FILED
U.S. Bankruptcy Appellate Panel
of the Tenth Circuit
March 12, 2014
Blaine F. Bates
Clerk

NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY APPELLATE PANEL

OF THE TENTH CIRCUIT

IN RE BLUEJAY PROPERTIES, LLC, doing business as Quinton Point, Debtor.	BAP No. KS-12-105
BANKERS' BANK OF KANSAS, NA, Appellant, v. BLUEJAY PROPERTIES, LLC, STUMBO HANSON, LLP, UNIVERSITY NATIONAL BANK, UNITED STATES TRUSTEE, KAW VALLEY BANK, JOHN LARKIN, LARKIN EXCAVATING, INC., and TICC PROPERTY MANAGEMENT, LLC, Appellees.	Bankr. No. 12-22680 Chapter 11 OPINION*

Appeal from the United States Bankruptcy Court
for the District of Kansas

Before MICHAEL, JACOBVITZ, and MARKER[1], Bankruptcy Judges.

MICHAEL, Bankruptcy Judge.

This appeal poses the question of how much protection a secured creditor needs in order for its claim in bankruptcy to be "adequately" protected? We

* This unpublished opinion may be cited for its persuasive value, but is not precedential, except under the doctrines of law of the case, claim preclusion, and issue preclusion. 10th Cir. BAP L.R. 8018-6.

[1] Honorable Joel T. Marker, United States Bankruptcy Judge, United States Bankruptcy Court for the District of Utah, sitting by designation.

conclude that where the value of the secured property exceeds the creditor's claim by a reasonable margin and is unlikely to decrease in value, then the claim is adequately protected, regardless of the number or types of security the creditor holds.

I. BACKGROUND

The facts are not subject to any significant dispute between the parties. Bluejay Properties LLC ("Debtor") is a single asset real estate debtor that owns a 192-unit apartment complex in Junction City, Kansas called Quinton Point (the "Property"). Debtor built the Property in 2009 with a $15 million construction loan from University National Bank ("UNB"). UNB's interest was partially paid down by other security UNB held and was then assigned to appellant Bankers' Bank of Kansas ("Bank"). UNB continues to hold a second mortgage on the Property. Bank's promissory note ("Note") is secured by both a first position mortgage and an assignment of Property rents.

Debtor filed a Chapter 11 bankruptcy petition on September 28, 2012. Since that filing, the Property's value has always exceeded Bank's total claim.[2] In addition to Bank's and UNB's mortgages, the Property is subject to an equitable mortgage and/or constructive trust claim by Kaw Valley Bank ("Kaw"). Kaw filed a state court lawsuit against UNB, claiming that UNB engaged in wrongful conduct in connection with the loan to Debtor and, pursuant to a constructive trust theory, its conduct invalidated the UNB/Bank loan transaction and security interest, leaving Kaw as the only security holder on the Property. The state court action was removed to the bankruptcy court as an adversary proceeding, in which Kaw will need to provide significant evidence of fraud or

[2] At the evidentiary hearing in the bankruptcy court, Debtor put on evidence that the Property was worth $16,945,000, and generated slightly more than $2 million in rental income per year (or approximately $167,000 per month). Bank's claim is slightly less than $14 million.

other serious misconduct in order to prevail.

Shortly after the petition was filed, Debtor filed a motion before the bankruptcy court seeking authorization to use Property rents pursuant to a proposed budget. Bank objected to that motion, in part. Bank did not object to use of its cash collateral for payment of Property operating expenses (under a court-approved budget), but did object to use of rents for payment of Debtor's legal expenses and management fees to Debtor's majority owner. An evidentiary hearing was held on Debtor's motion to use cash collateral. Following that hearing, the bankruptcy court issued an order allowing Debtor to use Property rents pursuant to its proposed budget, and granting Bank a replacement lien in future rents. Additionally, Debtor was required to make single asset real estate payments to Bank, pursuant to 11 U.S.C. § 362(d)(3),[3] in the amount of contract interest on the loan (6.5%).[4]

II. APPELLATE JURISDICTION[5]

This Court has jurisdiction to hear timely filed appeals from "final judgments, orders, and decrees" of bankruptcy courts within the Tenth Circuit, unless one of the parties elects to have the district court hear the appeal.[6] The order granting Debtor's motion to use cash collateral was entered on November 28, 2012, and Bank filed its notice of appeal on December 4, 2012, which was

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[3] Unless otherwise indicated, all further statutory references in this decision will be to the Bankruptcy Code, which is Title 11 of the United States Code.

[4] The *default* interest rate in the parties' contract is 18%.

[5] After this appeal had been briefed and argued, this Court issued an Order to Show Cause why the appeal should not be dismissed as moot. Mootness was premised on an apparent settlement of this dispute by the parties. Both parties responded to the OSC. Having reviewed those responses, it is apparent that the settlement that formed the basis for the OSC did not occur. This appeal is therefore not moot and may proceed.

[6] 28 U.S.C. § 158(a)(1), (b)(1), and (c)(1); Fed. R. Bankr. P. 8002; 10th Cir. BAP L.R. 8001-3.

within 14 days of the bankruptcy court's order. Neither side elected to have the appeal heard by the district court. The parties have therefore consented to appellate review by this Court.

A decision is considered final "if it 'ends the litigation on the merits and leaves nothing for the court to do but execute the judgment.'"[7] Whether cash collateral orders are final orders for purposes of appeal has not been definitively addressed by the Tenth Circuit Court of Appeals.[8] Typically, cash collateral orders have been reviewed by appellate courts without any specific discussion of their finality.[9] Various courts have speculated in dicta that such orders are final,[10] and others that they are non-final.[11] Given the lack of any decision "holding" that cash collateral orders are non-final, coupled with the plethora of cases that have treated them as final (albeit without specific discussion of finality), this Court concludes that the bankruptcy court's cash collateral order is final and appropriate for this Court's review.

III. ISSUE AND STANDARD OF APPEAL

Bank asserts the bankruptcy court erred in authorizing Debtor's use of Property rents for services that do not directly benefit either Bank or the Property,

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[7] *Quackenbush v. Allstate Ins. Co.*, 517 U.S. 706, 712 (1996) (quoting *Catlin v. United States*, 324 U.S. 229, 233 (1945)).

[8] *But see In re O'Connor*, 808 F.2d 1393, 1395 n.1 (10th Cir. 1987) (stating that if "the bankruptcy court's order was final for the purpose of [] appeal to the district court, the district court's order is final for the purpose of appeal to this court").

[9] *See, e.g., In re Premier Golf Props., LP,* 477 B.R. 767 (9th Cir. BAP 2012); *In re Proalert, LLC*, 314 B.R. 436 (9th Cir. BAP 2004); *In re Buttermilk Towne Ctr., LLC*, 442 B.R. 558 (6th Cir. BAP 2010).

[10] *See, e.g., Jesuit High Sch. of New Orleans v. 150 Baronne St. Ltd. P'ship*, No. 97-3613, 1997 WL 749418 (E.D. La. Dec. 3, 1997) (suggesting that a ruling on a motion to use cash collateral would be final and appealable).

[11] *See, e.g., In re KAR Dev. Assocs., L.P.*, 180 B.R. 629, 632-33 (D. Kan. 1995) (suggesting that a cash collateral order, alone, may not be final).

and in not treating Bank's assignment of rents as a separate interest requiring adequate protection. Both parties agree that the standard of review in this appeal is *de novo*, which requires an independent determination of the issues, giving no special weight to the bankruptcy court's decision.[12] However, while the necessity of adequate protection is a legal issue subject to *de novo* review on appeal, a bankruptcy court's determination of the adequacy of such protection is a question of fact, which is reviewed only for clear error.[13] A factual finding is "clearly erroneous" when "'it is without factual support in the record, or if the appellate court, after reviewing all the evidence, is left with the definite and firm conviction that a mistake has been made.'"[14]

IV. DISCUSSION

Bank makes two principal assertions of error in this appeal.[15] First, Bank contends the cash collateral order fails to take into account that it has a separate security interest in rents. Second, Bank argues the cash collateral order allows Debtor to use Property rents to pay expenses that do not directly benefit the collateral.

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[12] *Salve Regina Coll. v. Russell*, 499 U.S. 225, 238 (1991).

[13] *In re O'Connor,* 808 F.2d at 1397.

[14] *Las Vegas Ice & Cold Storage Co. v. Far W. Bank*, 893 F.2d 1182, 1185 (10th Cir. 1990) (quoting *LeMaire ex rel. LeMaire v. United States*, 826 F.2d 949, 953 (10th Cir. 1987)).

[15] To the extent that Bank argues its interest in the Property is not adequately protected due to Kaw's claim, that argument is without merit. Kaw's claims are being litigated in a separate adversary proceeding and, if successful, would eliminate Bank's security interest entirely, along with any entitlement Bank may have to adequate protection. If unsuccessful, Kaw will have no lien interest on the Property. Moreover, the bankruptcy court treated Bank as the first priority creditor on the Property, and Kaw's interest is such that it will either become first in priority on the Property or will have no claim against the Property at all. Therefore, any interest Kaw may have is irrelevant to Bank's adequate protection. *See* Brief of Appellee Bluejay Properties, LLC at 4-5.

A. Bank's entitlement to adequate protection with respect to rents

"Adequate protection" is a key concept in various bankruptcy contexts. Initially, it arises in connection with relief from the automatic stay. In that respect, § 362(d)(1) provides that, upon the request of a party in interest, a bankruptcy court shall allow some kind of relief from the stay, "for cause, including the lack of adequate protection of an interest in property of such party." In addition, pursuant to § 362(d)(3), a creditor with a secured interest in "single asset real estate,"[16] is entitled to relief from the stay unless the debtor, within 90 days of entry of the order for relief, either files a plan with a "reasonable possibility" of confirmation, or commences monthly payments to the creditor in the amount of the applicable nondefault contract interest rate. Thus, § 362(d) mandates that a debtor provide adequate protection in order to retain the benefit of the automatic stay with respect to his property and, where that property is single asset real estate, adequate protection must include either a quickly confirmable plan or payment of interest to the secured creditor.

Adequate protection is also required in the context of the debtor's use of certain bankruptcy estate property during the pendency of the case. Pursuant to § 363(c)(1), a trustee, and therefore also a debtor in possession, is permitted to use, sell, or rent property of the estate, other than cash collateral, in the ordinary course of business without notice or a hearing. But § 363(c)(2) provides that use, sale, or lease of cash collateral (as defined in § 363(a)) requires either the consent of creditors with a secured interest in such collateral, or court approval. Further, upon request of a secured party, § 363(e) requires the court to prohibit or condition such use, sale, or lease of property "as is necessary to provide adequate protection" of the creditor's interest. As set forth in § 361, adequate protection

[16] This term is defined in § 101(51B) as "real property constituting a single property or project . . . which generates substantially all of the gross income of a debtor." The parties agree that the Property in this case is single asset real estate.

may be provided by making cash payments to a creditor, granting a creditor additional or replacement liens, or granting a creditor such other relief as will result in the realization of the indubitable equivalent of its interest in property.

In this case, when Debtor sought authorization to use the Property rents, the bankruptcy court included a provision in its cash collateral order directing Debtor to comply with § 362(d)(3) by filing a plan of reorganization within 90 days of the petition date or making interest payments to Bank. The bankruptcy court also granted Bank additional and replacement security interests and liens in all past and future post-petition cash collateral not used by Debtor. Those parts of the bankruptcy court's order have not been challenged by either party in this appeal.

The focus of this appeal is on the bankruptcy court's determination that Bank was adequately protected in that its claim was oversecured by the Property alone, and as a result, not entitled to any additional form of adequate protection. Bank argues that "adequate protection" is applicable to each type of security a creditor holds. We disagree and conclude that because the Bank's claim itself is determined to be adequately protected, it is not entitled to demand more.

Here, Bank's nearly $14 million claim is secured by the Property, which is worth approximately $17 million, and such value is either stable or increasing. The Property also produces approximately $2 million in gross rental proceeds per year. As such, Bank's claim on the petition date was not in danger of non-payment when the bankruptcy court allowed Debtor to use Property rents, since the Property alone is sufficient to pay Bank's claim in full, including interest and allowable costs. The fact that Bank also secured its claim with a separate lien on the Property's proceeds is irrelevant, as its total "claim" is adequately protected.

Bank, relying primarily on the *Stearns*[17] and *Putnal*[18] decisions from other jurisdictions, argues that it has adequate protection rights in rents that must be separately considered from the same rights it has in the Property. However, neither these cases, nor the others cited by Bank, actually support its assertion that each type of collateral that secures a debt must have separate adequate protection. Rather, those cases hold only that an ***undersecured*** creditor with a lien on rents may be entitled to adequate protection from the debtor's use of rents. Both *Stearns* and *Putnal* focused on whether a "replacement lien" in future rents adequately protected the undersecured creditor's interest, rather than whether a separate lien on rents is entitled to separate consideration of adequate protection.

Significantly, whether a creditor's interest in rents is separate from an interest in real property only matters when the creditor is undersecured and/or the property is declining in value. Bank does not cite any case holding that cash collateral cannot be used by a debtor when the debt it secures is already oversecured by other collateral, which is the situation in the present appeal. No matter how many security interests a creditor has in a debtor's property, only the amount of the debt and the creditor's position need be adequately protected. And if its debt is adequately protected by less than all of the creditor's security interests, the creditor is not entitled to insist that each type of collateral be maintained "as is" in order to provide adequate protection. Simply put, "adequate protection" does not require "identical protection." As stated by Judge Krieger:

> Because creditors are entitled to adequate protection only to the extent that the value of the property securing their claim diminishes, undersecured creditors are not entitled to adequate protection for lost opportunity costs. Oversecured creditors may not be entitled to cash payments or postpetition liens because they are

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[17] *Stearns Bldg. v. WHBCF Real Estate (In re Stearns Bldg.)*, No. 98-1257, 1998 WL 661071 (6th Cir. Sept. 3, 1998).

[18] *In re Putnal*, 483 B.R. 799 (Bankr. M.D. Ga. 2012), *aff'd*, 489 B.R. 285 (M.D. Ga. 2013).

adequately protected through the existence of a value cushion.[19]

Bank asserts that the bankruptcy court relied on the *Barkley*[20] and *Mullen*[21] cases to apply a minority position that rents need not be separately considered in determining adequate protection. In reality, those cases only considered whether a replacement lien in rents can provide adequate protection to an undersecured creditor. Since that is not the situation here, we need not address the merits of *Barkley* or *Mullen*.

Bank is not just oversecured by the Property; the bankruptcy court granted Bank a replacement lien in future Property rents and also ordered Debtor to comply with § 362(d)(3) by making contract interest payments to Bank. The argument that Bank is entitled to more than this, simply because its loan is secured by multiple types of collateral, is disingenuous and ignores the fact that § 552(b) is an ***exception*** to the general rule that property acquired post-petition is not subject to pre-petition liens. As explained by another court:

> Read together, the provisions of § 363(c)(2) and § 552(b) protect a creditor's collateral from being used by a debtor postpetition if the creditor's security interest extends to one of the categories set out in § 552(b). Put another way, a creditor is not entitled to the protections of § 363(c)(2) unless its security interest satisfies § 552(b). Section 552(b) balances the Code's interest in freeing the debtor of prepetition obligations with a secured creditor's rights to maintain a bargained-for interest in certain items of collateral. It provides a narrow exception to the general rule of 552(a).[22]

Thus, adequate protection is intended to protect against a decline in a creditor's security cushion, it is not intended to allow a creditor to improve the security

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[19] *In re Gallegos Research Grp. Corp.*, 193 B.R. 577, 584 (Bankr. D. Colo. 1995) (citation omitted).

[20] *In re Barkley 3A Investors, Ltd.*, 175 B.R. 755 (Bankr. D. Kan. 1994).

[21] *In re Mullen*, 172 B.R. 473 (Bankr. D. Mass. 1994).

[22] *In re Premier Golf Props., LP*, 477 B.R. 767, 772 (9th Cir. BAP 2012) (citations, internal quotation marks, and emphasis omitted).

cushion that it had at the time the bankruptcy petition was filed.[23]

B. Debtor's use of cash collateral

Bank does not contest Debtor's use of rents to maintain the Property or to pay Property operating expenses, but takes issue with uses that do not "directly benefit" Bank or its collateral, such as payment of legal expenses and management fees. According to Bank, Debtor is prohibited from using the cash collateral "to pay expenses beyond § 506(c) expenses" unless it receives "adequate protection for its interest in the rental income."[24] With respect to use of encumbered assets to pay administrative expenses such as professional fees, one court stated:

> A secured creditor is not to be deprived of the benefit of its bargain and will be protected in bankruptcy to the extent of the value of its collateral. Only surplus proceeds are available for distribution to creditors of the estate and administrative claimants. Therefore, *absent equity in the collateral*, administrative claimants cannot look to encumbered property to provide a source of payment for their claims.[25]

The court then noted that professional fees should be allowed ahead of superior claims "only where the superior claim is fully protected."[26] That is precisely the situation here.

On appeal, Bank complains primarily about the bankruptcy court's reliance on *Barkley*,[27] and interprets such reliance to mean that a creditor is always adequately protected unless the underlying secured real estate is undersecured and declining in value. As we previously stated, we see little application of *Barkley*

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[23] *In re Young,* No. 7-11-12554, 2011 WL 3799245, at *7-8 (Bankr. D.N.M. Aug. 29, 2011); *In re Gallegos Research Grp.*, 193 B.R. at 584.

[24] Reply Brief at 4.

[25] *In re Am. Res. Mgmt. Corp.*, 51 B.R. 713, 719 (Bankr. D. Utah 1985) (emphasis added) (citations omitted).

[26] *Id.* at 720.

[27] *In re Barkley 3A Investors, Ltd.*, 175 B.R. 755 (Bankr. D. Kan. 1994).

to the present appeal. But the fact that the bankruptcy court relied upon *Barkley* is not a reversible error. An appellate court may "affirm the rulings of the lower court on any ground that finds support in the record, even where the lower court reached its conclusions from a different or even erroneous course of reasoning."[28] Based on the record before us, we conclude the bankruptcy court reached the right result in its cash collateral order

As already noted, Bank valued its claim against Debtor at $13,076,228.65, plus interest, costs, and fees.[29] The Property was appraised on December 6, 2010 at a value of approximately $17 million.[30] Income from the Property was slightly more than $2 million annually, less expenses of not quite $800,000.[31] Moreover, the appraiser testified that the Property's value had remained "stable to increasing," since the appraisal.[32] Bank also admits that "[t]he value of the security for the [Bank's] Loan currently exceeds its principal and accumulated interest and fees."[33] Finally, Bank acknowledges the bankruptcy court "implicitly found [the Property] was not depreciating in value," and does not appear to contest that fact.[34]

We conclude that Bank's claim is oversecured by the Property alone. There

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[28] *Cayce v. Carter Oil Co.*, 618 F.2d 669, 677 (10th Cir. 1980). *See also Jaffke v. Dunham*, 352 U.S. 280, 281 (1957) (judgment on appeal may be sustained on any ground supported by the record); *Richison v. Ernest Grp., Inc.*, 634 F.3d 1123, 1130 (10th Cir. 2011) (preference to affirm allows appellate court to find any basis to do so in the record, even if it requires consideration of arguments not presented to either court).

[29] *See* Appellant's Brief at 6.

[30] *See* Testimony of B. Shaner at 9-10, *in* Appendix of Appellee at 9-10.

[31] *Id.* at 12, *in* Appendix of Appellee at 12; *see also* Testimony of T. Marauth at 38, *in* Appendix of Appellee at 38.

[32] *See* Testimony of B. Shaner at 20, *in* Appendix of Appellee at 20.

[33] Appellant's Brief at 7.

[34] *Id.* at 10.

is therefore no need to consider whether its lien on rents requires adequate protection as well. Since the Property's value significantly exceeds Bank's claim, and its value is not declining, it is extremely unlikely that Bank will be anything other than oversecured during the bankruptcy. This is especially so in that the bankruptcy court also ordered Debtor to make non-default contract rate interest payments on Bank's claim, pursuant to § 362(d)(3), thereby minimizing the chance that Bank's position in the Property will be affected.[35]

Additionally, Bank's only real dispute regarding Debtor's use of the Property's cash collateral is its intent to pay "administrative" expenses that do not directly benefit the Property or Bank. Specifically, Bank challenged Debtor's use of cash collateral to pay legal fees and management fees to Debtor's owner, but did not object to its use "for continued employment of a rental management company and payment of necessary operating expenses under a court approved budget."[36] The bankruptcy court's cash collateral order was initially effective from the petition date, September 28, 2012, to January 31, 2013, a period of approximately four months.[37] During that period, Debtor budgeted a total of $30,000 for non-operating legal fees and $5,875 for "other owner expense," for a total of $35,875.[38] These expenses amount to less than 10% of Debtor's total budgeted expenses for that period, or approximately the same amount by which

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[35] We do not consider the "replacement lien" in cash collateral to be relevant to our inquiry because Bank's continuing lien on proceeds and replacement proceeds was already in place.

[36] Appellant's Brief at 7-8.

[37] The cash collateral order was subsequently extended by the bankruptcy court and remains in effect.

[38] *See* Fiscal Year Budgets, Jan 2013 to Dec 2013 and Jan 2012 to Dec 2012, *in* Appendix of Appellee at 211-23.

the bankruptcy court allowed Debtor's expenses to vary from its budget.[39]

V. CONCLUSION

We conclude, from the bankruptcy court record and Bank's admissions in this Court, that Bank's interest was adequately protected by a security cushion provided by the value of the Property. Bank is entitled to no more protection of its claim than was provided by the bankruptcy court, and the order allowing Debtor to use Property rents for expenses pursuant to an approved budget is not reversible by this Court. The bankruptcy court's cash collateral order of November 28, 2012, is therefore affirmed.

[39] *See* Final Order Authorizing Use of Cash Collateral and Granting Adequate Protection at 4, ¶10, *in* Appellant's Appendix at 244 (allowing a variation of 10% from the budget on a monthly basis).

JACOBVITZ, Bankruptcy Judge, concurring in the result.

The crux of the Bank's argument is that the bankruptcy court erred by relying on an incorrect legal theory of adequate protection of an interest in post-petition rents expounded in *In re Barkley 3A Investors, Ltd.*, 175 B.R. 755 (Bankr. D. Kan. 1994) and *In re Mullen*, 172 B.R. 473 (Bankr. D. Mass. 1994) and by granting a replacement lien in rents as adequate protection. Under that legal theory, the existence of an equity cushion is irrelevant if the value of the Property is not decreasing. The Bank contends that because it already had a lien in post-petition rents under 11 U.S.C. § 552(b), the replacement lien in rents adds nothing and cannot be adequate protection. The Bank urges us to remand so that the bankruptcy court can determine whether it was adequately protected by an equity cushion, taking into account the value of the Property in relation to the Bank's increasing claim due to post-petition interest accrual, costs and attorney's fees, and the pending claim to subordinate the Bank's lien.

Without considering the merits of the legal theory expounded in *Barkley* and *Mullen*, I am not convinced the finding of adequate protection is clearly erroneous. There is ample evidence in the record that the Bank's secured claim was adequately protected by a substantial equity cushion. The bankruptcy court allowed the Debtor to use the $35,875 of cash collateral in dispute, and the uncontroverted evidence suggests that the Bank was over-secured by several million dollars. There is no evidence in the record on appeal that a claim to subordinate the Bank's lien has any merit. Thus, even though the bankruptcy court did not rely on an equity cushion in finding the Bank was adequately protected, its decision must be affirmed. The result reached is supported by the record regardless of the proffered reasoning. *See Jordan v. U.S. Department of Justice*, 668 F.3d 1188, 1200 (10th Cir. 2011), *cert. denied*, 132 S.Ct. 2400 (2012) (An appellate court "may affirm on any basis supported by the record, even if it requires ruling on arguments not reached by the district court or even presented to

us on appeal."). Because the bankruptcy court reached the correct result, we need not decide whether the theory of adequate protection adopted by the bankruptcy court is correct.