UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF	:	
INDIANA REFRIGERATOR LINES, INC.,	:	Bk. No. 81-86 (Chapter 11)
	:	Adversary Proceeding No. A81-27
Debtor,	:	
ST. JOSEPH BANK AND TRUST COMPANY,	:	
Plaintiff,	:	
v.	:	
INDIANA REFRIGERATOR LINES, INC., debtor and debtor-in-possession,	:	
Defendant.	:	

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MEMORANDUM OF DECISION

At Omaha, in the District of Nebraska, on the 27th day of February, 1981.

PROCEEDINGS

On January 16, 1981, Indiana Refrigerator Lines, Inc. ("IRL"), an Indiana corporation, filed a petition for rehabilitation under Chapter 11 of Title 11 of the United States Code.

On January 20, 1981, the plaintiff, St. Joseph Bank and Trust Company ("Bank"), filed a "Complaint for Relief from Stay, Reclamation of Collateral, or in the Alternative Request for Adequate Protection." The complaint alleges that the Bank is the holder of a claim against IRL in the sum of $1,550,000 plus interest, secured by all of IRL's accounts receivable and interstate motor freight operating authority; that the level of the accounts receivable is declining; and that IRL has failed to comply with the terms of its security agreement with the Bank relating to the collection of accounts, remittance, disposition of cash collateral and the maintenance of specified accounts receivable levels. The Bank asks the court to vacate the automatic stay of 11 U.S.C. § 362 as it relates to the Bank and order a turnover of the Bank's collateral, alleging further that there is no reasonable prospect for the reorganization of IRL in a reasonable period of time, and that the Bank's interest in its collateral is impaired. In a Count II the Bank alternatively asks for adequate protection of its interest in the collateral provided by 11 U.S.C. §§ 361, 362.

On January 30, 1981, IRL filed its answer to the Bank's complaint. In effect the answer asserts that the Bank does not have a claim against IRL; in the alternative that any secured claim should be avoided by the court as it was founded on <u>ultra vires</u> actions by IRL; and by way of counterclaim, that the granting of the security interest to the Bank was a voidable preferential transfer under the provisions of 11 U.S.C. § 547.

On January 30, 1981, IRL filed an application to use the cash proceeds of accounts receivable, and a motion to dismiss the Bank's complaint.

By agreement of the parties in interest, and on order of the court filed January 23, 1981, the above matters came on for trial on February 4, 1981. The motion to dismiss will be considered with the proceedings on their merit.

FINDINGS OF FACT

On or about June 15, 1976, the owners of the capital stock of IRL, R. Tetrault and J. W. Hartmeyer, agreed to sell their capital stock to a corporation named St. Abbs. St. Abbs was formed about the same time by J. L. Coulter and M. Meiseles.*

The stock purchase agreement was for $2,300,000. The

*St. Abbs has also filed a petition under Chapter 11 of the Bankruptcy Code in this District.

terms were $250,000 down and $2,050,000 in variable installments over ten years. On June 15, 1976, as a part of the stock transaction, the parties joined in a financing arrangement ("credit agreement") with the Bank. The credit agreement provided that the Bank was to issue a letter of credit guaranteeing payment of the deferred installments under the St. Abbs' stock purchase agreement. The present balance due on the stock purchase is $1,550,000.

On June 15, 1976, as a part of the credit agreement, IRL and the Bank entered into a security agreement. IRL granted the Bank a security interest in IRL's accounts, accounts receivable, contract rights, chattel paper, general intangibles and other collateral to secure the Bank's obligation under its letter of credit and for any funds advanced to IRL pursuant to a fixed line of credit. IRL is not directly (personally) liable to the Bank under the security agreement. It is nonrecourse in nature.

IRL is indebted to the Bank under its line of credit and other obligations in an approximate amount of $248,000.

IRL, as the name conveys, is engaged in interstate freight transportation. It operates principally in the transport of the products of food industries. Its principle place of business prior to April of 1980, was in Muncie, Indiana. In that month the corporate headquarters and business was moved to Omaha, Nebraska. The reasons given by management for the move were that IRL was losing accounts in the Muncie area, and a belief that the Missouri River Basin held more promise for IRL's type of operation.

At the time of the move, Mr. F. Ralph Nogg was a chief operating officer of IRL and has held that position to this time. He acquired the stock of St. Abbs in December of 1979.

The parties are in agreement, and the testimony is uncontroverted, that F. Ralph Nogg has an outstanding reputation in the motor freight transportation industry, and that he has distinguished himself as a management expert in salvaging financially troubled motor freight operations.

When Mr. Nogg acquired and undertook the operation of IRL, the entire motor freight industry was suffering. As for IRL the audited consolidated financial statements for St. Abbs, IRL and also the Indiana Leasing Corporation ("ILC"), show the following history of losses.

1978	($112,683)
1979	($1,617,653)
1980 (first 8 months)	($627,097)
1980 (year end)	($873,032)

The accounting firm of Price-Waterhouse & Co. made an eight month consolidated audit of the businesses dated August 31, 1980. Prior thereto the audits had been made "in-house." The Price-Watershouse & Co. audit revealed an eight month loss of ($627,097). In a consolidated statement dated September 30, 1980, the accountant for St. Abbs stated a loss of ($112,000).

Price-Waterhouse & Co. found the consolidated businesses had an equity deficit of ($1,112,433). St. Abbs' accountants, thirty days later (September 30, 1980), fixed the stockholders' equity at $6,184,073.

St. Abbs was merely a holding company of which IRL and ILC were wholly owned subsidiaries. The only reason for the existence of ILC was to lease equipment to IRL. Therefore, as IRL goes, so goes the parent and sister corporations.

The revelation of the companies' true financial conditions led to the immediate recapitalization of the business. This resulted in a "memorandum of understanding" dated September 22, 1980; amended October 3, 1980, between the principal stockholders of St. Abbs and the Bank. The main ingredients of the agreement were the return of $1,500,000 in accounts receivable previously purchased by the Bank under a factoring arrangement with IRL, and the release of some security interests not material here. It further allowed the extension of the maturity of the debt of St. Abbs to some of the stockholders, and the acceptance of St. Abbs' long term notes for all of the St. Abbs' capital stock of those stockholders. The Bank further agreed to extend a $500,000 line of credit for one year to IRL collateralized in a manner satisfactory to the Bank.

Mr. Nogg, for his part, gave the Bank his personal guarantee of any liability the Bank might incur under the letter of credit guaranteeing the purchase price of IRL stock by St. Abbs, and pledged the fruit of his life's work in support of his guarantee. The Bank's bargain was like those banks make in such circumstances, hard on Mr. Nogg, but it was his bargain also. It reinforces the court's opinion that desperation in a desperate situation clouds management's judgment.

These measures and Mr. Nogg's management skills may have improved the business slightly by the end of 1980, which facts, coupled with the existence of a large 1980 nonreoccurring expenditure made in the transfer of the business, portended a brighter future than is otherwise reflected in the 1980 loss. The ultimate fact is, however, that the business continued a recent history of financial losses. It is the classic too little and too late syndrome.

Because St. Abbs generates no income itself and ILC is simply an adjunct of IRL, unless IRL prospers, St. Abbs will not be in a position to honor the next $250,000 installment due in 1981 for the acquisition of IRL, much less the installments due after 1981. The full amount of the guarantee by the letter of credit is at risk.

IRL has no equity in the collateral held by the Bank. The financial statement of January 31, 1981, offered by IRL for IRL and ILC carries accounts receivable at $1,369,542 after an allowance for bad debts. Only a fraction (estimated at less than $40,000) are ILC's. There are only $1,100,000 in trade accounts. The balance are accounts of $587,530 due from brokers, drivers and employees, and $343,428 due from terminal agents. Based on the court's experience the allowance for bad debts of $343,428 in the light of two facts alone makes the adjustment for bad debts woefully inadequate. First, the fact of the Chapter 11 case makes receivables melt like they are soluble in air. Second, the fact that the debtor IRL is not operational compounds that condition. The court cannot on the evidence alone fix the exact value of the accounts receivable, but with mind at ease will estimate their present value at less than $1,000,000.

The operating authority of IRL is carried on the books at $1,640,264. There may be sound accounting reasons for carrying such authority at an acquisition figure for going concern purposes. IRL's own expert witness could not place a value on them for going concern purposes of more than $2,000,000 or less than $500,000, which makes his judgment somewhat of a guess. In the light of the recent "deregulation" of the interstate motor freight industry the I.C.C. has concluded "with the passage of the Motor Carrier Act of 1980 and other recent Commission decisions, the true value of carrier operating rights has diminished" 46 Fed. Reg. 2076 (1981) (to be codified in 49 C.F.R. § 1207). The court is more concerned with the fair market value of the operating authority. The Bank's expert witness speaking in terms of "replacement" value has testified the operating rights are presently worth between $50,000 and $70,000. Again, the court cannot find an exact figure to place on the fair market value of IRL's operating authority. It will state and so finds that the fair value of the operating authority as collateral under present circumstances is closer to the estimate of the Bank's witness.

The collateral of the Bank is worth less than the amount of its secured claim.

Mr. Nogg has prepared a tentative proposal for the reorganization of IRL and ILC. It provides that all "frozen" funds be released to provide operating capital; a 90 day moratorium on equipment payments; and a payment of $25,000 a month for the first three months escrowed in a fund designated by the court on behalf of the Bank with interest being released to the Bank on a quarterly basis. It further proposes the use of escrowed drivers' money, now held in trust, for current drivers' expenses. Uneeded assets will be liquidated. A plan of arrangement will be filed by the middle of the seventh month following start up. The plan is to capitalize debt, reject "certain" executory contracts, bring long term obligations current and pay other creditors within two years. Other proposals are boiler plate for reorganization plans.

In support of the tentative plan, Mr. Nogg offers a _pro forma_ cash flow statement and statement of income with explanatory notes.

The tentative plan and the _pro forma_ statements offered do not establish that the Bank's collateral will be adequately protected. The tentative plan is no more than a proposal to continue the operation of a losing business over a test period using creditors' money. If these exhibits are of any probative value, it would have to be for establishing that it is reasonable to expect this business can be reorganized within a reasonable time.

The court cannot favor such a conclusion in the light of other established facts. The "tentative plan," which is not a plan at all, and _pro forma_ financials, admittedly no more than an "educated guess," do not outweigh the following evidential litany of high probative value.

1. The industry is experiencing a poor economic climate.

2. There is no fresh capital available.

3. The business is not operating, and in the event of an appeal of this order by either side, will not be able to start up in the immediate future.

4. The principal asset of IRL is rapidly depreciating.

5. The Chapter 11 case in itself represents a negative element in continuing the good will of the companies and stable owner-operator relations.

6. The business has not operated profitably for at least three years, and the losses sustained have been substantial.

7. The major creditor is openly antagonistic to a continuation of the businesses.

8. The great personal stake of Mr. Nogg in the reorganization tends to color key decisions.

9. The recent move to Omaha has had a disorienting effect on the direction and momentum of the businesses.

10. The time requested for the implementation of the tentative plan is not realistically available.

11. The simplistic and speculative rehabilitation course proposed is entirely at the creditors' risk.

12. Acknowledging Mr. Nogg's achievements in his field, the management of St. Abbs and its subsidiaries, must be found to be wanting.

13. The Chapter 11 proceeding was filed as a last minute means of haulting creditors moving against the assets of IRL.

There is no reasonable expectation that St. Abbs or its subsidiaries can be rehabilitated in a reasonable time.

The debtor, IRL, has failed to offer satisfactory evidence to establish that the Bank's collateral will not be adversely affected by the continuing operation of IRL's business, or that the Bank's present interest can be protected in any alternative manner.

Based on all of the foregoing, the court finds that there is no reasonable likelihood that the debtor could prevail at a final hearing of this matter.

MEMORANDUM OF THE LAW

This case is the classic confrontation of a major creditor's efforts to satisfy debt secured by all of the debtor's accounts receivable or other assets, and the debtor's need for the assets to continue the operation of its business. When a debtor so confronted seeks the protection of the courts afforded by Chapter 11 of the Bankruptcy Code, the automatic stay of 11 U.S.C. § 362 provides such protection immediately. 11 U.S.C. § 362(a)(4). It states that the stay applies to all entities and prohibits, "(4) any act to create, perfect, or enforce any lien against property of the estate;..."*

A creditor feeling aggrieved by the effect of the automatic stay is provided a course of action to terminate, annul, modify or condition the stay. Section 362(d) of Title 11 permits the creditor to petition the court for such relief. There are two grounds upon which the court may grant relief from the automatic stay. Only the ground specified in 11 U.S.C. § 362(d)(1) is applicable and states that a stay may be terminated, annulled, modified or conditioned, "for cause, including lack of adequate protection of an interest in property;..."

The Bank claims that its interest in IRL's property is not adequately protected. The issues before the court are then, does the Bank have a claim against the debtor and is there a lack of adequate protection.

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*The term "Lien" is broadly defined in 11 U.S.C. § 101(28) and includes security interest.

The Bank does have a claim against IRL. The Code gives the term claim a very broad definition. It is defined as a right to payment, which may be liquidated or unliquidated, fixed or contingent, matured or unmatured, disputed or undisputed, legal or equitable, secured or unsecured, or whether or not the right is reduced to judgment. 11 U.S.C. § 101(a)(4)(A) The argument of IRL that the Bank has no claim because IRL has no personal liability under the stock sale financing agreement or security agreement is without merit. The rules of construction contained in 11 U.S.C. § 102(2) provide that "'claims against the debtor' includes a claim against the property of the debtor;..." Therefore, a nonrecourse claim against a debtor's property is a "claim" within the intendment of that term in the Bankruptcy Code.

"Adequate protection," as used in 11 U.S.C. § 361, includes periodic cash payments equal to the depreciation of the collateral, the substitution of additional liens, or the realization of the indubitable equivalent of the property. The purpose of adequate protection is to preserve a creditor's position at the time of filing the bankruptcy case.

If the value of the creditor's collateral will be eroded during the proceeding, the creditor is, by virtue of 11 U.S.C. § 362(d)(1), entitled to protection from such erosion or to foreclose upon its collateral. Therefore, value is an important factor in determining whether a creditor has adequate protection inasmuch as a debtor's lack of equity would mean that there would be no cushion protecting a creditor from decreases in value. In re Pleasant Valley, Inc., 6 B.R. 13 (B.C. D.Nev. 1980) See In re Blazon Flexible Flyer, Inc., 407 S.Supp. 861 (N.D.Ohio 197

The value the court has placed on the collateral in this case is neither the liquidation value nor the full going concern value. The court has tried to establish a fair market value. It happens to be closer to the liquidation end of the value spectrum. This is based on the depreciable nature of the collateral, and the poor prospects for rehabilitation of the debtors' businesses. The legislative history of the Code suggests:

> Neither is it expected that the courts will construe the term value to mean, in every case, forced sale liquidation value or full going concern value. There is wide latitude between those two extremes although forced sale liquidation value will be minimum.
>
> In any particular case, especially a reorganization case, the determination of which entity should be entitled to the difference between the going concern value and the liquidation value must be based on equitable considerations arising from the facts of the case. Finally, the determination of value is binding only for the purposes of the specific hearing and is not to have a res judicata effect.

S. Rep. No. 989, 95th Cong., 2d Sess. (1978).

The Bank has established that IRL has no equity in the accounts receivable.

In a hearing on any request for relief from the automatic stay, the burden of proof of all issues, other than a lack of equity in the debtor, rests on the party seeking continuation of the stay. 11 U.S.C. § 362(g).

IRL, for its part, has not established that it is in a position to make sufficient periodic cash payments to adequately protect the Bank against a decrease in value of its collateral, particularly in the light of IRL's need for the use of the cash collateral in the start up and continuing operation of its business.

IRL has no other property of adequate value which it can offer as adequate protection by grant of an additional or replacement lien.

There is no reason to lard this opinion with the often repeated coinage of the pretentious term "indubitable equivalent." The indubitable equivalent of cash proceeds of receivables is the cash proceeds. This would call for their segregation, which would contradict their proposed continued use by IRL. See Reconstruction Finance Corp. v. Kaplan, 185 F.2d 791 (1st Cir. 1950); 11 U.S.C. § 363(c)(4).

The idea of granting the Bank some type of administrative priority as suggested in In re Yale Express System, Inc., 384 F.2d 990 (2nd Cir. 1967), is expressly dissapproved. 2 Collier on Bankruptcy, ¶ 262.07, p. 362-46 (15th ed.); 124 Cong. Rec. H. 11,092 (daily ed. Sept. 28, 1978).

Does F. Ralph Nogg's guarantee to the Bank provide adequate protection? This question is answered in In re Kenny Kar Leasing, Inc.:

> It is impossible to analyze these provisions of the Code and its legislative history in the context of the debtor's struggle for survival in the early stages of a Chapter 11 proceeding, without recognizing a statutory effort to provide rules of fairness and equity to govern, adjust, and balance the rifhts of secured creditors and debtors. No one questions the right of a debtor to a fair chance at rehabilitation. On the other hand, that right is not so pervasive as to permit the destruction of economic rights equally entitled to the sanction and protection of law. The cited provisions of the Code are an effort to balance these conflicting interests; to grant to the debtor the right to continued enjoyment and exploitation of property and assets upon which rehabilitation depends, not at the expense of secured creditors, but on terms which protect secured creditors in the realization of the value of their interest in such property and assets. Against the theme of adequate protection in the use of the secured creditor's collateral, the statute and legislative history repeat and emphasize the right of secured creditors to realization of the value of the collateral and the right to be protected against decrease in the value of the interest affected. To the extent that the debtor is unable to provide adequate protection in these terms, it is unable to play the game according to the rules. In such instances, the risk of financial loss incident to failure of the rehabilitation effort must be borne by the debtor.
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> The use of Crocker's cash collateral, and the depreciation associated with Kenny's use of the non-cash collateral, expose Crocker to a decrease in the value of its interests and a present risk of impairment of its ability to realize on the value of its collateral package. To compel a

> secured creditor to accept such risks on the basis of rights to pursue a guarantor, is to shift the hazards and the cost of the rehabilitation effort from the debtor to the secured creditor. Such a proposition is not within the contours of the concept of adequate protection embodied in the Code.

5 B.R. 304 (B.C. C.D.Cal. 1980).

IRL has taken the position that any security interest claimed by the Bank is void by reason of ultra vires acts, or because it constituted a voidable preferential transfer. Collier treats this procedural problem quite succinctly.

> Under the Code any question of the jurisdiction to hear the matters that might be raised in a counterclaim has been ended. However the defensive and informal nature of stay litigation should continue to preclude the formal assertion of counterclaims. While no direct position on the matter is taken in section 362 other than by inference from the brief time periods of section 362(e), the legislative history is quite clear. Of course, this does not mean that the existence and issuance of affirmative defenses and possible counterclaims cannot be raised and considered by the court in deciding whether or not to vacate the stay but simply that a res judicata determination of the issues at that time would be inappropriate. [citations omitted]

2 Collier on Bankruptcy, ¶ 362.08, p. 362-53 (15th ed.); See In re Essex Properties, Ltd., 430 F.Supp. 1112 (D.Cal. 1977). Such matters are properly the subject of more complete proceedings by trustees to recover property of the estate or to object to the allowance of a claim. The court has considered the facts and law relative to these issues. The case presented by IRL on the crucial weight of these collateral issues is not so compelling as to permit this court to override its decision relative to the presence of a claim and the lack of adequate protection. This is as far as the court will go in order to insure that a future trial on the issues of ultra vires acts or a voidable preferential transfer will not be tainted. The court insists this comment should carry no weight in any future consideration of those matters.

CONCLUSIONS OF LAW

1. The court has jurisdiction over the subject matter and the parties.

2. The defendant, Indiana Refrigerator Lines, Inc., in the matter of the complaint for the relief of the automatic stay of 11 U.S.C. § 362 has failed to establish that the interest of the St. Joseph Bank and Trust Company in the collateral in the possession of Indiana Refrigerator Lines, Inc., is adequately protected under 11 U.S.C. § 362(d)(1), and as to the St. Joseph Bank and Trust Company, the stay should be modified.

3. The proceeds of the collateral of the St. Joseph Bank and Trust Company obtained from any source should be segregated pending further order of this court.

4. The application of the Indiana Refrigerator Lines, Inc., to use the cash proceeds of accounts receivable in the operation of its business should be denied.

5. The motion to dismiss the complaint of the St. Joseph Bank and Trust Company, filed by Indiana Refrigerator Lines, Inc., should be denied.

6. The St. Joseph Bank and Trust Company is entitled to injunctive relief.

7. Relief in all other respects should be denied.

Judgment will be entered in accordance herewith.

BY THE COURT

RICHARD STAGEMAN
U. S. BANKRUPTCY JUDGE