2002 BNH 031 **Note: This is an unreported opinion. Refer to AO 1050-1 regarding citation.**

UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW HAMPSHIRE

In re:

Clarkeies Market, L.L.C.,
Debtor

Clarkeies Market, L.L.C.,
Movant

v.

Kelley's Food Town, Inc.,
K&R Supermarkets, Inc., and
Karl C. Kelley,
Respondents

Bk. No. 01-10700-JMD
Chapter 11

Objection to Claims No. 69, 73, 79, 80, and 81

M. Elaine Beauchesne, Esq.
SANDERS & McDERMOTT, P.L.L.C.
Attorney for Debtor

Daniel P. Luker, Esq.
PRETI , FLAHERTY, BELIVEAU, PACHIOS & HALEY, LLC
Attorney for Kelley's Food Town, Inc.,
K&R Supermarkets, Inc., and Karl C. Kelley

MEMORANDUM OPINION

I. INTRODUCTION

The Court has before it the Objection by Debtor to Proof of Claim and Restated/Updated Proof of Claim of Kelley's Food Town, Inc. and Karl C. Kelley (POC 69 and 80) (Doc. No. 267), Objection by Debtor to Proof of Claim and Restated/Updated Proof of Claim of K&R Supermarkets, Inc. and Karl C. Kelley (POC 69 and 79) (Doc. No. 268), and Objection by Debtor

to Proof of Claim and Restated/Updated Proof of Claim of K&R Supermarkets, Inc. Regarding a Berlin Cash Register Lease (POC 73 and 81) (Doc. No. 269).[1] In deciding the Debtor's objections to the Kelley Group's claims, the parties have asked the Court, prior to their presentation of evidence on valuation, to determine what value (i.e. liquidation or going concern) should be used under 11 U.S.C. § 506(a) in computing the value of collateral turned over to the Kelley Group and Associated Grocers of New England, Inc. ("AGNE") at the beginning of the Debtor's bankruptcy case.

This Court has jurisdiction of the subject matter and the parties pursuant to 28 U.S.C. §§ 1334 and 157(a) and the "Standing Order of Referral of Title 11 Proceedings to the United States Bankruptcy Court for the District of New Hampshire," dated January 18, 1994 (DiClerico, C.J.). This is a core proceeding in accordance with 28 U.S.C. § 157(b).

II. FACTS

On March 13, 2001, the Debtor filed a Chapter 11 bankruptcy petition. At the time the Debtor owned and operated four grocery stores known as Clarkeies Market located in the towns of Berlin, Colebrook, Groveton, and Woodsville, New Hampshire. On March 15, 2001, AGNE and the Debtor filed an assented to ex parte motion for relief from the automatic stay on an expedited basis. Doc. No. 2. In the motion the parties represented that the Berlin and Woodsville stores had been previously owned by the Kelley Group. When the Debtor purchased the stores in 1998, it obtained financing from the Kelley Group, and the Kelley Group obtained a first priority security interest in the equipment of both stores. AGNE guaranteed payment of the Debtor's obligations to

[1] Kelley's Food Town, Inc., K&R Supermarkets, Inc., and their principal Karl C. Kelley shall be referred to hereinafter as "the Kelley Group."

the Kelley Group.[2] In addition, at the time the Debtor purchased the Berlin and Woodsville stores it granted a security interest to AGNE in the stores' inventory, equipment, accounts receivable, leasehold interest, and products.

Upon the filing of its bankruptcy petition, the Debtor informed AGNE that it intended to close the Berlin and Woodsville stores. The Debtor indicated that it would support and consent to a motion by AGNE for immediate relief from the automatic stay so that AGNE could take possession of the two stores. AGNE indicated in the motion that it believed that the Kelley Group's claims were undersecured.

The Court held an expedited hearing on the motion for relief on March 16, 2001, at which counsel for the Debtor, AGNE, the Kelley Group, Berlin City Bank, and the United States Trustee appeared. Doc. No. 7. The Court granted the assented to motion for relief at the hearing and its written order specifically provided:

> AGNE is granted relief from the automatic stay to take possession of and operate the Debtor's stores located in Berlin, New Hampshire and Woodsville, New Hampshire (collectively, the "Stores"), and to exercise all of its rights, subject to any senior rights or liens of other secured creditors, with regard to AGNE's interest in the Debtor's inventory, equipment, leasehold interests, and other tangible property located at the Stores . . . .

Doc. No. 8. The order was served on interested parties, including counsel for the Kelley Group, and was not appealed.

After the Court granted relief to AGNE effective March 16, 2001, AGNE began operating the Berlin and Woodsville stores. AGNE apparently closed the Berlin store in the fall of 2001.

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[2] It appears that all periodic payments due to one or more members of the Kelley Group from the Debtor since the petition date on account of such guaranteed obligations have been paid by AGNE when due.

As of September 11, 2002, nearly eighteen months after the Court granted relief, AGNE continued to operate the Woodsville store.

III. DISCUSSION

The Kelley Group has asserted various claims against the Debtor and has filed five separate proofs of claims. POC 69, 73, 79, 80, and 81. The Debtor objects to the Kelley Group's claims on various grounds. In particular, the Debtor argues that the secured portion of the Kelley Group's claims should be based on the going concern value of the collateral it turned over on March 16, 2001. The only issue addressed in this memorandum opinion is whether the collateral from the Berlin and Woodsville stores should be valued using a liquidation value or a going concern value in order to determine the secured portion of the Kelley Group's claims.

"[A] secured creditors's claim is to be divided into secured and unsecured portions, with the secured portion of the claim limited to the value of the collateral. . . . To separate the secured from the unsecured portion of a claim, a court must compare the creditor's claim to the value of 'such property,' i.e., the collateral." Associates Commercial Corp. v. Rash, 520 U.S. 953, 961 (1997) (citations omitted). Section 506(a) of the Bankruptcy Code specifically provides:

> An allowed claim of a creditor secured by a lien on property in which the estate has an interest . . . is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property . . . and is an unsecured claim to the extent that the value of such creditor's interest . . . is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

11 U.S.C. § 506(a) (emphasis added). According to the United States Supreme Court, "the 'proposed disposition or use' of the collateral is of paramount importance to the valuation question." Rash, 520 U.S. at 962. The First Circuit Court of Appeals has indicated that "[a] court

remains faithful to the dictates of § 506(a) by valuing the creditor's interest in the collateral in light of the proposed post-bankruptcy reality . . . ." Winthrop Old Farm Nurseries, Inc. v. New Bedford Inst. for Sav. (In re Winthrop Old Farm Nurseries, Inc.), 50 F.3d 72, 74 (1st Cir. 1995).

In the instant case, the Kelley Group agreed, if not explicitly then implicitly, that AGNE would take possession of the Berlin and Woodsville stores and all of the assets within them, including the collateral securing the Kelley Group's claims, on March 16, 2001, and would continue to operate the stores. It is undisputed that AGNE intended to operate the stores until it could find a buyer for them. The Kelley Group apparently acquiesced to AGNE's plan as it never raised an issue or an objection to such course of action with the Debtor or the Court. Apparently, AGNE was unable to secure a buyer for the Berlin store and opted to close the store and liquidate the collateral in the fall of 2001. AGNE has not yet found a buyer for the Woodsville store, and it continues to operate it using the equipment securing the Kelley Group's claims.

Given these facts and the holding of Rash, the Court finds that the Kelley Group's collateral should be valued at going concern. There is no reason to reduce the value of the Kelley Group's collateral to liquidation value when no forced sale of that collateral was contemplated at the time the Debtor turned the collateral over to AGNE. See Taffi v. United States (In re Taffi), 68 F.3d 306, 308 (9th Cir. 1995). AGNE and the Kelley Group made a choice in March 2001 to retain the collateral instead of selling it at a foreclosure or liquidation sale. The creditors elected to seek the going concern value of the collateral; i.e., their "interest" in the collateral within the meaning of section 506(a) was as a going concern. The creditors took back the collateral for the purpose of operating the Berlin and Woodsville stores in order to maximize their recovery under their various notes and agreements through a sale of the collateral as a going concern.

The United States Supreme Court indicated in Rash that "[s]ection 506(a) calls for the value the property possesses in light of the 'disposition or use' in fact 'proposed,' not the various dispositions or uses that might have been proposed." Rash, 520 U.S. at 964. Thus, it is of no consequence that AGNE ultimately discontinued the Berlin store operations and liquidated the collateral because the relevant time is March 2001 when the Debtor indicated its intent to surrender the collateral to its creditors. Nonetheless, to ensure that a valuation is based in reality, the Court may consider information after the valuation date if that information will tend to shed light on a fair and accurate assessment of the collateral or liability as of the relevant date. Union Bank of Switzerland v. Deutsche Fin. Serv. Corp., No. 98 Civ. 3251(HB), 2000 WL 178278 (S.D.N.Y. Feb. 16, 2000) (citations omitted). Here, the creditors' continued use of the collateral suggests that the going concern value of the collateral was greater than the liquidation value as of March 2001. See Ardmor Vending Co. v. Kim (In re Kim), 130 F.3d 863, 865 (9th Cir. 1997) (citing In re Penz, 102 B.R. 826, 828 (Bankr. E.D. Okla. 1989)).

The instant case presents the mirror image of Winthrop Old Farm Nurseries, 50 F.3d 72. In Winthrop Old Farm Nurseries, the debtor intended to effectively retain control of the real estate on which it operated its retail garden shop and commercial landscaping business but proposed to strip down the mortgagee's claim to the real estate's liquidation value. Winthrop Old Farm Nurseries, 50 F.3d at 73. The First Circuit Court of Appeals held that the lower court correctly valued the collateral in light of the debtor's proposal to retain it and to ascribe to it its going concern or fair market value with no deduction for hypothetical costs of sale. Id. at 74-75. The debtor's retention and use or disposition of collateral, as in Rash and Winthrop Old Farm Nurseries, is the prototypal fact pattern. However, nothing in the Rash or Winthrop Old Farm

Nurseries decisions, or section 506(a), limits the application of "the proposed disposition or use" of collateral to the debtor's proposed use or disposition.[3]

In this case, the Kelley Group urges the Court to disregard the fact that its collateral has in fact been used by AGNE, with the Kelley Group's apparent acquiescence, to continue the Debtor's grocery store operations in order to maximize recovery. Instead the Kelley Group asks the Court to adopt a liquidation value for its collateral despite the creditors' continued use of it in anticipation of generating an income stream, capturing going concern value upon the stores' sale, and reducing their deficiency claims. This the Court will not do. Rather, the Court holds that the secured portions of the Kelley Group's claims should be based on the going concern value of its collateral as of March 16, 2001. This holding is consistent with equitable considerations regarding which entity, the debtor or the creditor, should be entitled to the difference between the going concern value and the liquidation value. See Winthrop Old Farm Nurseries, 50 F.3d at 74 (indicating that a court should consider equitable factors arising from the circumstances of the case) (citing S. Rep. No. 989, 95th Cong., 2d Sess. 54 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5840); but see Rash, 520 F.3d at 963 n.4 and 5 (indicating that no weight should be given to the legislative history of section 506(a) and rejecting a ruleless approach allowing use of different valuation standards based on the facts and circumstances of individual cases).

[3] The Court notes that under certain circumstances the use of collateral by a creditor after repossession may affect the valuation of the collateral through application of implied strict foreclosure. See Lamp Fair, Inc. v. Perez-Ortiz, 888 F.2d 173 (1st Cir. 1989); Banker v. Upper Valley Refrigeration Co., Inc., 771 F. Supp. 6 (D.N.H. 1991).

IV. CONCLUSION

For the reasons outlined above, the Court sustains in part the Objection by Debtor to Proof of Claim and Restated/Updated Proof of Claim of Kelley's Food Town, Inc. and Karl C. Kelley (POC 69 and 80) (Doc. No. 267), Objection by Debtor to Proof of Claim and Restated/Updated Proof of Claim of K&R Supermarkets, Inc. and Karl C. Kelley (POC 69 and 79) (Doc. No. 268), and Objection by Debtor to Proof of Claim and Restated/Updated Proof of Claim of K&R Supermarkets, Inc. Regarding a Berlin Cash Register Lease (POC 73 and 81) (Doc. No. 269). Those objections are sustained to the extent of the Court's determination to value the Kelley Group's collateral at going concern value. Any remaining grounds articulated in the Debtor's objections to the Kelley Group's claims, on which the Court has not previously ruled, will be determined by the Court separately.

This opinion constitutes the Court's findings of fact and conclusions of law in accordance with Federal Rule of Bankruptcy Procedure 7052. The Court will issue a separate order consistent with this opinion.

DATED this 26th day of September, 2002, at Manchester, New Hampshire.

/s/ J. Michael Deasy
J. Michael Deasy
Bankruptcy Judge