UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In the Matter of

ROSE WAY, INC.	Case No.	89—1273-C
DOUBLE-D LEASING, INC.		89-1274-C
DOUBLE-D, INC.,		89-1275-C
	Chapter 11	

Debtors.

ORDER- -APPROVAL OF STIPULATION AND AGREEMENT FOR ADEQUATE PROTECTION AND REGARDING USE OF CASH COLLATERAL. FINANCING AND FOR INTERIM FINANCING

On August 11, 1989, a hearing was held on the amended motion for final approval of the Stipulation And Agreement For Adequate Protection And Regarding Use of Cash Collateral, Financing And For Interim Financing (hereinafter "Financing Agreement"). The following attorneys appeared on behalf of their respective clients: William I. Kampf and Elizabeth A. Nelson for Rose Way, Inc. (hereinafter "Rose Way"); Mark U. Abendroth for MDFC Equipment Leasing and Eaton Leasing Corp.; Gary R. Hassel for Associates Leasing, Inc.; Mark Lorence for Whirlpool Leasing, Inc.; John Lorentzen for FBS Leasing/FBS Business; Roger J. Kuhle for NCNB Leasing Corp.; Peter S. Cannon for Signal Capital Corp.; Mark D. Walz and Elizabeth E. Goodman for Greyhound Financial Corp. (hereinafter "Greyhound"); Kevin R. Query and John D. Griffith for the Internal Revenue Service (hereinafter "IRS"); David Heller, Douglas Taber and Don Neiman for Exchange National Bank of Chicago (hereinafter "Exchange"); and Terry Gibson for U.S. Trustee. At

the conclusion of said hearing, the Court took the matter under advisement. The Court considers the matter fully submitted.

This is a core proceeding pursuant to 28 U.S.C. §157(b) (2). The Court, having reviewed the file, arguments of counsel, and evidence admitted, now enters its findings and conclusions pursuant to F.R.Bankr.P. 7052.

FINDINGS OF FACT

1. Rose Way filed its voluntary Chapter 11 petition on June 8, 1989.

2. On June 9, 1989, the Court authorized Rose Way's use of $40,000.00 of Exchange cash collateral pending a continuance of the June 9th hearing to June 12, 1989. On June 12, 1989, the Court held two hearings concerning the emergency use of cash collateral, authorizing the use of $25,000.00 of Exchange cash collateral per day. On June 15, 1989, the Court entered an order authorizing Rose Way to use a maximum of $25,000.00 of Exchange cash collateral per day, seven days a week in the conduct and operation of Rose Way's business.

3. On July 11, 1989, the Court entered an order authorizing interim financing pursuant to the Financing Agreement, pending a final hearing on the Financing Agreement August 11, 1989. Numerous creditors resisted the final approval of the Financing Agreement.

4. Without the financing provided under the Financing Agreement, Rose Way's business operations will not continue. Rose Way has been unable to obtain alternative financing on acceptable terms, and Exchange will not accede to less preferential terms.

5. From the date Rose Way filed its Chapter 11 petition, to August 11, 1989, Rose Way accumulated cash of approximately $170,000.

6. Rose Way's Projected Statement of Income and Cash Flow projects a positive net income of $27,271.00 per month from August 1989 through July 1990.

7. The IRS has filed a proof of claim in the amount of $708,442.30, which is secured by virtue of federal tax liens recorded in the office of the Polk County, Iowa Recorder and with the Secretary of State of Iowa on November 14, 1986. Rose Way commenced an adversary proceeding challenging the IRS claim in a complaint filed August 10, 1989.

8. The pre—petition security interests of Exchange are covered by a financing statement filed with the Secretary of the State of Iowa on July 14, 1987.

DISCUSSION

Creditors have objected to a number of provisions of the Financing Agreement. The Court's duty is to deny its blessing of any provisions that are not appropriate, not to dictate the terms of any post—petition financing arrangement between Rose Way and a lender. See In re Roblin Industries, Inc., 52 B.R. 241, 243 (Bankr. W.D. N.Y. 1985). In the discussion infra, the Court will address many of the creditors' objections. To the extent the provisions of the Financing Agreement are specifically rejected by the Court in this order, they do not bind Rose Way and Exchange.

All provisions of the Financing Agreement that are either specifically authorized by the Court in this Order, or are not specifically rejected, remain in the Financing Agreement and bind Rose Way and Exchange.

A. Sixty—Day "Sunset Provision"

Greyhound argues that any financing agreement authorized by the Court should have a sunset provision of not more than sixty days from its approval. Rules 4001(c) and (d) provide the procedures for interim and final hearings on a motion for use of cash collateral and motion for authority to obtain credit. These provisions clearly provide sufficient protection for the interests of Rose Way's unsecured creditors. Rose Way complied with the provisions of Rules 4001(c) and (d) in seeking the Court's approval of the Financing Agreement. Therefore, the interests of Rose Way's unsecured creditors have been protected and a sixty—day sunset provision is not necessary. This order on the Financing Agreement is a final order.

B. Interest of Leasing or Financing Entities in Rose Way's Vehicles

Numerous entities which either leased vehicles to Rose Way or financed Rose Way's acquisition of vehicles, object to the Financing Agreement on the grounds that the Financing Agreement grants Exchange a security interest in all of Rose Way's vehicles. The Court does not agree with these objections.

To the extent that an entity is the actual owner of a vehicle, and has leased the vehicle to Rose Way pursuant to a "true lease",

the vehicle remains the property of this lessor, and is not subject to any security interest created by the Financing Agreement. Further, if an entity actually financed Rose Way's acquisition of such vehicle, but has taken the proper steps to perfect a security interest in such vehicle, the Financing Agreement will also not affect this entity's rights. This is due to the fact that paragraph 3 of the Financing Agreement grants Exchange a first priority interest in Rose Way's assets "except to the extent prior liens exist pursuant to law and such liens were perfected prior to the (Rose Way Chapter 11) filing." Finally, to the extent that the entity owns the vehicle, or has perfected a security interest in the vehicle, the entity will also have priority over any proceeds of the vehicle, including proceeds of an insurance policy on the vehicle.

C. Paragraph 14 Proceeds Provision

Greyhound objects to paragraph 14 of the Financing Agreement which provides that certain property including cash, checks, notes, drafts, etc., in the possession of Rose Way or a financial institution is deemed proceeds of the Exchange pre-petition collateral, and requires Rose Way to deliver this property to Exchange upon entry of the order approving the Financing Agreement. Exchange counters this objection by arguing that Rose Way has not delivered any such cash, deposits, etc. to Exchange because all such funds were used by Rose Way pursuant to the June 1989 cash collateral orders. If it is indeed true that all such funds have been used by Rose Way pursuant to the cash collateral orders, there

is no need for a provision requiring Rose Way to deliver such funds to Exchange. Further, the status of these funds as proceeds of the Exchange pre-petition collateral is clearly in dispute. Therefore, Court approval of a provision deeming these funds as proceeds of Exchange's pre—petition collateral is inappropriate. The court does not authorize paragraph 14 of the Financing Agreement.

D. Recoveries of Transfers Avoided Under §544, 547, 548, 549 or 553.

Greyhound objects to paragraph 24 of the Financing Agreement which provides that Exchange shall be entitled to receive all recoveries of cash or proceeds of property representing recoveries of preferential transfers or fraudulent conveyances under §§544, 547, 548, 549 or 553 to the extent such funds or proceeds represent proceeds of the Exchange pre-petition or post-petition collateral.

Exchange counters this objection by asserting that a majority of cases hold that property recovered by the estate through the trustee's avoiding powers remains subject to a pre—petition perfected security interest, citing In re Figeraro, 79 B.R. 914, 916 (Bankr. D. Nev. 1989); Accord, In re Ellingsen MacLean Oil Co.. Inc., 98 B.R. 284 (Bankr. W.D. Mich. 1989). Exchange also argues that at least one case, Ellingsen MacLean Oil Co., held that if a lender's pre-petition security interest did not reach this property, the lender would be entitled to this property under a post-petition security interest.

While Exchange's assertions may be correct, there clearly are cases that hold that property recovered by the estate through the

trustee's avoiding powers does not remain subject to a pre—petition perfected security interest. See, e.g., In re Antinarelli Ent. Inc., 94 B.R. 227 (Bankr. D. Mass. 1988). Therefore, it is not appropriate for the Court to approve a provision in the Financing Agreement which attempts to resolve by agreement between Rose Way and Exchange, an issue that should be decided by this Court on motion in a contested matter or in an adversary proceeding. The Court does not authorize paragraph 24.

E. Rosenbergers' Real Estate

Greyhound asks for a valuation of real estate owned by Rosenbergers which secures the Rosenbergers' guarantee of Rose Way's obligations to Exchange. The Rosenbergers' real estate mortgage and guarantee is only tangentially related to the issues involved in the Court's approval of the Financing Agreement. The Court finds that valuation of this real estate is not necessary for the Court to approve the Financing Agreement.

F. Cross—collateralization

Greyhound and other Rose Way creditors object to the cross—collateralization provisions of the Financing Agreement. Specifically, these creditors object to the provisions of the Financing Agreement that provide that payments or proceeds received with respect to post-petition collateral may be applied to satisfy pre-petition indebtedness.

Clearly, ex parte approval of cross—collateralization agreements is not permitted. In re Texlon Corp., 596 F2d 1092 (2nd Cir. 1979). One court even held that after notice and a hearing,

cross—collateralization is not valid. In re Monarch Circuit Ind. Inc., 41 B.R. 859 (Bankr. E.D. Pa. 1984). Other courts, while stating that cross—collateralization should be discouraged, have recognized that cross—collateralization is permissible in some circumstances. In re Vanguard Diversified. Inc., 31 B.R. 364 (Bankr. E.D.N.Y. 1983); In re FCX. Inc., 54 B.R. 833 Bankr. E.D.N.C. 1985); In re Roblin Ind. Inc., 52 B.R. 241 (Bankr. W.D.N.Y. 1985). Although cross-collateralization is controversial, it is often used and even the courts that discourage it have approved its use. In re Ellingsen MacLean Oil Co.. Inc., 834 F2d 599 (6th Cir. 1987).

Approval of this Financing Agreement and its cross—collateralization provisions is clearly not pursuant to an ex parte order. Therefore, the Court must decide whether the cross—collateralization provisions of the Financing Agreement are otherwise permissible.

In Vanguard, the court states that if the debtor wishes to engage in cross—collateralization, the debtor must demonstrate that:

1) Absent the proposed financing, its business operations will not survive;

2) It is unable to obtain alternative financing on acceptable terms;

3) The proposed lender will not accede to less preferential terms; and

4) The proposed financing is in the best interest of the general creditor body. (citations omitted).

Vanguard, 31 B.R. at 366.

Under the Vanguard test, Exchange is entitled to cross—collateralization. Concerning the first element, at the August 11, 1989 hearing on approval of the Financing Agreement, Michael Favilla, president and chief executive officer of Rose Way, testified that absent the proposed financing provided under the Financing Agreement, Rose Way would not survive. To finance its operations post-petition, Rose Way initially used Exchange's cash collateral pursuant to the various cash collateral orders. To finance its post—petition operations since 7/11/89, Rose Way has used the interim financing allowed under the Financing Agreement, authorized July 11, 1989.

At the August 11, 1989 hearing, Michael Favilla also testified that Rose Way was unable to obtain alternative financing on acceptable terms from lenders other than Exchange. Further, at the August 11, 1989 hearing on the Financing Agreement, attorneys for Exchange made a professional representation that Exchange was not willing to provide financing to Rose Way without the cross collateralization protections provided in the Financing Agreement.

The final element to consider is whether the financing proposed under the Financing Agreement is in the best interests of the general creditor body. Michael Favilla testified that Rose Way had a positive cash accumulation since the time of filing the Chapter 11 petition of approximately $170,000.00. Further, Rose Way's Exhibit 1, Projected Statement of Income and Cash Flow, predicts a positive net income of $27,271.00 per month from August

1989 through July 1990. Rose Way thus appears to have potential as a going concern.

Michael Favilla also testified that without the financing provided under the Financing Agreement, Rose Way would be forced to liquidate. If Rose Way liquidates, there would undoubtedly be no distribution for the unsecured creditors of the Rose Way Chapter 11 estate due to Exchange's security interests in Rose Way's property, and possibly the IRS's disputed security interest in Rose Way's property. Therefore, the proposed financing is in the best interests of the general creditor body.

The fact that a lender's pre-petition indebtedness is over-secured by debtor's pre—petition collateral may be a relevant factor in determining whether the lender is entitled to cross collateralization of that pre-petition indebtedness. See ***FCX,*** 54 B.R. at 840; Matter of Borne Chemical Co.. Inc., 9 B.R. 263 (Bankr. D.N.J. 1981). However, the court in Vanguard indicated that the lender's under—secured status was a factor which supported the court's holding that the lender was entitled to cross—collateral—ization of its pre-petition indebtedness. Vanguard, 31 B.R. at 367.

In the case ***sub judice,*** evidence is not clear concerning whether Exchange's pre-petition indebtedness is fully secured by prepetition collateral of Rose Way. Rose Way has stipulated and has offered testimony that the value of the pre-petition collateral subject to Exchange's security interest is not less than Rose Way's

pre—petition indebtedness to Exchange. However, this testimony and stipulation did not take into account the potentially prior secured position of the IRS. Despite the fact that it is unclear whether Exchange's pre—petition indebtedness is fully secured by Rose Way's pre-petition collateral, the Court finds that Exchange is entitled to cross—collateralization because it meets the Vanguard test requirements.

G. Bar Date for Filing Objections

The bar date for the filing of objections to the validity, extent and priority of the lender's security interest and liens in paragraph 23 of the Financing Agreement is impermissible. Thus, the Court does not authorize this bar date provision.

H. Designation of the Plan Treatment of $200,000 of the Indebtedness to Exchange

The Court does not authorize paragraph 7 of the Financing Agreement which impermissibly designates the plan treatment of $200,000 of the indebtedness to Exchange. This is not appropriate nor permissible under §1122(a) or §506.

ORDER

WHEREFORE, based on the foregoing analysis, the Court concludes that the Financing Agreement may be approved under applicable law.

IT IS ACCORDINGLY ORDERED that all provisions of the Financing Agreement that are either specifically authorized by the Court in this Order, or are not specifically rejected, are approved and remain in the Financing Agreement. All provisions of the Financing

Agreement that are specifically rejected by the Court in this Order, are not approved and do not bind Rose Way and Exchange.

Dated this 12th day of September, 1989.

RUSSELL J. HILL
U.S. BANKRUPTCY JUDGE