

**BANKRUPTCY LAW –
MAY A CREDITOR INTERNALLY ALLOCATE
COLLATERAL TO BECOME OVERSECURED AFTER
THE BANKRUPTCY PETITION HAS BEEN FILED?**

By Alanna Beck^{*}

In re Geijssel, 480 B.R. 238 (Bankr. N.D. Tex. 2012).

In August 2012, the United States Bankruptcy Court for the Northern District of Texas, Fort Worth Division, rejected a secured creditor's contention that it could internally allocate the collateral that secures the debt, becoming effectively oversecured regarding one or more of the claims, after the bankruptcy petition had been filed.¹ The Court ultimately followed the analysis in *In re T-H New Orleans Ltd. P'ship*² and applied the cash on hand and adequate protection payments, for collateral that did not depreciate in value, to reduce the amount of the secured claim, resulting in the creditor becoming oversecured anyway and entitled to attorney's fees and interest.³

Arjen and Kimberly Geijssel (the "Geijsels") are the sole owners of a limited liability company, The Luckie Dutchman, LLC (the "LLC"), and the Geijsels together with the LLC own and operate a dairy farm and are collectively referred to as the Debtors.⁴ Throughout the years 2006-2009 the Debtors took out numerous loans, nine of which were outstanding at the time the bankruptcy petition was filed; eight of the loans were from two separate entities, Lone Star, FLCA (FLCA) and Lone Star, PCA (PCA), collectively referred to as Lone Star.⁵ The Debtors secured these loans with "all of the real and personal property [they] owned," which included, among other things, their ranch and dairy facility.⁶ During the pendency of the bankruptcy, the Debtors continued to remain in possession of and operate the dairy business.⁷ The value of the dairy facility at the time of filing was approximately \$3,380,000.⁸ The debt owed to Lone Star by the Geijsels at the filing of bankruptcy was approximately \$8,425,000 and the debt owed by LLC to Lone Star totaled \$1,463,000.⁹ All the loans were cross-collateralized between both Debtors and each Lone Star entity.¹⁰

On June 15, 2010, the Debtors each filed separate petitions for relief under Chapter 11 of Title 11 of the United States Code (the "Bankruptcy Code"); the cases were jointly administered.¹¹ At the time of filing, the value of all the collateral securing Lone Star's claim totaled \$8,595,313.26.¹² PCA filed a proof of claim in the Geijssel's case totaling approximately

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¹ *In re Geijssel*, 480 B.R. 238 (Bankr. N.D. Tex. 2012).

² 116 F.3d 790 (5th Cir. 1997).

³ *Id.* at 263.

⁴ *Id.* at 243.

⁵ *Id.* at 244.

⁶ *Id.*

⁷ *Id.*

⁸ *Id.* at 262.

⁹ *Id.* at 245.

¹⁰ *Id.* at 247.

¹¹ *Id.* at 243.

¹² *Id.* at 248.

\$5,317,000.¹³ FLCA filed a proof of claim in the Geijsel's case totaling approximately \$4,571,000, which includes the debt owed by LLC.¹⁴ The total value of the indebtedness claimed by Lone Star as of the petition filing is \$9,774,086.90.¹⁵

On September 15, 2010, the Debtors were required to start making adequate protection payments of \$50,000 per month to Lone Star, which were in fact made through June 2012.¹⁶ Although the total amount of debt owed exceeds the total value of the collateral, "after credit [was] given for accumulated cash on hand...and adequate protection payments," Lone Star became an oversecured creditor by the time of the confirmation hearing.¹⁷

In determining whether to confirm the Debtor's Chapter 11 plan, the Court began its analysis with an examination of Lone Star's claim.¹⁸ The Court first addressed Lone Star's contention that it can internally allocate collateral within PCA and FLCA to become oversecured with regard to some claims, allowing Lone Star to be able to collect interest and attorney's fees from the equity cushion.¹⁹ Specifically, Lone Star wanted to internally allocate collateral causing the \$1,463,000 FLCA claim to become oversecured by the security interest in the dairy facility, which was valued at \$3,380,000.²⁰ The effect would be Lone Star maximizing the amount it can collect through the bankruptcy proceeding. Lone Star argued that this was proper even though allowing it would effectively disregard the fact that the dairy facility was also collateral for prior loans by Lone Star that were involved in the Geijsel's individual case.²¹

In rejecting Lone Star's contention that it can internally allocate the collateral, as addressed in footnote 18 of the opinion, the Court began with the notion that a creditor's claims in bankruptcy are determined at the time the debtor files the bankruptcy petition.²² In this case, at the time the Debtors filed the petitions, Lone Star's claims exceeded the total value of the collateral by \$1,178,773.64.²³ This remainder of the claim would then become an unsecured debt, and Lone Star would share with the other unsecured creditors on a pro rata basis of the balance left in the estate.²⁴ Also, in this scenario, because there would be no equity cushion on the collateral, Lone Star would not be entitled to interest or attorney's fees.²⁵

The Court reasoned that allowing Lone Star to internally allocate collateral after the Debtors filed their bankruptcy petition would disrupt the distributional structure of the Bankruptcy Code.²⁶ The distributional structure is in place to protect the rights of all creditors in the bankruptcy proceeding.²⁷ Allowing Lone Star to add to their secured claim after the petition is

¹³ *Id.* at 245.

¹⁴ *Id.*

¹⁵ *Id.* at 247–48.

¹⁶ *Id.* at 251.

¹⁷ *Id.* at 262.

¹⁸ *Id.* at 261.

¹⁹ *Id.* at 262.

²⁰ *Id.*

²¹ *Id.*

²² *Id.* at 275, note 18.

²³ *Id.*

²⁴ *Id.*

²⁵ *Id.*

²⁶ *Id.*

²⁷ *Id.*

filed would be at the expense of the other unsecured creditors.²⁸ This would be at the expense of the other unsecured creditors because it would create one oversecured claim for Lone Star, to which interest and attorney's fees would be added, not exceeding the value of the collateral securing the claim. In this case the potential interest and fees could be up to \$1,917,000—the value of the dairy facility minus FLCA's claim against the LLC.²⁹ That would in effect increase the amount of unsecured debt regarding Lone Star's other claims and decrease the likelihood of the other unsecured creditors receiving anything.³⁰

The Court acknowledged that the purpose of section 506 of the Bankruptcy Code is “to protect the creditor's interest in the property securing its claim; it is not to protect something more than that.”³¹ This means the protection of the secured creditor extends only to the value of the collateral securing the claim at the time the petition is filed.³² The Court rejected Lone Star's contention by stating that allowing Lone Star to internally allocate collateral post-bankruptcy petition filing would disrupt the equitable distribution structure of the Bankruptcy Code.³³

In defining Lone Star's claim, the Court applied the analysis articulated in *In re T-H New Orleans Ltd. P'ship*.³⁴ The court in *In re T-H* applied a two part test: 1) “whether the secured creditor was entitled to accrue interest under § 506(b),” and 2) “if it can, when does interest begin to accrue and to what extent is the creditor entitled to post-petition interest?”³⁵ The *In re T-H* court posited that the “secured creditor's entitlement to accrue interest under § 506(b) matures at the point in time where the creditor's claim becomes oversecured[.]” and the determination is “not limited to a single point in time.”³⁶ In addressing the second part of the test, the court in *In re T-H* held that a secured creditor may add post-petition interest but not to exceed the value of the collateral securing the claim.³⁷

In applying this analysis with regard to Lone Star's claim, the Court concluded that the adequate payments paid from the post-petition cash collateral, which is the income from operation of the dairy business, can be applied to reduce the amount of debt.³⁸ The determination of the date Lone Star became oversecured, and subsequently entitled to accrue interest and attorney's fees, was calculated by subtracting the monthly adequate protection payments from the total amount of the claim, the date that the value of the collateral exceeded the amount of the claim is the date the right to accrue began.³⁹

Although, the Court ultimately determined that Lone Star would be entitled to post-petition interest and attorney's fees, the Court refused to accept the contention that creditors could internally allocate collateral to become oversecured regarding certain claims. The potential oversecurity under the Court's analysis would be approximately \$653,000 (the difference

²⁸ *Id.*

²⁹ *Id.*

³⁰ *Id.*

³¹ *Id.*

³² *Id.*

³³ *Id.*

³⁴ *Id.* at 263 (citing *In re T-H New Orleans Ltd. P'ship*, 116 F.3d 790 (5th Cir. 1997)).

³⁵ *Id.*

³⁶ *Id.*

³⁷ *Id.*

³⁸ *Id.* at 266–67 (discussing the majority “addition” view).

³⁹ *Id.* at 268 and addendum chart following the opinion.

between the \$9,477,000 collateral value and the \$8,824,000 secured claim)⁴⁰—significantly less than the \$1,917,000 potential oversecurity under Lone Star’s analysis.

⁴⁰ *Id.* at 262.