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IN UNITED STATES DISTRICT COURT FOR THE DISTRICT OF UTAH

CENTRAL DIVISION

In re RALSU, INC. BANK OF AMERICAN FORK, Appellant, vs. RALSU, INC., Appellee.	BANKRUPTCY APPEAL 85A-02848 Civil No. C-85-1410A

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I. INTRODUCTION

The Bank of American Fork (hereinafter "the Bank"), a secured creditor in the chapter 11 bankruptcy filing of Ralsu, Inc. (hereinafter "Ralsu"), is appealing from an order of the bankruptcy court entered December 18, 1985, denying the Bank's Motion to Dismiss or in the Alternative for Relief from the Automatic Stay. The Bank presents four issues on appeal:

1. Was the debtor's petition filed in bad faith?

2. Should the stay imposed on the Bank be lifted for lack of adequate protection under 11 U.S.C 362(d)(1)?

3. Was the transfer of certain assets to Ralsu shortly before filing its voluntary petition in bankruptcy a fraudulent transfer under Utah law?

4. Did the stay automatically expire under the terms of 11 U.S.C § 362(e) because the bankruptcy court failed to enter its final order within 30 days of the hearing?

Oral argument on the appeal was heard June 2, 1986 and the court took the matter under advisement. The court has considered the oral argument and written memoranda submitted by counsel and has conducted its own review of the record and research of the relevant law and is ready to render its decision. After setting forth the facts of the case, the court will consider each of the issues set forth by the appellant.[1]

II. FACTS

Suzanne Borcherds is the sole shareholder of the debtor, Ralsu. In 1984, Borcherds acquired some real estate which she intended to develop into a planned unit development known as Ilangeni Estates. The development was to contain 37 lots of 4 acres each as well as several commons areas. Four of the lots in this planned development were purchased by Thomas Moore. The Bank of American Fork loaned Moore $250,000, secured by a trust deed, to purchase the lots. Moore's note became due on March 1, 1985, but was not paid at that time. Moore, shortly after default, reconveyed the property to Borcherds by quit-claim

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1 Ralsu has indicated in its Reply Brief that it accepts the appellant's statement of the issues in the case. Appellee's Brief at 1.

deed. On April 29, 1985, the Bank served a notice of default and subsequently gave notice of a trustee's sale scheduled for August 30, 1985.

On August 27, 1985, Borcherds conveyed all of the lots constituting Ilangeni Estates and some other personal property to Ralsu. Borcherds also transferred debts which are apparently related to the property, including a portion of a debt owed by her to the Internal Revenue Service and a debt for engineering services performed on the Ilangeni development. The formal requirements to incorporate Ralsu were not completed until August 28. On August 29, the day before the scheduled trustee's sale, the newly created Ralsu filed a voluntary petition in bankruptcy under chapter 11 of Bankruptcy Code. The parties stipulated that as of the day of filing the amount owing the Bank was $283,055.88.

On September 23, 1985, the Bank filed its "Motion to Dismiss or, in the Alternative, for Relief from the Automatic Stay." The Bank sent notice on September 25 that a hearing was scheduled on October 30, 1985. The hearing was held on October 30 and 31. At the conclusion of the hearing, the court took the matter under advisement. On December 6, 1985, the judge signed an order and separate memorandum opinion denying the Bank's motion. This order was subsequently entered on December 18, 1985, and is on appeal here.

III. ANALYSIS

A. Bad Faith Filing of the Petition in Bankruptcy

The Bank of American Fork argues that the debtors filed their bankruptcy petitions in "bad faith." Although the former Bankruptcy Act contained an explicit "good faith" requirement for chapter 11 filings, the present Code does not. Despite this apparent change in the provisions, courts have continued to view good faith as an "implicit prerequisite to the filing or continuation of a proceeding under Chapter 11 of the Code." In re Dolton Lodge Trust No. 35188, 22 Bankr. 918, 922 (Bankr. N.D. Ill. 1982). See also Albany Partners, LTD. v. W.P. Westbrook (In re Albany Partners, Ltd.), 749 F.2d 670, 674 (11th Cir. 1984). A great number of bankruptcy court decisions have considered the good faith requirement under the Code and have, in nearly all cases, found that a bankruptcy court has equitable power to dismiss a chapter 11 petition for lack of good faith under 11 U.S.C. § 1112(b).[2]

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2 Section 1112(b) states:

> (b) [O]n request of a party in interest, and after notice and a hearing, the court may convert a case under this chapter to a case under chapter 7 of this title or may dismiss a case under this chapter, whichever is in the best interest of creditors and the estate, for cause, including --
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> (1) continuing loss to or diminution of the estate and absence of a reasonable likelihood of rehabilitation;
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> (2) inability to effectuate a plan;
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> (3) unreasonable delay by the debtor that is prejudicial to creditors;
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> (4) failure to propose a plan under section 1121 of this title within any time fixed by the court;
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> (5) denial of confirmation of every proposed plan and denial of a request made for additional time for

Judge Ordin, a bankruptcy judge in the central district of California, has described the power given to the bankruptcy court under § 1112(b):

> [T]he bankruptcy court is said to have the inherent discretionary power to prevent the continuation of a proceeding where the court perceives an intent to abuse the purpose of the Code. This is said to derive from the court's general equitable powers. Conduct and transactions of doubtful integrity are measured by and compared to the conduct of a hypothetical debtor who is required to demonstrate exemplary motives and scrupulous good faith as a prerequisite to obtaining the benefits of rehabilitation in the bankruptcy court. Absent such a motivation, i.e., good faith, the petition may be dismissed.

Ordin, The Good Faith Principle in the Bankruptcy Code: A Case Study, 38 Bus. Law. 1795, 1797 (1983) (citations omitted). Although bad faith is an accepted "cause" for dismissing a chapter 11 case, the bankruptcy court has "wide discretion" in determining whether bad faith exists in a particular case. See House Rep. No. 595, 95th Cong., 1st Sess. 405, reprinted in 1978 U.S. Code Cong. & Ad. News 5787, 6361. The Eleventh Circuit found that the existence of a good faith standard is rooted in the discretion granted the court under § 1112(b):

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filing another plan or a modification of a plan;
(6) revocation of an order of confirmation . . . .
(7) inability to effectuate substantial consummation of a confirmed plan;
(8) material default by the debtor with respect to a confirmed plan; and
(9) termination of a plan by reason of the occurrence of a condition specified in the plan.

The following sources discuss a number of the cases which have found an implied standard of good faith in Section 1112(b): Ordin, The Good Faith Principle in the Bankruptcy Code: A Case Study, 38 Bus. Law. 1795 (1983); Norton, 1985 Annual Survey of Bankruptcy Law (Callaghan) 686-95; Norton, 1984 Annual Survey of Bankruptcy Law (Callaghan) 425-28.

> [Section] 1112(b) of the Code permits a bankruptcy court to convert or dismiss a case for "cause." The provision lists nine examples of cause, but the list is not exhaustive. The pertinent legislative history states, "The court will be able to consider other factors as they arise, and use its equitable powers to reach an appropriate result in individual cases." H.R. Rep. No. 595, 95th Cong., 1st Sess. 406 (1977), [reprinted in] 1978 U.S. Code Cong. & Ad. News 5787, 6362. Accordingly, the determination of cause under § 1112(b) is "subject to judicial discretion under the circumstances of each case." The equitable nature of this determination supports the construction that a debtor's lack of "good faith" may constitute cause for dismissal of a petition.

Albany Partners, 749 F.2d at 674 (some citations omitted). Since good faith is not an explicit requirement under chapter 11 but rather an implied requirement born of judicial discretion, the court must necessarily be given wide latitude in its ability to decide whether a particular case will be dismissed for lack of good faith. When matters are left to the discretion of the bankruptcy judge, a district court can disturb the bankruptcy court's ruling only upon a finding of "abuse of discretion." Rosinski v. Boyd (In re Rosinski), 759 F.2d 539, 540-41 (6th Cir. 1985) (decision to reopen bankruptcy case and allow amendment of schedules reviewable for abuse of discretion); MacDonald v. MacDonald (In re MacDonald), 755 F.2d 715 (9th Cir. 1985) (review of decision to lift automatic stay); Addison v. Langston (In re Brints Cotton Marketing, Inc.), 737 F.2d 1338, 1341 (5th Cir. 1984) (bankruptcy court's estimation of the value of an unliquidated claim); Shaver v. Shaver, 736 F.2d 1314, 1316 (9th Cir. 1984) (decision granting a discharge in bankruptcy);

Holtkamp v. Littlefield (In re Holtkamp), 669 F.2d 505, 507 (7th Cir. 1982) (decision to lift the automatic stay). This standard of review is necessarily narrow:

> [The abuse of discretion] standard of review is narrow. The appellate court must defer to the congressional intent to accord wide latitude to the decisions of the the tribunal in question. Section 502(c)(1) of the Code [assignment of values for unliquidated claims] embodies Congress' determination that the bankruptcy courts are better equipped to evaluate the evidence supporting a particular claim within the context of a particular bankruptcy proceeding. Thus, an appellate court can impose its own judgment only when "the factors considered [by the bankruptcy court] do not accord with those required by the policy underlying the substantive right or if the weight given to those factors is not consistent with that necessary to effectuate that policy."

Bittner v. Borne Chemical Co., 691 F.2d 134, 136 (3rd Cir. 1982) (citation omitted). This court will reverse the bankruptcy court's denial of the motion to dismiss for lack of good faith only if it finds that the court's ruling was an abuse of discretion or that the facts upon which the court based its ruling were "clearly erroneous." Bankruptcy Rule 8013.

The court will first review the bankruptcy court's factual findings and then determine whether the bankruptcy court abused its discretion in failing to dismiss the case. The bankruptcy court based its decision on the following factual findings:

> 1. Major reasons for forming the corporation were to place others in charge of the management of the assets and to "obtain protection of the corporate veil" in structuring future development.
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> 2. The Chapter 11 petition was not filed merely to delay or hinder the secured creditor. The Chapter 11 filing allows Ralsu to attempt to arrange the debts connected with the property through refinancing, new capital investment or liquidation.

> 3. Suzanne Borcherds could have accomplished the same result by filing a Chapter 11 petition as an individual. The formation of the corporation was unnecessary and did not, of itself, hinder the recourse of the Bank to its collateral.
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> 4. Ms. Borcherds remains personally liable on her personal debts. The creditor restrained by this bankruptcy also retains the same real property security as had protected it prior to the transfer.

Memorandum Opinion at 2-5 (December 18, 1985). Upon a thorough review of the record, including the testimony heard by the bankruptcy court, this court concludes that the findings of the bankruptcy court are not clearly erroneous. Although the record contains some discrepancies in testimony, the bankruptcy judge is in a better position to evaluate the credibility of testimony in that hearing than this court can by reviewing the written record. The bankruptcy judge's findings are based on evidence in the record and are not clearly erroneous.

Further, the court's refusal to dismiss the action for lack of good faith was not an abuse of discretion. Although bankruptcy courts faced with the question have required good faith, or at least a lack of bad faith, they have varied in their identification of the factors required for a finding of bad faith. As a starting point, the court will evaluate those factors which the Bank claims require a finding of bad faith.

A major factor that the Bank points to as evidencing bad faith is the creation of Ralsu, Inc. on the eve of filing the bankruptcy action which occurred the day before a scheduled foreclosure sale. This sequence of events is commonly termed "the new debtor syndrome." A number of cases have considered

whether a newly created debtor can file a petition on the eve of a foreclosure sale in good faith. Although courts carefully scrutinize such transactions, the majority of cases have held that the new-debtor syndrome, without more, does not justify a finding of bad faith. See, e.g., Oregon Bank v. Scott (In re Scott) 42 Bankr. 35, 38 (Bankr. D. Ore. 1984); Sundstorm Mortgage Co. v. 2218 Bluebird Ltd. Partnership (In re 2218 Bluebird Ltd. Partnership) 41 Bankr. 540, 543 (Bankr. S.D. Cal. 1984); Glassmanor Apartments Ltd. Partnership v. Corporation Deja Vu (In re Corporation Deja Vu), 34 Bankr. 845, 850 (Bankr. D. Md. 1983); Duggan v. Highland-First Ave. Corp., 25 Bankr. 955, 961-62 (Bankr. C.D. Cal. 1982) (Ordin, Bankruptcy Judge) (listing a number of factors relevant to an inquiry into bad-faith filing); In re Levinsky, 23 Bankr. 210, 218 (Bankr. E.D.N.Y. 1982) (new-debtor syndrome not fatal since no substantive or procedural right of a creditor was adversely affected); Myers v. Beach Club (In re Beach Club) 22 Bankr. 597, 599 (Bankr. N.D. Cal. 1982).

In a 1982 case addressing the issue of good faith under § 1112(b), Judge Ordin summarized the trend that courts had followed in assessing the good faith of a debtor:

> The test of the debtor's good faith is not whether a transfer of property and/or a change of entity occurred on the eve of filing; timing of the change and/or transfer is not controlling. The question is whether any substantive or procedural rights of creditors available prior to transfer have been altered or eroded by the transfer and subsequent filing. It is detriment to creditors, not the advantage to prior owners which has the greater relevance in determining whether creditors are fraudulently hindered or delayed by the filing.

> The inquiry often focuses on the following:
> (1) Would the secured creditor have had any greater potential for foreclosure or realization on its claim if the petition had been filed by the transferor?
> (2) Did the transfer to the new entity improve the debtor's ability to protect or remove collateral from the secured creditor's reach?
> (3) Did the transaction improve or at any rate not decrease, the debtor's potential to provide adequate protection to the secured creditor's interest in the collateral?
> (4) Was the transaction motivated by an intent and desire to avoid submitting the actual entities in interest to the jurisdiction of the court, together with other assets not transferred to the debtor? Is this an "asset-culled entity"?
> (5) Was the petition filed solely for the purpose of thwarting and frustrating secured creditors in the enforcement of lien rights under circumstances which amount to "malicious", "frivolous", or "unwarranted" delay?

Duggan, 25 Bankr. at 961-62. Applying these question to the circumstances of this case, the court finds that the bankruptcy court did not abuse its discretion in refusing to dismiss this action for lack of good faith. Under the first inquiry set forth in Duggan, the secured creditor would have had no "greater potential for foreclosure" if Suzanne Borcherds would have filed the chapter 11 petition rather than the newly created Ralsu, Inc. Judge Mai found that, "Mrs. Borcherds could have accomplished the same result by filing a chapter 11 as an individual." Memorandum Opinion at 5. This finding correctly assesses the eligibility of an individual to file under chapter 11. See 11 U.S.C.A. §§ 109(d), 101(33) (West 1979 & Supp. 1986). If Borcherds had been ineligible to file the petition as an individual, the conclusion here would be different. See infra note 7.

The bankruptcy judge further found that, "the creditor restrained by this Chapter 11 case retain [sic] the same real property security as had protected it prior to transfer." Memorandum Opinion at 5. Under the second inquiry set forth in Duggan, the transfer to Ralsu did not "improve the debtor's ability to protect or remove collateral from the secured creditor's reach."

The third inquiry described in Duggan is whether the transaction improves, or at least does not decrease the debtor's potential to provide adequate protection. Ralsu, Inc. is an "asset-culled entity." Admittedly, Borcherds did not transfer all of her personal assets to the corporation. In this case, however, such "asset culling" does not establish a bad faith motive in the transfer. In Beach Club v. Myers (In re Beach Club), 22 Bankr. 597 (Bankr. N.D. Cal. 1982), the bankruptcy court held that a transfer of part of the assets of an existing partnership to a newly formed partnership on the eve of filing a chapter 11 bankruptcy did not justify the finding of bad faith under the circumstances of the case. There was an equity cushion in the property transferred to the debtor and the transferee was still fully liable after the transfer. Although the property which was the subject of the foreclosure is apparently over secured, leaving no equity cushion, Borcherds transferred other related properties to the corporation and she remains personally liable for any debts for which she was liable prior to the

transfer.[3] The court could have found, on the evidence before it, that the transfer did not decrease the debtor's potential to provide adequate protection.

The fourth factor, already discussed to some degree above, is whether the transfer was motivated by a desire to avoid submitting the actual entities in interest to the jurisdiction of the court (e.g. whether the entity was "asset-culled"). It is apparent that Suzanne Borcherds did not transfer all of her personal assets to Ralsu; only those related to the subdivision were transferred. This factor is not determinative, however. Lots other than those which were secured by the bank's trust deed were also transferred to the corporation. Further, Suzanne Borcherds remained personally liable for all of the debts for which she was liable prior to the transfer. This factor's primary use is in identifying those transfers where an encumbered property is transferred as the sole asset of a new entity in an attempt to shield prior owners from liablility. The transfer here did not accomplish such a purpose and the bankruptcy court found that the primary motivation for the transfer was for purposes other than shielding personal assets. Memorandum Opinion at 4-5.

The final factor is whether the petition was filed solely for the purpose of thwarting and frustrating secured creditors,

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3 The Bank acknowledged that Suzanne Borcherds remains personally liable for such debts in its Memorandum Supporting its motion before the bankruptcy court. See Memorandum in Support of Motion to Dismiss or, in the Alternative, for Relief From the Automatic Stay at 13 (Oct. 29, 1985).

amounting to malicious, frivolous, or unwarranted delay. The bankruptcy court found that the filing of the petition was not just to delay or hinder the secured creditors. Memorandum Opinion at 4. The court finds that this determination is not clearly erroneous. The record does reveal motives in the filing of the petition other than to delay creditors. Of course, the circumstances strongly suggest, and the testimony of Suzanne Borcherd's husband confirms, that one purpose for Ralsu filing the bankruptcy on the date it did was to prevent the foreclosure by the Bank. See Transcript of Hearing at 105-06. The Bank argues that such a purpose is improper and must lead to a conclusion that the bankruptcy was filed in bad faith. A major purpose of bankruptcy law is to prevent further action by creditors against a debtor's estate pending the confirmation of a plan. This is the only purpose served by the automatic imposition of the stay. An intent to stop a foreclosure action, without more, is insufficient to support a finding of bad faith:

> Neither can this court condemn the filing of this petition on the ground that it presumably was filed to forestall the Bank's foreclosure action. The preeminent purpose of chapter 11 is to give a debtor an extension of time to restructure debts. Thus, in the absence of any circumstances indicative of bad faith, I find no basis in the Code to dismiss this petition on this ground.

In re Levinsky, 23 Bankr. 210, 221 (Bankr. E.D.N.Y. 1982). See also In re Nickerson, 40 Bankr. 693, 695 (Bankr. N.D. Tex. 1984). The court finds that the filing was not done to affect a "malicious, frivolous or unwarranted delay" on the Bank. To the extent the debtor desired to prevent the foreclosure from going

forward, this motive, when examined together with the other facts of the case was not improper.

B. Relief Based on Lack of Adequate Protection

This court will not overturn the bankruptcy court's finding that the creditor was adequately protected unless it was "clearly erroneous." See Martin v. United States (In re Martin), 761 F.2d 472, 474 (8th Cir. 1985); Chrysler Credit Corp. v. Ruggiere (In re George Ruggiere Chrysler Plymouth, Inc.), 727 F.2d 1017 (11th Cir. 1984). But cf. Philadelphia Consumer Discount Co. v. Commercial Credit Business Loans, Inc. (In re Philadelphia Consumer Discount Co.), 37 Bankr. 946, 949 (E.D. Pa. 1984) (holding that the sufficiency of protection is a matter of law).

1. Adequate Protection Under § 362(d)(1). The Bank argues that it should be granted relief from the automatic stay because the debtor has not adequately protected the bank's security interest as required under 11 U.S.C. § 362(d)(1). That section provides:

> (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--
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> (1) for cause, including the lack of adequate protection of an interest in property of such party in interest . . .

This subsection allows the court to grant relief from the automatic stay for "cause." "Cause" under this section, as under section 1112(b), has commonly been interpreted to include filing in bad faith. The bankruptcy judge held that a finding of good faith under § 1112(b) made it unnecessary to redetermine the good

faith issue under § 362. This court agrees that a finding of good faith applies equally under both sections.

The bankruptcy judge, however, seemed to suggest that good faith was the only "cause" under section 362(d)(1): "The court having determined that the debtor's Chapter 11 petition was filed in good faith, the Bank is not entitled to relief from the stay for "cause" under § 362(d)(1)." Memorandum Opinion at 6. The court failed to address a second potential "cause" for relief: the lack of adequate protection.

On appeal, the Bank argues that it should be granted relief from the automatic stay because the debtor failed to sustain its burden of proving that the Bank was adequately protected. See § 362(g). The Bank points out that the bankruptcy court determined that Ralsu has no equity in the property and that interest is accruing on the debt at a rate of $123.00 per day. Ralsu responds that since the Bank is undersecured on the property in question "there is nothing to adequately protect." Appellee's Brief at 13. The court is unable to agree with either parties' position on this issue.

The evidence before the bankruptcy court clearly established that Ralsu has no equity in the five lots and that the Bank is undersecured in its security interest in the five lots. See Memorandum Opinion at 3, 7 (on day of filing amount owed the Bank on the five lots was stipulated to be $283,055.88 and the value of the lots was found by the court to be $145,000). The court finds that the undersecured position of the Bank neither

conclusively establishes that Bank is not adequately protected nor establishes that "there is nothing to adequately protect." Adequate protection is not defined in the Code. Judge Mabey defined it as "interim protection, designed not as a purgative of all creditor ailments, but as a palliative of the worst: re-organization, dismissal, or liquidation will provide the final relief." Bankers Life Insurance Co. v. Alyucan Interstate Corp. (In re Alyucan Interstate Corp.), 12 Bankr. 803, 806 (Bankr. D. Utah 1981). Relief from the automatic stay must be viewed as an extreme remedy; the grant of such relief in a case like this may frustrate the aims of the reorganization and render the debtor incapable of proposing a workable plan.

On the other hand, the interest of the debtor in effectuating a successful reorganization cannot come at the expense of a creditor holding a security interest in property. Clearly, the court must balance the interests: the creditor's security interest must be protected while the debtor is given the full opportunity possible to propose a workable plan of reorganization. In this case the balancing is a very delicate process. The creditor is already undersecured and wants assurance that its interest is not further diminished. The debtor argues that successful reorganization is dependent upon being able to improve the subdivision as an entire unit. If five of the lots are lost to foreclosure by the bank, Ralsu may be unable to further develop the subdivision as a unit and reorganization may arguably no longer be feasible.

The first issue that must be determined is what interest of the creditor must be protected. When a creditor is undersecured, the Code provides that the creditor's claim be divided into two parts, the secured claim, equal to the value of the collateral, and the unsecured claim, equal to the remainder of the debt. 11 U.S.C. § 506(a). The House Report describes this approach:

> [T]he bill makes clear that an undersecured creditor is to be treated as having a secured claim to the extent of the value of the collateral and an unsecured claim for the balance of his claim against the debtor. The new treatment of secured claims, especially bifurcation of the claims into secured and unsecured claims, has important protective consequences for both creditors and the debtor. For the creditor, the bill requires that <u>once the secured claim is determined</u>, the court must <u>insure that the holder of the claim is</u> adequately protected. The creditor is entitled to realize his claim, and not have his collateral eroded by delay or by use by the estate.

H.R. Rep. No. 595, 95th Cong., 1st Sess. 180-81 (1977), <u>reprinted in</u> 1978 U.S. Cong. & Ad. News 5787, 6141 (emphasis added). <u>See also</u> <u>id</u>. at 338, 356, 1978 U.S. Code Cong. & Admin. News at 6312. As the legislative history points out, the creditor is entitled to adequate protection only on that portion of its interest which comprises its secured claim. <u>See also</u> <u>United Savings Assoc. v. Timbers of Inwood Forest Assoc.</u> (<u>In re Timbers of Inwood Forest Assoc.</u>), 793 F.2d 1380, 1382, 1387-89, 1390 n.14 (5th Cir. 1986) (exhaustive opinion on adequate protection for an undersecured creditor which concluded that adequate protection provisions were "intended to protect a secured creditor against a decrease in the value of its collateral due to the debtor's use, sale or lease of that collateral during the stay" and "does not require periodic

postpetition interest payments to an undersecured creditor to compensate it for the delay . . ." id. at 1389, 1416); First National Bank v. Dahlquist (In re Dahlquist), 34 Bankr. 476, 480 (Bankr. D.S.D. 1983) ("Unsecured and undersecured debts do not merit adequate protection because there is no collateral or value securing those debts"). In this case, the bankruptcy court found the value of the five lots to be $145,000, an amount determined by the Bank's own expert witness. Memorandum Opinion at 3. The parties stipulated that the amount due and owing the Bank on the day of filing was $283,055.88. The Bank, therefore, can seek relief under 362(d)(1) only to the extent that the $145,000 secured portion of its claim is not adequately protected.

In order to determine whether the secured portion of the Bank's claim is adequately protected, several additional issues must be discussed. First, some courts have held that the "opportunity cost" or the time value of money is compensable as part of adequate protection. These courts have required cash payments, replacement liens, or other methods of adequate protection to compensate the creditor for lack of access to the collateral for the period of time foreclosure is forestalled due to the automatic stay. Other courts have found that such "costs" should not be considered in determining the existence or lack of adequate protection. Upon reviewing both lines of cases, this court is of the opinion that the better reasoned authority establishes that what is being preserved is the status quo, and that the creditor is entitled to protection against any

depreciation or diminution in the value of the collateral as it existed and was available to satisfy the debt on the date of the filing of the petition for relief, until such time as a plan of reorganization is confirmed. This approach is very ably set forth by Judge Mabey in General Elec. Mortgage Co. v. South Village, Inc. (In re South Village, Inc.), 25 Bankr. 987 (Bankr. D. Utah 1982). See also United Savings Assoc. v. Timbers of Inwood Forest Assoc. (In re Timbers of Inwood Forest Assoc.), 793 F.2d 1380 (5th Cir. 1986); In re Sun Valley Ranches, Inc., 38 Bankr. 595, 597-98 (Bankr. D. Idaho 1984) ("the fact that [the creditor] is stayed from immediate foreclosure is not compensable unless that restraint somehow causes the property to decrease in value" id. at 598); Barclays Bank v. Saypol (In re Saypol), 31 Bankr. 796, 799-802 (Bankr. S.D.N.Y. 1983) ("adequate protection centers on protection of a secured creditor from suffering a decline in the value of the collateral during the bankruptcy proceeding" id. at 800).

A separate but related issue that must be considered by the court is whether adequate protection is dependent upon the existence of an "equity cushion." Simply stated, "the equity cushion is the difference between outstanding debt and the value of the property against which the creditor desires to act. Where the difference is substantial, a cushion is said to exist, adequately protecting the creditor. As interest accrues, or depreciation advances, and the margin declines, the cushion weakens and the stay may be lifted." Bankers Life Insurance Co.

v. Alyucan Interstate Corp. (In re Alyucan Interstate Corp.), 12 Bankr. 803, 809-10 (Bankr. D. Utah 1981) (J. Mabey) (critically discussing the "equity cushion" concept). Courts using an equity cushion approach have suggested that a cushion of fifteen, twenty, or even fifty percent might be required. See cases cited in Alyucan, 12 Bankr. at 810 n.14. Under an equity cushion approach, an undersecured creditor would always be entitled to relief from the automatic stay since by definition there would be no equity cushion in the collateral. A growing number of cases have held that the equity cushion is an improper, mechanical approach to determining adequate protection. This court agrees with these cases that the equity cushion approach is not an appropriate standard. The court particularly concurs with the scholarly analysis set forth by Judge Mabey in Alyucan, 12 Bankr. at 809-13.[4] The court in Alyucan identifies facts similar to

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4 Judge Mabey rejected the cushion analysis upon four grounds:

> (1) It is inconsistent with the purpose of adequate protection. (2) It is inconsistent with the illustrations of adequate protection found in Section 361. (3) It is inconsistent with the statutory scheme of Section 362(d). (4) It has no basis in the historical development of relief from stay proceedings.

Alyucan, 12 Bankr. at 810. In the context of this case, the court is particularly in agreement with Alyucan's third point: the equity cushion requirement is inconsistent with the statutory scheme of 362(d). The Bank sought relief under both §§ 362(d)(1) and (d)(2). Under (d)(2), the absence of equity is not enough to warrant relief from the stay. The court must make a further showing that the property is unneccessary to an effective reorganization, a showing that would be difficult to make in this case. See In re Sunstone Ridge Associates, 51 Bankr. 560 (D. Utah 1985) (Winder, J.) (no relief can be granted under (d)(2) if the property is "necessary" to a reorganization). Judge Mabey describes the inconsistency created between a cushion analysis standard

the facts involved in this case as representative of the improper result that occurs under a cushion analysis:

> The cushion analysis . . . obscures the purpose of adequate protection, viz., to guard against impairment of a lien. This blurring of objectives may produce improper results. If [the creditor] had been undersecured at the petition, for example, the absence of cushion would have dictated relief from the stay, even though the stay did not impair its lien and notwithstanding the usual appreciation in the value of realty.

Id. at 810. In the case before this court, there is no evidence that the lots are in danger of further depreciation. Evidence was presented that the proposed plan would cause a drastic appreciation in the value of the five lots held as security by the bank. Clearly, if depreciable assets were involved, the court's analysis would be different. For instance, a security interest in a car or a machine would clearly warrant further protection if the bank's interest equalled or exceeded the value. An interest in a depletable resource such as timber or minerals would also require careful supervision by the court. Here the value of unimproved (or partially improved) real estate is involved. The court will not assume, absent some evidence, that

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under (d)(1) and the provisions of (d)(2):

> [T]he absence of equity is not alone dispositive [under (d)(2)]--the court must still weigh the necessity of the property to an effective reorganization. The cushion analysis is inconsistent with this judgment. It makes surplusage out of Section 362(d)(2) which speaks in terms of equity and reorganization. Indeed, this dual requirement emphasizes the role of equity, when present, not as a cushion, but to underwrite, through sale or credit, the rehabilitation of debtors.

Alyucan, 12 Bankr. at 811 (emphasis in original) (footnote omitted).

the property will further depreciate in value as a result of the time delay caused by the filing of the debtor's petition. The debtor has refuted any claim that its activities will somehow impair the value of the lots; its own self-interest in installing improvements in the subdivision as a whole will protect the Bank in its interest in the five lots it holds as security.

In conclusion, although the bankruptcy judge did not specifically rule on the issue of adequate protection under 362(d)(1), this court finds that the Bank is adequately protected to the extent of the value of the five lots at the time the bankruptcy petition was filed. Of course, a renewed claim for relief from the stay can be made if the Bank is later able to show a change in circumstances that threatens its interest.

2. Relief From the Stay Under Subsection 362(d)(2). Section 362(d)(2) provides that relief from the automatic stay should be granted as to a particular property if:

> (A) the debtor does not have an equity in such property; and
> (B) such property is not necessary to an effective reorganization.

The bankruptcy court found that the debtor did lack equity in the five lots securing the bank's interest. It held, however, that the lots were "necessary to an effective reorganization" under the narrow "necessity" test set forth in In re Sunstone Ridge Assoc., 51 Bankr. 560 (D. Utah 1985) (Winder, J.). Since the conditions of subpart (B) were not satisfied, the judge held that relief could not be granted under 362(d)(2). The appellant argues that the property cannot be "necessary" to an effective

reorganization of Ralsu because the transfer of the property to Ralsu was void; thus the property is not even part of the debtor's estate. The Bank's argument begs the question. Clearly, if Ralsu, Inc. obtained the property by fraud, then the property is not properly part of the bankrupt's estate.[5] Subpart (B) of § 362(d)(2), however, is concerned only with necessity. Judge Winder's opinion in Sunstone Ridge describes the "narrow" focus of the necessity test. Id., 51 Bankr. at 562. Whether or not Ralsu holds an equitable interest in the five lots, the lots are arguably "necessary to an effective reorganization" in the sense that without them a reorganization may not be possible. The appellant does not argue that a reorganization is possible without the five lots and this court upholds the bankruptcy court's determination that the lots are necessary for an effective reorganization. Memorandum Opinion at 7. Consequently, the court affirms the bankruptcy court's denial of a relief from the automatic stay under § 362(d)(2).

C. Transfer to Ralsu as a Fraudulent Conveyance

Although the court finds that whether the lots were fraudulently conveyed is irrelevant to the issue of necessity under § 362(d), the court acknowledges that the issue is very relevant in a different context. The appellant argues that the conveyance of the five lots to Ralsu was a fraudulent conveyance under Utah law thus rendering the transfer void. Section 541 of the Bankruptcy Code defines the property of the estate as

5 See section C, infra on fraudulent conveyances for a detailed discussion of this issue.

including all "legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1) (1979).[6] Property that has been obtained through fraud is not a part of the estate. The Eighth Circuit summarized the status of such property as follows:

> [A] Trustee in Bankruptcy can have no interest in property acquired by the fraud of a bankrupt, or anyone else, as against the claim of the rightful owner of such property.

Nicklaus v. Bank of Russellville, 336 F.2d 144, 146 (8th Cir. 1964), quoted with approval in Lambert v. Flight Trans. Corp. (In re Flight Trans. Corp), 730 F.2d 1128, 1136 (8th Cir. 1984), cert. denied, 105 S. Ct. 1169 (1985). See also Heyman v. Kemp (In re Teletronics, Ltd.), 649 F.2d 1236, 1239 (7th Cir. 1981); In re Independent Clearing House, 41 Bankr. 985, 998-1004 (Bankr. D. Utah 1984) (pending on appeal to the district court on other issues). If the transfer of the five lots to Ralsu was in fact a fraudulent transfer, the lots would no more be a part of the estate than if they had been obtained through a scheme to defraud investors. The issue is whether Ralsu holds any cognizable interest in the transferred property. Upon review of the bankruptcy court's decision, the record on appeal and the arguments of counsel, the court is of the opinion that bankruptcy court did not commit reversible error in determining that the transfer was not a fraudulent conveyance in violation of Utah Code Ann. § 25-1-8 (1984). The critical argument supporting the

6 A few exceptions exist under section 541 which are not relevant to our analysis.

Bank's claim is that the Bank was "hindered or delayed" by the transfer. _See_ Brief of Appellant at 9, 11, 12. The bankruptcy judge rejected this argument, finding that "the formation of the corporation and transfer of the property to it does not materially hinder or delay the creditors nor shelter assets from them." Memorandum Opinion at 5.

As discussed under the the good faith section, the formation of the corporation was not necessary to file a chapter 11 petition. To the extent that the creditor was hindered or delayed in its recourse to its collateral, the delay can be attributed to the filing of the bankruptcy petition, not the formation of the corporation.

The appellant relies on _Shapiro v. Wilgus_, 287 U.S. 348 (1932), to support its argument that the transfer from Borcherds to Ralsu was a fraudulent conveyance. The two cases, although sharing some similarities, are fundamentally different. In _Shapiro_, the debtor wanted more time to work things out with his creditors. Under the applicable law, a business conducted by an individual was not entitled to the appointment of a receiver but a corporation was so entitled. The debtor created the corporation, transferred his property to the corporation and went into receivership. The Supreme Court, finding that a fraudulent conveyance had taken place, stated: "The sole purpose of the conveyance was to divest the debtor of his title and put it in such a form and place that levies would be averted. . . . _The design would have been ineffective if the debtor had been_

suffered to keep the business for himself." Id. at 353, 355 (emphasis added). As the Court pointed out, the debtor, as an individual, was not entitled to protect his assets from creditors through the use of a receivership. The transfer of his assets was the means by which he accomplished an impermissible end resulting in a fraud upon creditors. In contrast, in this case there has been no showing of an impermissible end. As previously described, Borcherds, as an individual, was eligible to file a chapter 11 petition.[7] The bankruptcy court found, and this

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[7] Courts have acknowledged that, for purposes of determining the good faith of a petition filed in bankruptcy by a newly created debtor, there is a difference between a transfer from an ineligible entity to an eligible entity and a transfer between equally eligible entities. Where the transferor could have filed the petition, courts have looked to other factors to determine whether the filing was in good faith. See, e.g., Chattanooga Federal Savings and Loan v. Northwest Recreational Activities, Inc. (In re Northwest Recreational Activities, Inc.), 4 Bankr. 36, 40 (Bankr. N.D. Ga. 1980); Myers v. Beach Club (In re Beach Club), 22 Bankr. 597, 600 (Bankr. N.D. Cal. 1982); In re Tolco, 6 Bankr. 482, 487 (Bankr. E.D. Va. 1980). If, however, the transferor is ineligible for the type of relief sought by the transferee, courts have found the transfer and subsequent filing to be in bad faith. See, e.g., In re Metropolitan Realty Corp, 433 F.2d 676 (5th Cir. 1970), cert. denied, 401 U.S. 1008 (1971); Polkin v. Lotus Investments, Inc. (In re Lotus Investments, Inc.), 16 Bankr. 592 (Bankr. S.D. Fla. 1981); In re G-2 Realty Trust, 6 Bankr. 549 (Bankr. D. Mass. 1980). In Metropolitan Realty, the court stated:

> In considering the presence or absence of good faith, it must be borne in mind that the Act is not to be abused by the extension of its privileges to those not within the contemplation of it, such as where individual debtors convey their property to a corporation for the purpose of utilizing Chapter X proceedings.

Metropolitan Realty, 433 F.2d at 678 (quoting Mongiello Coal Corp. v. Houghtaling Properties, Inc., 309 F.2d 925, 929 (5th Cir. 1962) (discussing good faith under the former Bankruptcy Act). Under chapter 11, corporations and individuals have equal standing to file a voluntary petition.

court has affirmed, that the debtor was entitled to file a chapter 11 petition and that the petition should not be dismissed. If the appellant had been able to demonstrate that the filing of the bankruptcy petition was itself somehow fraudulent or improper, it might be able to argue that the related transfer of assets was an integral part of the larger fraud or impropriety. That is not the case, however. There has been no showing that the transfer altered the Bank's rights or that the transfer was tainted by a subsequent improper filing.

In summary, the Bank has failed to establish the existence of a fraudulent transfer for the following reasons: (1) There was no showing that the creditor's rights were impaired or changed as a result of the transfer. (2) The filing of the bankruptcy was not dependent upon the creation of the corporation. Even if the testimony had established that the filing of the bankruptcy petition was done with the intent to delay or hinder the creditor (the bankruptcy court found that this was not the case), it does not follow that the transfer of the assets to the corporation was done with the same purpose. Improper motives attributed to the filing of the bankruptcy, even if they could be established, cannot be imputed to the transfer of assets since the transfer of assets in no way aided Borcherds in filing the bankruptcy. (3) The bankruptcy court concluded, upon review of the evidence and testimony of the witnesses, that Borcherds created the corporation (and transferred assets into it) for purposes other than to hinder and delay the secured creditor.

D. <u>Expiration of the Automatic Stay</u>

The appellant argues that the automatic stay expired under the express terms of the bankruptcy provisions of chapter 11 because a final order was not entered within 30 days of the commencement of a final hearing on the request for relief from the automatic stay.

Section 362(e) provides that the stay is terminated thirty days after the relief from the stay is requested unless a preliminary hearing is held in which the judge orders the stay continued or unless the preliminary hearing is consolidated with the final hearing. Once the final hearing is held, Rule 4001(b) provides:

> The stay of any act against property of the estate under § 362(a) of the Code expires 30 days after a final hearing is commenced pursuant to § 362(e)(2) unless within that time the court denies the motion for relief from the stay.

The legislative history of subsection § 362(e) compares the stages of the automatic stay to the more familiar stages of an injunction:

> Because the stay is essentially an injunction, the three stages of the stay may be analogized to the three stages of an injunction. The filing of the petition which gives rise to the automatic stay is similar to a temporary restraining order. The preliminary hearing is similar to the hearing on a preliminary injunction, and the final hearing and order is similar to a permanent injunction. The main difference lies in which party must bring the issue before the court.

H.R. Rep. No. 595, 95th Cong., 1st Sess. 344, <u>reprinted in</u> 1978 U.S. Code Cong. & Ad. News 5787, 6300. The Motion to Dismiss or in the Alternative for Relief from the Automatic Stay was filed

by the Bank on September 23, 1985. The Bank sent notice to Ralsu on September 25, 1985, notifying it of a hearing scheduled for October 30. The hearing took place on October 30 and 31, thirty-eight days after the motion was filed and 36 days after notice was sent. At the conclusion of the hearing, the judge took the matter under advisement and stated that "we will render a formal ruling within the next week, I hope." Transcript of Hearing on Motion to Dismiss or for Relief from Stay, at 283 (Oct. 31, 1985). For reasons not set forth in the record, the order denying the bank's motion was not entered until December 18, 1985, forty-nine days after the hearing was held on the matter.[8] Although the hearing was set on a date beyond the thirty days granted under § 362(e), the appellant does not raise this as an issue on appeal.[9] It does, however, argue that the

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8 Considerable administrative delay was apparently involved in the matter. The Order and accompanying Memorandum Opinion were both signed on December 6 and filed with the clerk on December 9 but the order was not "entered" until December 18, nearly two weeks after it was initially signed by the judge.

9 The appellant stated the issue as follows:

> Did the automatic stay imposed by 11 U.S.C. § 362(a) expire by operation of law pursuant to 11 U.S.C § 362(e) based upon the failure of the bankruptcy court to enter a final determination on the Motion for Relief from Stay within 30 days following the conclusion of the hearing on the Motion?

The appellee's argument considers both the time lapse before the hearing and the time lapse following the hearing prior to the issuance of the order. It appears that an argument by the creditor on the time period between filing and the hearing would be without merit. In this case, two days after filing its motion, the bank sent notice to the debtor of the hearing set for October 30, 1985, a date outside of the 30-day limit. This court concurs with other courts who have held that a creditor who fails to schedule a hearing within

time lapse in excess of thirty days between the hearing and the issuance of the order resulted in an automatic lifting of the stay which rendered the subsequent order moot.

A number of courts have faced difficulties arising from noncompliance with the 30 day requirement set forth under § 362(e) (the time between filing the request and the initial hearing) and under Rule 4001(b) (time between final hearing and order). The majority of these cases have found that the court can invoke its equitable powers under § 105 to reinstate the stay even if it was terminated under the express provisions of § 362(e) or Rule 4001(b).[10] See In re Rolanco 43 Bankr. 150, 152 (Bankr. E.D. Mo. 1984). See also John Deere Co. v. Kozak Farms, Inc. (In re Kozak Farms, Inc.), 47 Bankr. 399, 402-03 (W.D. Mo. 1985); Barclay Properties v. Small (In re Small), 38 Bankr. 143, 147-48 (Bankr. D. Md. 1984). Judge Clark in In re Meadow, 51 Bankr. 816, 821 (Bankr. D. Utah 1985), provides a comprehensive citation to numerous decisions which hold that the court has power under § 105 of the Code to reinstate the automatic stay following its expiration. This court concurs with the clear

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the 30-day period may impliedly waive its right to automatic termination under Section 362(e). See In re McNeely, 51 Bankr. 816, 821 (Bankr. D. Utah 1985); Barclay Properties v. Small (In re Small), 38 Bankr. 143 (Bankr. D. Md. 1984); Iseberg v. Exchange National Bank (In re Wilmette Partners), 34 Bankr. 958 (Bankr. N.D. Ill. 1983); Agristor Credit Corp. v. Fairchild (In re Fairchild), 30 Bankr. 630, 632 (Bankr. S.D. Ohio 1983).

10 Subsection 105(a) states:

> The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.

weight of authority supporting the court's power to reinstate the automatic stay.

The bankruptcy court's order was not worded as an order to reinstate but rather as an order denying the creditor's motion for relief from the stay. The effect, however, is the same. As the legislative history points out, the enjoined creditor must move for relief from the stay. A final order denying such relief is, in essence, an order imposing a permanent injunction. Whether the court realized in issuing the order that the stay had technically expired under the terms of Rule 4001(b) is irrelevant. The court's clear intent was to impose a stay on the creditor and that result will not be disturbed by this court.

In In re Rolanco, Inc. 43 Bankr. 150 (Bankr. E.D. Mo. 1984), a creditor filed a motion to modify the automatic stay on August 29, 1983. The hearing was scheduled for September 19 but at the request of both parties was continued to October 28, 1983. No final decision was issued by the court following the hearing. The creditor argued that since the bankruptcy court did not deny the motion for relief from the stay within 30 days after the hearing, the stay provisions of § 362 automatically expired. In an opinion issued on May 15, 1984, nearly six months after the hearing, the court found that although the stay had expired under the terms of § 362(e), the court had power to reinstate the stay. The court's discussion of the circumstances in Rolanco are particularly relevant and instructive to this case:

> If this Court had granted the movant's motion for relief from the stay within 30 days after the final hearing, the debtor would have had the right to appeal

> the merits of that decision. However, as previously stated, through no fault of the movant or debtor in possession, such a decision was not rendered within the prescribed time frame. The movant urges this Court to terminate the automatic stay based solely on the provisions of 11 U.S.C. § 362 and Bankruptcy Rule 4001(b). In the instant case, such an order would be patently inequitable since it would penalize the debtor in possession through no fault of its own, it would not take into consideration the merits of the issue and would effectively deny the debtor its right of appeal.

Id. at 152. In this case, the result would be equally or more inequitable. The 30-day period was missed by a matter of days. Unlike Rolanco, a final order was issued in this case. After the expiration of the 30 days but before the order was issued, the Bank took no action to foreclose its interest or move the court to grant it relief under § 362(e) and Rule 4001(b). Further, the Bank combined its motion for relief from the automatic stay with a motion to dismiss which it based on claims of fraudulent transfer and bad faith. The final order, therefore, had to deal with a number of issues beyond merely granting or denying relief from the stay. It could be expected to take longer. Some courts have held that such alternative pleading can result in an implicit waiver by the filing party of the time limitations under § 362(e). See, e.g., Barclay Properties, Inc. v. Small (In re Small), 38 Bankr. 143, 147 (Bankr. D. Md. 1984). The bankruptcy judge issuing the order was a visiting judge with a heavy work load. It would be patently inequitable to penalize the debtor and deny it the benefits of the stay because the court was two weeks late in issuing its opinion. A party has much less control over the amount of time the court takes to issue an opinion than

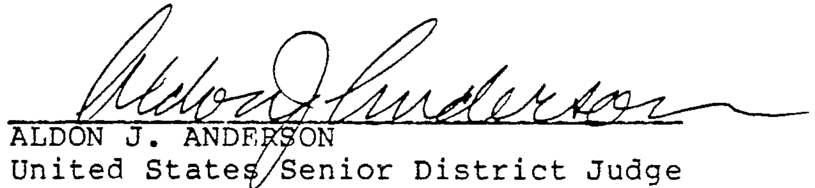
the time scheduled by the court for a hearing.

In this case the preliminary and final hearings were consolidated. Under the provisions of the bankruptcy code the stay automatically terminated on November 29, 1985. The judge signed the order on December 6, 1985 and it was finally entered on December 18, 1985. Although the stay had terminated by December 18, the judge had equitable power to reinstate the stay under 11 U.S.C. § 105. The equitable powers of § 105 need not be referred to specifically to be invoked. To the extent that the automatic stay had terminated in this case, the bankruptcy judge's order and accompanying memorandum opinion are viewed by this court as an exercise of his equitable powers under § 105 to reinstate the stay. The close comparison in the legislative history to the stages of an injunction further supports this approach. Because of the impact on the creditor, the stay imposed by the filing of the case is similar to a TRO or preliminary injunction that must necessarily be limited in time. Once that time lapses, the stay is lifted from the creditor and he is free to proceed against his collateral. An inadvertent lapse should not impair the court's right to subsequently reinstate the stay in more permanent form. The Bank in this case chose not to take any action on its own or through motion to the court during the period when the initial stay had lapsed. The final order stands in the place of a permanent injunction and served, in this case, to reinstate the stay. It matters not that the power to issue this order is found in § 105 rather than § 362.

IV. CONCLUSION

The court affirms the bankruptcy court's findings that there was no fraudulent transfer, that the petition was not filed in bad faith, and that there was no cause for relief for lack of adequate protection. Further, the court finds that the bankruptcy judge's order served to reinstate the stay. The order of the bankruptcy court is, therefore, AFFIRMED.

DATED this 30 day of September 1986.



ALDON J. ANDERSON
United States Senior District Judge

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