

UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In the Matter of
CUTTY'S, INC.,

Case No. 89-1097-C H
Chapter 11

Debtor.

ORDER- -MOTION TO USE CASH COLLATERAL

On July 24, 1989, an evidentiary hearing was held on the motion to use cash collateral. The following attorneys appeared on behalf of their respective clients: John Neiman for Cutty's, Inc.; Jon P. Sullivan for Norwest Bank Minnesota, N.A.; Anthony A. Longnecker for United Federal Savings Bank; Michael Mallaney for American Centennial Insurance Company; and John Lorentzen for GEI Bank Industrial Bank, GEICO Financial Services, Inc., and GEFECO Management Systems. At the conclusion of said hearing, the Court took the matter under advisement.

This is a core proceeding pursuant to 28 U.S.C. §157(b) (2) (M). The Court, upon review of 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. On May 17, 1989, Cutty's, Inc. (hereinafter "Cutty's") filed a voluntary Chapter 11 petition.

2. Cutty's is a publicly held corporation engaged in the business of owning and operating four campground resorts in Iowa,

Indiana, and Colorado. The resorts feature individual campsites and recreational amenities.

3. Memberships sold at the Iowa resort entitle purchasers to an undivided interest (1/3000) in the Des Moines real estate as tenants in common, along with the use of the resort facilities. There is an owners association at the Des Moines facility which controls operation of the resort and assesses annual membership dues for its members to support resort operations.

4. Memberships purchased at Cutty's other locations do not carry with them any ownership of the resorts themselves, but do entitle members to use of the facilities for an extended period of years. The Cutty's Indiana membership certificate specifically states a period of 99 years. In addition, members pay annual maintenance fees to Cutty's for resort maintenance, operating and administrative expenses.

5. Purchase of a membership under an installment contract (hereinafter "membership contract") requires a minimum downpayment of ten percent, with the balance payable over a 24 to 72-month period.

6. Debtor-in-possession is seeking the use of cash collateral from basically three different parties:

a) United Federal Savings Bank

United Federal Savings Bank (hereinafter "UB") has been loaning funds to Debtor, taking assignments of membership contracts as security. UB has a perfected security interest in the membership contracts. UB also has other security: a first mortgage

on the Des Moines, Iowa, location; a second mortgage on the two Colorado locations; and a fifth mortgage on the LaPorte, Indiana, location. Further, on August 11, 1988, UB and Cutty's executed, among other documents, a secured loan agreement. Pursuant to §8.1 of the loan agreement, Cutty's in exchange for an offset in its debt to UB, is required to transfer to UB all right, title and interest Cutty's has in and to all non-delinquent membership contracts which UB has in its possession.

b) Norwest Bank Minnesota. N.A.

Norwest Bank Minnesota, N.A., (hereinafter "Norwest") has been lending funds to Cutty's, and taking Cutty's membership contracts principally relating to the LaPorte, Indiana, facility as security. Norwest has a perfected security interest in these membership contracts. Norwest also has an insurance policy with American Centennial Insurance Company (hereinafter "American Centennial") under which American Centennial pays Norwest for any delinquencies in the payments under the membership contracts, and is then subrogated to Norwest on any contracts upon which American Centennial has made payments.

c) GEIBank Industrial Bank. GEICO Financial Services, Inc. and GEFCO Management Systems

Through contract purchase agreements dated 2/24/87 and 11/24/87 with GEIBank Industrial Bank (hereinafter "GEIBank" and GEICO Financial Services, Inc. (hereinafter "GFS"), Cutty's agreed to sell its interests in various membership contracts.

DISCUSSION

A. UB and GEIBank/GFS Status as Owners or Secured Parties. UB and GEIBank/GFS assert that they are owners of membership contracts rather than secured parties. Cutty's disputes this assertion. Pursuant to this order, Cutty's is not entitled to use the cash generated by these membership contracts whether UB and GEIBank/UB are owners or secured parties. Thus, in this order concerning Cutty's motion to use cash collateral, the Court does not determine whether UB and GEIBank/GFS own the membership contracts, or are secured parties.

B. Cutty's Motion to Use Cash Collateral

In its motion to use cash collateral, Cutty's prays for authorization to use cash collateral. The use of cash collateral is permitted pursuant to §363(c) (2), which provides in pertinent part:

The Trustee may not use, sell or lease cash collateral under paragraph (1) of this subsection unless -- A) each entity that has an interest in such collateral consents; or B) the court, after notice and hearing authorizes such use, sale, or lease in accordance with the provisions of this section.

Section 363(c) (2).

Cutty's has not obtained the consent of the entities with an interest in the cash collateral, thus for Cutty's to use cash collateral, the Court must authorize the use of the cash collateral under §363(c)(2)(B). To authorize the use of cash collateral, the

Court must determine that the interest of the secured party is adequately protected. §363(e).

Cutty's has not offered adequate protection to the secured parties. Instead, Cutty's offers the following argument: 1) the membership contracts are executory contracts; 2) the executory contracts should be deemed rejected for purposes of the motion to use cash collateral; 3) because the executory contracts are deemed rejected, the interests of UB, GEIBank/GFS, and Norwest Bank/American Centennial are worthless; and 4) a secured creditor's interest in worthless collateral does not require adequate protection. Because Cutty's has not offered adequate protection, Cutty's ability to use the cash collateral is totally dependent on the Court's agreement with the above-described argument.

The Court finds that Cutty's has provided no basis in law for its assertion that the Court should presume that the membership contracts are deemed rejected. Therefore, even assuming arguendo that the membership contracts are indeed executory contracts, these membership contracts are not worthless and the secured creditors' interest in cash collateral requires adequate protection. Because Cutty's has not offered adequate protection, its motion must be denied.

Cutty's primary support for its assertion that the executory contracts should be deemed rejected is the 1964 9th Circuit decision, Bank of America National Trust & Savings Assoc. v. Smith, 336 F2d 528 (9th Cir. 1964), and the 1959 3rd Circuit decision, In re Luscombe Engineering Co., 268 F2d 683 (3rd Cir. 1959). The 3rd

Circuit did hold in Luscombe that rejection is to be inferred unless assumption is satisfactorily proved. Luscombe, 268 F2d at 687. Further, the 9th Circuit cited this holding with approval in Bank of America, 336 F2d at 528. However, the Luscombe holding is clearly inapplicable to the case ***sub judice***.

The Luscombe holding was based on the 3rd Circuit's interpretation of §70(b) of the Bankruptcy Act of 1898. That section provided that absent assumption or rejection of an executory contract or lease by a trustee within a specified period of time, the executory contract or lease not assumed or rejected within that time is deemed to be rejected. The 3rd Circuit interpreted that provision of the Bankruptcy Act of 1898 to mean that rejection of an executory contract or lease is to be inferred unless assumption is satisfactorily proved.

The case ***sub judice*** is subject to the Bankruptcy Code of 1978, as amended (hereinafter "Bankruptcy Code"). The Bankruptcy Code does provide in a Chapter 7 case that if the trustee does not assume or reject an executory contract or unexpired lease within 60 days after the order for relief, or within such additional time as the court for cause fixes, then such contract or lease is deemed rejected. 365 (d) (1). Further, the Bankruptcy Code does provide that if a trustee does not assume or reject an unexpired lease of non-residential real property under which the debtor is the lessee within 60 days after the date of the order for relief, or within such additional time as the court for cause fixes, then such lease

is deemed rejected. However, concerning an executory contract in a Chapter 11 Case, the Bankruptcy Code provides only that the trustee may assume the executory contract at any time before the confirmation of a plan, unless the court on the request of any party to such contract orders the trustee to determine within a specified period of time whether to assume or reject the contract. §365(d)(2). Thus, under §365(d) (2), the Chapter 11 debtor must take some affirmative action to reject an executory contract. In re Matis, 74 B.R. 363 (Bankr. N.D.N.Y. 1987). The rationale and holding of Luscombe therefore do not apply to the contracts in this Chapter 11 case, and the Court does not deem these contracts rejected.

CONCLUSIONS AND ORDER

WHEREFORE, based on the foregoing analysis, the Court concludes that Cutty's has provided no basis in law for its assertion that the Court should deem the membership contracts rejected. Therefore, even assuming arguendo that the said contracts are indeed executory contracts, these contracts are not worthless and the secured creditors' interest in cash collateral requires adequate protection. Cutty's has not offered adequate protection.

IT IS ACCORDINGLY ORDERED that Cutty's motion to use cash collateral is denied.

Dated this 12th day of September, 1989.

RUSSELL J. HILL
U.S. BANKRUPTCY JUDGE