UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF WISCONSIN

Cite as: [Unpublished]

Loren D. Hennekens, Debtor
Bankruptcy Case No. 99-13921-13

United States Bankruptcy Court
W.D. Wisconsin, Madison Division

March 19, 2001

Daniel R Freund, Freund Law Office, Eau Claire, WI for Debtor

Robert D. Martin, United States Bankruptcy Judge

MEMORANDUM DECISION

Wells Fargo moved for stay relief to liquidate stock it held under a pledge by the chapter 13 debtor as collateral for a letter of credit. A final hearing was held on March 14, 2001.

The parties stipulated to:

1. On April 26, 1996 and at the debtor's behest, Wells Fargo issued an irrevocable letter of credit in the amount of $500,000 in favor of the Wisconsin Department of Natural Resources (DNR). The letter of credit secures the debtor's obligations under a DNR-approved closure plan for the debtor's hazardous waste facility.

2. As security for the issuance of the letter of credit, the debtor signed a promissory note in favor of Wells Bank pledging as collateral all securities accounts maintained by the debtor at Northwest Investment Services (a Wells Fargo affiliate). The debtor agreed to "replenish" the accounts whenever the value of the stocks in them fell below $525,000. Wells Fargo perfected its security interest in the accounts by possession.

3. After an initial termination date of April 26, 1997, the letter of credit was subject to automatic renewal until the requirements of the closure plan were fulfilled or until such time as Wells Fargo elected to cancel the letter. Cancellation by

Wells Fargo would require notice to the debtor and payment to DNR of the balance

under the letter of credit unless the debtor provided DNR with a replacement letter of credit. Wells Fargo has not moved to cancel the letter and remains obligated to honor a demand by the DNR.

4. On August 25, 1999, the debtor filed a chapter 13 petition. On that date, the stock pledged to Wells Fargo comprised 14,771 shares of common stock in Waste Management Inc. (WMI) and had a value of $336,040.25 or $22.75 a share.

5. The WMI stock is currently traded on the New York Stock Exchange. The value of the stock has fluctuated since the date of petition. The value of the stock in March of 2000 fell to $13.5625 a share, but rose to $28.625 a share in January of 2000. The value of the stock has been generally on the decline and, as of February 26, 2001, was estimated to be $25.20 a share.

6. The debtor has a basis in the WMI stock of $22.04 a share and faces a potential capital gains tax liability of 21% depending on the timing of the stock's sale.

7. The debtor proposes to adequately protect Wells Fargo's interest in the stock by including these two provisions in the chapter 13 plan:

   a. If the DNR makes a demand under the letter of credit, Wells Fargo would have immediate relief from the stay to liquidate the WMI stock.

   b. If the value of the WMI stock falls to $22.75 a share or less, Wells Fargo would have stay relief to place an automatic sell order.

Section 362(d) provides the grounds upon which relief from stay may be granted:

(d) On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (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 property of such party in interest;(2) with respect to a stay of an act against property under subsection (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 ...

11 U.S.C. §362(d). The party seeking relief from stay need establish only one of the two stated grounds to prevail. The party opposing relief from stay has the burden of proof on all issues other than on the issue of equity.[1]

Wells Fargo seeks relief under §362(d)(1) claiming a lack of adequate protection of its interest in the stock. The concept of adequate protection was described by Judge Deitz in In re Family Investments, Inc., 8 B.R. 572 (Bankr. Ky. 1981):

> Adequate protection is a concept which, like so many of the Code's amorphisms, Congress intentionally left undefined. And although illustrations of what might constitute adequate protection are provided in s 361, they neither exclude nor exhaust the types of arrangements which might ensure protection of a creditor's property interest. Rather, adequate protection must be determined based upon the facts of each case by applying general equitable principles. Congress advanced the concept of adequate protection so that a creditor could be assured that it would realize the value of its interest in the property affected. Its roots are constitutional, its effect practical. It is derived from the fifth amendment protection of property interests, but it also preserves for a secured creditor, when strict enforcement of legal rights is impossible or detrimental to bankruptcy law, the essence of what that creditor bargained for. Because there are no set guidelines for what constitutes adequate protection, a bankruptcy court may flexibly determine whether the form of protection offered reflects the spirit and intent of s 361.

Id. at 576. Because adequate protection is flexible, the methods set out in §361 for furnishing a secured party with the "indubitable equivalent" of its security are neither exclusive nor necessary in each case.[2]

---

[1]§362(g) provides:

In any hearing under subsection (d) or (e) of this section concerning relief from the stay of any act under subsection (a) of this section- (1) the party requesting such relief has the burden of proof on the issue of the debtor's equity in property; and (2) the party opposing such relief has the burden of proof on all other issues.

[2]§361 provides:

When adequate protection is required under section 362, 363, or 364 of this title of an interest of an entity in property, such adequate protection may be provided by– (1) requiring the trustee to make a cash payment or periodic cash payments to such entity, to the extent that the stay under section 362 of this title, use, sale, or lease under section 363 of this title, or any grant of a lien under section 364 of this title results in a decrease in the value of such entity's interest in such property; (2) providing to such entity an additional or replacement lien to the extent that such stay, use, sale, lease, or grant results in a decrease in the value of such entity's interest in such property; or (3) granting such other relief, other than entitling such entity to compensation allowable under section 503(b)(1) of this title as an

Adequate protection is afforded only to the extent that a creditor is secured. A creditor's secured status is determined under §506, which provides that:

> (a) An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff 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.[3]

11 U.S.C. §506(a). Thus, an undersecured claim is divided. The creditor has a secured claim to the extent of the value of the collateral and an unsecured claim as to the deficiency. The creditor's interest entitled to adequate protection is the value of the collateral. As explained by Judge Lawless in In re Aegean, 33 B.R. 745 (Bankr. D. Mass. 1983):

> the "interest in property" entitled to [adequate] protection is not measured by the amount of the asserted debt but by the value of the lien. In other words, the creditor's right to adequate protection is limited to the lesser of the value of the collateral or the amount of the secured claim. It is also settled that the value of the property on the day the petition is filed determines the amount of the claim entitled to adequate protection[4].... Thus, to the extent that the [creditor's] lien

---

> administrative expense, as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property.

[3]Most courts holds that value may be reexamined as the case progress, so that a value determined in the light of lifting the stay may not be the controlling value, for example, in the case of plan confirmation. *See* In re Hoskins, 102 F.3d 311 (7th Cir. 1996) ("[b]ecause that value will differ among the different stages and kinds of bankruptcy, the reference to 'purpose' could imply usefully that the section 506(a) standard of valuation is not unitary"), *abrogated on other grounds*, Associates Commercial Corp. v. Rash, 520 U.S. 953, 117 S.Ct. 1879, 138 L.Ed.2d 148 (1997).

[4]Courts are divided on whether the petition date or the motion date is the controlling date for valuing collateral for adequate protection purposes. *See* In re Best Products Co.,Inc., 138 B.R. 155 (Bankr. S.D. N.Y. 1992) (collecting cases); In re Northeast Chick Services, 43 B.R. 326, 331 (Bankr. D. Mass. 1984) ("creditor whose cash collateral is being used has right to demand adequate protection, but bankruptcy court's discretionary power to provide such protection arises only when the creditor requests same"); In re Greives, 81 B.R. 912, 965 (Bankr. N.D. Ind. 1987) ("If the adequate protection payments for decrease in value by post-petition use of the collateral by the debtor were to be required retroactively to the date of the commencement of the case, this brief

> claim exceeded the value of the Debtor's collateral on the day of the filing, the claim was an unsecured claim... which was not entitled to adequate protection. Conversely to the extent that the value of the Debtor's property secured by the lien exceeded the value of the claimed lien, an "equity cushion" or "value cushion" existed which under some circumstances can itself constitute adequate protection.

Id. at 748 (citations omitted). *See* In re Johnson, 47 B.R. 204 (Bankr. W.D. Wis. 1985) (citing Aegean with approval); In re Harvey Road Associates VII, 140 B.R. 302 (Bankr. D. Mass. 1992) (no relief from stay based on lack of adequate protection where creditor's claim roughly equaled value of collateral and that value was not depreciating); In re Wilson, 965 F.2d 160, 171 (7th Cir. 1992) ("[a] security interest is--a security interest. It is not a fee simple.... [Creditor] does not own a $6 million building or the rents that th[e] building throws off month after month, year after year. It is just a creditor with a claim currently worth about $3.2 million that it has secured with liens against the building, and against the rents, to assure repayment. It has no right to fence off the entire collateral in which it has an interest so that no other creditor can get at it. Its only entitlement is to the adequate protection of its interest").

It follows that adequate protection would be required whenever the value of collateral is depreciating but not where that value is holding firm or appreciating. *See also* In re Cadwell's Corners Partnership, 174 B.R. 744 (Bankr. N.D. Ill. 1994) (creditor deemed adequately protected if: (1) the value of property is stable; (2) property is properly maintained; and (3) debtor is current on post-petition obligations). Adequate protection immunizes the secured creditor against depreciation of the value of its collateral during the enforcement of the stay; it is a means of preserving the status quo as of the date of the petition:

> It must be remembered that Section 362 is designed as a holding pattern for secured claims under the Code providing there is adequate protection until a plan takes hold. Should the case be dismissed, or confirmation denied, the secured claimant is entitled to the interim adequate protection.

---

respite intended by 11 U.S.C. §362 would be vitiated.... Awarding depreciation from the date of the petition seems unduly harsh, burdensome and detrimental to the goal of Chapter 11 bankruptcy, that being, a successful reorganization"); In re Wilson, 70 B.R. 46, 48 (Bankr. N.D. Ill. 1987)(value of collateral measured from date of motion seeking adequate protection for purposes of determining depreciation which had to be compensated for to adequately protect creditor); In re Kennedy, 177 B.R. 967 (Bankr. S.D. Ala. 1995) ("[i]n most instances, only when adequate protection is properly requested by motion or response to a motion is such relief granted and then only prospectively from the date of the request"); In re Cook, 205 B.R. 437 (Bankr. N.D. Fla. 1997) (right to adequate protection is prospective from the date motion is filed).

In re BBT, 11 B.R. 224, 232 (Bankr. Nev. 1981). *See also* In re Addison Properties Ltd. Partnership, 185 B.R. 766, 769 (Bankr. N.D. Ill. 1995) ("it is now established that 'adequate protection' is meant only to assure that a secured creditor does not suffer a decline in the value of its interest in the estate's property, rather than to compensate the creditor for the bankruptcy-imposed delay in enforcing its rights in that property").

In United Savings Ass'n of Texas v. Timbers of Inwood Forest Assocs., Ltd., 484 U.S. 365, 108 S.Ct. 626, 98 L.Ed.2d 740 (1988), the debtor owned and operated an apartment project in Houston, Texas. United Savings Association of Texas held a note in the principal amount of $4,100,000, secured by a lien on the apartment project and an assignment of rents. United Savings was undersecured and the debtor agreed to pay United Savings the post-petition rents from the project, less operating expenses. United Savings moved for relief from stay, and continuance of the stay was conditioned upon the debtor making certain monthly payments. At issue was whether United Savings, as an undersecured creditor, was entitled to interest and costs accruing post-petition on its collateral. Holding that an undersecured creditor was not entitled to be adequately protected for lost opportunity costs attributable to the stay, the Supreme Court stated:

> It is common ground that the "interest in property" referred to by § 362(d)(1) includes the right of a secured creditor to have the security applied in payment of the debt upon completion of the reorganization; and that that interest is not adequately protected if the security is depreciating during the term of the stay. Thus, ... if the apartment project in this case had been declining in value petitioner would have been entitled, under § 362(d)(1), to cash payments or additional security in the amount of the decline, as § 361 describes. The crux of the present dispute is [whether] the phrase "interest in property" also includes the secured party's right (suspended by the stay) to take immediate possession of the defaulted security, and apply it in payment of the debt. If that right is embraced by the term, it is obviously not adequately protected unless the secured party is reimbursed for the use of the proceeds he is deprived of during the term of the stay. The term "interest in property" certainly summons up such concepts as "fee ownership," "life estate," "co-ownership," and "security interest" more readily than it does the notion of "right to immediate foreclosure." Nonetheless, viewed in the isolated context of § 362(d)(1), the phrase could reasonably be given the meaning petitioner asserts. Statutory construction, however, is a holistic endeavor. A provision that may seem ambiguous in isolation is often clarified by the remainder of the statutory scheme--because the same terminology is used elsewhere in a context that makes its meaning clear... or because only one of the permissible meanings produces a substantive effect that is compatible with the rest of the law.... That is the case here. Section 362(d)(1) is only one of a series of provisions in the Bankruptcy Code dealing with the rights of secured creditors. The language in those other provisions, and the substantive dispositions that they effect, persuade us that

> the "interest in property" protected by § 362(d)(1) does not include a secured party's right to immediate foreclosure. Section 506 of the Code defines the amount of the secured creditor's allowed secured claim and the conditions of his receiving postpetition interest.... In subsection (a) of this provision the creditor's "interest in property" obviously means his security interest without taking account of his right to immediate possession of the collateral on default. If the latter were included, the "value of such creditor's interest" would increase, and the proportions of the claim that are secured and unsecured would alter, as the stay continues--since the value of the entitlement to use the collateral from the date of bankruptcy would rise with the passage of time. No one suggests this was intended. The phrase "value of such creditor's interest" in § 506(a) means "the value of the collateral."

484 U.S. at 370-72 (citations omitted).

More importantly for our consideration Timbers holds that the "interest in property" protected in §361 does not include the right to immediate foreclosure. Wells Fargo argues lack of adequate protection principally because the WMI stock may depreciate in value. It seeks the ability to lock in gains enjoyed since the filing of the case as well as protection from decline below the value of the stock when the case was filed. It is clear under Timbers that if Wells Fargo is undersecured it seeks more than it is entitled to. But is Wells Fargo undersecured? The answer to that question depends in part on the understanding of the bank's obligation under the letter of credit which the stock secures. An explanation of letters of credit is found in In re North Shore & Central Illinois Freight Co., 30 B.R. 377 (Bankr. N.D. Ill. 1983):

> Letters of credit traditionally have served as an important source of financing for commercial transactions. See Baird, Standby Letters of Credit in Bankruptcy, 49 U.Chi.L.Rev. 130 (1982). Essentially, the purpose of a letter of credit is to insure the certainty of payment for services or goods rendered regardless of any intervening misfortune which may befall the other contracting party. Generally, the party who benefits from the provision of the goods or services will arrange for a letter of credit to be issued by a bank. Under the terms of the letter of credit, the provider of the goods or services is named as beneficiary. The transaction involved in this controversy resembles a standby letter of credit arrangement. Under a standby letter of credit arrangement the bank becomes primarily liable to the beneficiary upon the default of the bank's customer. In return the bank charges the customer a fee based upon the customer's probability of insolvency. It is argued that this arrangement spreads the allocation of risk to the parties who are best able to ascertain the risk.... The success of letter of credit arrangements as a financing tool is demonstrated by the widespread use of letters of credit to facilitate commercial transactions.

Id. at 378. *See also* In re Carley Capital Group, 118 B.R. 982 (Bankr. W.D. Wis. 1990) *and* In re Taggatz, 106 B.R. 983 (Bankr. W.D. Wis. 1989)(both describing letter of credit transaction). A letter of credit gives rise to three independent relationships: the issuer-customer; the issuer-beneficiary; and the customer-beneficiary. In our case, for example, Wells Fargo has an independent and primary obligation to DNR to honor a draw upon the presentment of proper documentation under the letter of credit. This obligation is wholly independent of any existing obligation between Wells Fargo and the debtor or the debtor and the DNR. *See* Eakin v. Continental Ill. Bank & Trust Co., 875 F.2d 114, 116 (7th Cir. 1989)("[l]etters of credit are designed to avoid complex commercial disputes about how much beneficiaries 'really' owe. The promise and premise are 'pay now, argue later' ... the issuer must pay without regard to the rights and defenses available on the underlying contract"); In re Bergner & Co., 140 F.3d 1111, 1119 (7th Cir. 1998)("if [customer] did not comply with its own agreement with [issuer] ... then [issuer] would have ... a perfectly good contract action against [customer], but it would have ... no defense against honoring the beneficiary's demand"). The bankruptcy of a customer does not affect the issuer's obligation to honor a demand by the beneficiary under a letter of credit.[5] However, collateral pledged by a customer to the issuer is estate property when that customer enters bankruptcy. *See* In re Sabratek Corp., 257 B.R. 732, 735 (Bankr. D. Del. 2000)("[Issuer] ... has a secured claim, albeit a contingent secured claim, against the estate for its obligation under the letter of credit. That claim arose when the letter of credit was posted...."); In re Auto Specialties Mfg. Co., 153 B.R. 510 (Bankr. W.D. Mich. 1993)(intervention of account party's bankruptcy will not prevent beneficiary from drawing on letter of credit, nor will issuer be barred from including amount of draw in its secured claim); Val Decker Packing Co., 61 B.R. at 839 ("the collateral which secures a letter of credit is considered property of the debtor's estate").

Wells Fargo holds a contingent secured claim. The contingency is that DNR may demand an as yet undetermined amount under the letter of credit. When the DNR draw is made, Wells Fargo will have a right to reimbursement from the proceeds of stocks pledged by the debtor. The right to reimbursement is governed solely by the documents executed between the debtor and Wells Fargo, which set the maximum amount of the debtor's liability to Wells Fargo for reimbursement at $500,000. The debtor's liability could of course be very much less, if the DNR makes no demand or if its demand is for less than $500,000. Without knowing what the DNR's demand will be, Wells Fargo's claim against the debtor lies

[5] In re Green, 210 B.R. 556, 559 (Bankr. N.D. Ill. 1997) ("[a] letter of credit is an independent obligation, and neither the letter of credit nor its proceeds are debtor's property even if the letter of credit is secured by the debtor's property"); In re Duplitronics, Inc., 183 B.R. 1010, 1015 (Bankr. N.D. Ill. 1995)("[b]ecause a bank's obligation on a letter of credit is independent of the transaction between the beneficiary and the bank's customer, it is settled law that the letter of credit is not property of the estate and that the § 362 automatic stay is inapplicable"); North Shore & Central Illinois Freight Co., 30 B.R. at 377 (Bankr. N.D. Ill. 1983) (holding that funds which issuer was obligated to pay to the beneficiary upon presentment of conforming documents were property of the issuer, not the estate).

somewhere between zero and $500,000.

The value of the WMI stock is fluctuating almost daily. The parties agree that the value of stock on the date of the petition was $336,040 and that, as of February 26, 2001, the value had climbed to $372,229. The debtor has proposed two forms of adequate protection. First, that Wells Fargo could liquidate immediately sufficient stock to cover a draw made by the DNR. Secondly, that the Wells Fargo could place an automatic sell order if the value of the stock falls to $22.75 a share (multiplied by 14,771 shares yields an aggregate value of $336,040). Under either method Wells Fargo is protected from a diminution in the value of the stock below that on the date of filing. The debtor, in fact, offers what Timbers withholds: a right to immediate foreclosure, albeit in limited circumstances. Whether in doing so the debtor is more generous than necessary is not clear.[6] Timbers bars an undersecured creditor from compensation for opportunity costs and permits post-petition appreciation of collateral to redound to the estate's benefit.[7] But the debtor's proposal does meet the requirement of providing Wells Fargo's interest adequate protection.

Wells Fargo also seeks relief under §362(d)(2). Wells Fargo bears the initial burden of proving the debtor has no equity in the stock. If successful, the burden shifts to the debtor to demonstrate that the property is necessary to an effective reorganization. *See* In re Syed, 238 B.R. 126 (Bankr. N.D. Ill. 1999).

The presence of equity depends on the draw by the DNR under the letter of credit. By its contract, Wells Fargo is entitled to reimbursement of up to $500,000 against the pledged

---

[6]Other provisions of chapter 13 may be offended if Wells Fargo were to receive all the benefit of the stock's appreciation at the time of the DNR draw in amount greater than $336,040. See §§1322; 1325(a)(5).

[7]Wells Fargo has not argued that post-petition appreciation of collateral should inure to the benefit of an undersecured creditor based on the following statement in Dewsnup v. Timm, 502 U.S. 410, 417, 112 S.Ct. 773, 778, 116 L.Ed.2d 903 (1992): "[a]ny increase over the judicially determined valuation during bankruptcy rightly accrues to the benefit of the creditor, not to the benefit of the debtor and not to the benefit of other unsecured creditors ... who had nothing to do with the mortgagor-mortgagee bargain." Taken in isolation, this statement appears to endorse the view that increased value of collateral during the bankruptcy inures to the benefit of the secured creditor. However, Dewsnup was a chapter 7 liquidation and the collateral in that case had been abandoned. The issue was limited to whether §506(d) permitted the "strip down" of the lien held by an undersecured creditor. Dewsnup did not determine how claims should be valued for purposes of §506(a) or adequate protection. Indeed, the Court limited its holding: "[a]part from reorganization proceedings ... no provision of the pre-Code statute permitted involuntary reduction of the amount of a creditor's lien for any reason other than payment on the debt." 502 U.S. at 418-19, 112 S.Ct. at 779. Where Dewnsup has proved troublesome in the chapter 13 context it has been on the issue of whether bifurcation of an undersecured claim secured only by the debtor's principal residence is permitted or a prohibited modification under §1322(b)(2).

stock, but its interest in the stock in the bankruptcy is fixed at $336,040. To the extent that the DNR draw (and the costs allowed under §506(b)) is less there is equity. If the draw is more than $336,040 there is no equity. But because there is no part of the stock's value that is free from the contingent claim of Wells Fargo as of the date of the petition, the debtor has no equity for purposes of §362(d)(2)(A). *See* In re Jones, 119 B.R. 996 (Bankr. N.D. Ind. 1990) ("'equity' as contemplated by § 362(d)(2) ... means 'the difference between the value of the property and all encumbrances against it'") (citations omitted).

The issue of whether the stock is necessary to the debtor's effective reorganization is more difficult to resolve. In Timbers, the Supreme Court stated:

> What this requires is not merely a showing that if there is conceivably to be an effective reorganization, this property will be needed for it; but that the property is essential for an effective reorganization that is in prospect. This means, as many lower courts ... have properly said, that there must be "a reasonable possibility of a successful reorganization within a reasonable time." ... And while the bankruptcy courts demand less detailed showings during the four months in which the debtor is given the exclusive right to put together a plan, see 11 U.S.C. §§ 1121(b),(c)(2), even within that period lack of any realistic prospect of effective reorganization will require § 362(d)(2) relief.

Timbers, 484 U.S. at 375-76, 108 S.Ct. at 633 (citations omitted).

Assuming that the debtor's reorganization is reasonably feasible (and the withdraw of the DNR objection and the favorable recommendations of the chapter 13 trustee seem to support the assumption), the question becomes when will a particular piece of property be deemed necessary to an effective reorganization? Courts have focused on the income producing qualities of property in making this decision, finding a car necessary to get to work, or a rental property necessary to fund the plan. However, the cost side of the ledger also received attention when houses have been deemed necessary in the face of high disposition costs or high cost of alternative shelter.

In the present case, the debtor's cost of disposition of the stock includes a potentially substantial tax liability that would have to be paid as a post-petition indebtedness. That additional expense would certainly jeopardize the debtor's ability to make payment on pre-petition debts under the plan. Although there may be a certain inevitability to this expense (parties agree that the DNR will draw some amount under the letter of credit), to permit the bank to accelerate the crisis by selling the stock before it lacks adequate protection and before the DNR draws on the letter of credit would undermine the feasibility of the plan. So at least for now the maintenance of the stock is a benefit for creditors who are to participate in the distribution of the plan payments and because it supports the feasibility of the plan, it is necessary.