate protection along the following line:

(a) an increase in the total cash payment between now and June of \$23,000;

(b) state a specific date by which the delinquent taxes and accrued interest plus penalties, if any, will be paid, such date to be prior to June 16, 1986.

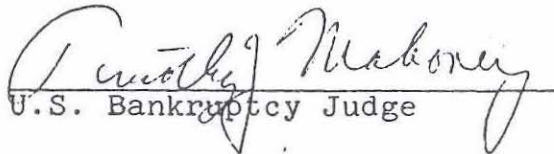
If such an amended proposal is filed on or before November 15, 1985, and such proposal includes arrangements for granting appropriate liens in the 1985 crop to protect the cash payments, an order will be entered finding the adequate protection proposal to be sufficient and overruling the motion for relief. If such amendment is not filed on or before November 15, 1985, the motion for relief will be granted.

The parties should take note that ruling covers the time period from October 17, 1985, through and including June 16, 1986.

The automatic stay remains in effect pending further order of this Court on or about November 15, 1985.

DATED: October 25, 1985.

BY THE COURT:


U.S. Bankruptcy Judge

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