Secured Creditors and the Eely Character of Bankruptcy Valuations

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SECURED CREDITORS AND THE EELY CHARACTER OF BANKRUPTCY VALUATIONS

DAVID GRAY CARLSON* 

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* Professor of Law, Benjamin N. Cardozo School of Law, Yeshiva University. Thanks go to Frank Kennedy and Jeanne L. Schroeder for reviewing earlier drafts of this article. This Article will eventually become a chapter in G. GILMORE & D. CARLSON, SECURITY INTERESTS IN PERSONAL PROPERTY (2d ed.) (forthcoming).
The fallacy in that argument stems largely from lack of recognition of the eely character of the word "value." It is a bewitching word which, for years, has disturbed mental peace and caused numerous useless debates. Perhaps it would be better for the peace of men's minds if the word were abolished. Reams of good paper and volumes of good ink have been wasted by those who have tried to give it a constant and precise meaning.

Judge Jerome Frank

Throughout the bankruptcy process—and especially in any reorganization process—the secured party's collateral must be valued. Congressional history celebrates the fact that judges are to make the rules for valuation on a case-by-case basis. Bankruptcy Code section 506(a), the provision that describes valuations of collateral, is careful to specify that “[s]uch value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.” Thus, the lesson about valuation is that it should vary from case to case according to the purpose of the valuation.

Not surprisingly, bankruptcy courts have indeed gratified the wishes of Congress by producing an extremely diverse and contradictory set of valuation theories. These theories share a common element, however. None of them is a verifiable proposition. That is to say, the values derived by bankruptcy courts are not objective or even subjective facts. Rather, they are subjunctive facts—facts that can be assessed only contingently in the context of a hypothetical universe which can never be.

Because valuations are not verifiable propositions, it is impossible to say as an objective matter whether valuation standards must adhere to "liquidation" versus "going concern" value, or between "use" or "exchange" value, or whether valuations should be ex ante or ex post transaction costs.

But this is not to say that valuations are worthless. Even if valuation theory cannot be viewed as a coherent and verifiable system, the ideas on which valuation depend have logical implications for issues not directly in view. A thorough study of valuation theories in

1. Commissioner v. Marshall, 125 F.2d 943, 946 (2d Cir. 1942) (footnotes omitted).
2. See S. Rep. No. 989, 95th Cong., 2d Sess. 54 (1978); H.R. Rep. No. 595, 95th Cong., 1st Sess. 356 (1977) (stating that "'value' does not necessarily contemplate forced sale or liquidation value of the collateral; nor does it always imply a full going concern value. Courts will have to determine value on a case by case basis, taking into account the facts of each case and the competing interests in the case.'").
bankruptcy will better enable a judge or lawyer to know the domain that a selected valuation theory actually covers. Furthermore, if valuation theory suffers from contingency and is neither an entirely objective nor subjective practice, this is precisely the state of all other forms of knowledge. Reality does not come to us except as mediated by thought. To shun valuations because they are a pale shadow of real market transactions\textsuperscript{4} condemns all thought as effectively as it does valuation theory.

This Article explores the valuation theories that have emerged from bankruptcy law. First, I will describe briefly why a bankruptcy court needs to value the collateral of a secured party. This list is only tentative because bankruptcy lawyers are constantly expanding and changing the parameters of their practice and, accordingly, will always find new reasons to assess the worth of property. Second, I will describe the subjunctive nature of these valuations. According to this nature, value is neither subjective nor objective, but rather a distinct category in which subject and object both have a role. Third, I will examine the choice between liquidation and going concern value, and the various permutations of these theories that have emerged from the bankruptcy courts. Finally, I will examine the difficult issue of whether valuations ought to deduct expected transaction costs of a hypothetical sale that might never take place. In each of these areas, there is a great deal of conflict in the case law. Reconciliation of these authorities is not possible and—according to Congress—not even desirable. Nevertheless, I do hope to illuminate the nature of the contradictions that confront bankruptcy courts.

I. WHY VALUATIONS ARE NECESSARY IN BANKRUPTCY

A. Generally Speaking

A bankruptcy court is not necessarily required to value collateral at all.\textsuperscript{5} But valuations must occur for a long set of reasons. It might be useful to list some of them at the outset of this Article:\textsuperscript{6}

\textsuperscript{4} See Baird, The Uneasy Case for Corporate Reorganizations, 15 J. LEGAL STUD. 127, 128, 139-46 (1984) (questioning right of chapter 11 to exist because it is based on bankruptcy court valuations of property).

\textsuperscript{5} In fact, unless some context demands a valuation, courts refuse to value the collateral. See In re Mesa Bus. Park Partnership, 127 Bankr. 144, 147-48 (Bankr. W.D. Tex. 1991) (Clark, J.) (refusing to value property which had been sold); In re Turnbow, 121 Bankr. 11, 13 (Bankr. S.D. Tex. 1990) (Clark, J.) (declining to value property subject to security interest since no workable reorganization plan had been presented to court); In re Richardson, 97 Bankr. 161, 162 (Bankr. W.D.N.Y. 1989) (Hayes, J.) (finding that bankruptcy court does not have jurisdiction to conduct valuation absent express or valid purpose).

\textsuperscript{6} On purposes of valuations, see generally In re Maitland, 61 Bankr. 130, 134 (Bankr.
(1) Bankruptcy, of course, automatically stays all creditor actions against the debtor or property of the estate, except in bankruptcy court. A secured party is entitled to relief from the stay if the secured party’s interest is not receiving adequate protection within the meaning of Bankruptcy Code section 363(e). One common type of adequate protection is a large debtor equity in the collateral. When a debtor asserts debtor equity as the relevant means of adequate protection, valuation is necessary to adjudicate the propriety of the automatic stay. For the purpose of this motion, “debtor equity” means a value in the collateral that exceeds the moving creditor’s claim plus the claim of any senior secured party.

Even if adequate protection is provided through some means other than a large debtor equity, a valuation is still needed in any liquidation case because the trustee’s right to retain the collateral depends on the existence of a positive debtor equity. For this purpose, debtor equity means enough value in the collateral to exceed all the aggregate secured claims against the collateral. Thus, the definition of debtor equity differs, depending on whether the moving secured party claims that it has no adequate protection under section 362(d)(1) or whether it claims that a chapter 7 trustee has no grounds to retain the collateral under section 362(d)(2)(A). Debtor


8. See 11 U.S.C. § 362(d)(1) (1988) (requiring that stay be lifted by bankruptcy court “for cause, including the lack of adequate protection of an interest in property”). Bankruptcy Code section 363(e) provides:

Notwithstanding any other provision of this section, at any time, on request of an entity that has an interest in property used, sold, or leased, or proposed to be used, sold, or leased, by the trustee, the court, with or without a hearing, shall prohibit or condition such use, sale, or lease as is necessary to provide adequate protection of such interest.


10. In re Simmons, 86 Bankr. 160, 161 (Bankr. S.D. Iowa 1988) (Jackwig, C.J.). For example, if $A, B,$ and $C$ each have mortgages for $10,000 on land worth $21,000, $A$ has an equity cushion of $11,000, $B$ has a cushion of $1,000, and $C$ has no equity cushion at all. Only $C$ can unambiguously that an equity cushion cannot constitute adequate protection. As to whether $B$ can claim no adequate protection (in light of a thin equity cushion), see Carlson, Oversecured Creditors Under Bankruptcy Code Section 506(b): The Limits of Postpetition Interest, Attorneys’ Fees, and Collection Expenses, 7 Bankr. Dev. J. 381, 397-407 (1990).

11. See 11 U.S.C. § 362(d)(2) (1988) (stating that automatic stay may be lifted upon request of party in interest when “debtor does not have an equity in such property”).

equity in this second sense is irrelevant, however, if the collateral is needed to accomplish an effective reorganization. This necessity constitutes an independent ground for the trustee to retain collateral in the estate.

(3) If a secured party enjoys an equity cushion, a trustee may wish to obtain new credit by granting a senior security interest under section 364(d). The trustee’s ability to obtain new credit in this manner depends on whether the trustee can supply adequate protection to the current secured creditors, a determination that depends heavily on valuation of the collateral. The new senior lien must not invade the value reserved for the soon-to-be-subordinated lenders.

(4) An oversecured party is entitled to postpetition interest, but the extent to which the collateral is oversecured is usually thought to be the limit on such an entitlement. A valuation will be necessary to limit the amount of postpetition interest an oversecured party will receive.

B. Undersecured Creditors

Valuation is especially important for an undersecured creditor whose total claim exceeds the value of the collateral. When a creditor is undersecured, a bankruptcy court will be compelled to assess the value of collateral for at least the following reasons:

(1) The trustee may wish to abandon the collateral to the undersecured party. If so, a valuation of the collateral could determine the secured party’s unsecured deficit claim against the bankrupt es-

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14. Initially, section 362(d)(2)(B) was open to competing interpretations. Some courts thought the words meant only that a chapter 11 petition had been filed. See In re Rassier, 85 Bankr. 524, 527-30 (Bankr. D. Minn. 1988) (Kressel, J.). Other courts thought that section 362(d)(2)(B) meant that it was likely, under the circumstances, that a chapter 11 plan could be confirmed. See In re Planned Systems, Inc., 78 Bankr. 852, 865-66 (Bankr. S.D. Ohio 1987) (Cole, J.). In the course of depriving undersecured creditors of postpetition interest, the Supreme Court has endorsed the latter interpretation. See United Sav. Ass’n of Texas v. Timbers of Inwood Forest Assocs., 484 U.S. 365, 375-77 (1988) (Scalia, J.) (requiring a “realistic prospect of effective reorganization” to protect trustee from lifting of automatic stay).
17. There are many hidden controversies regarding the statement in the text. These are covered in Carlson, Postpetition Interest Under the Bankruptcy Code, 43 U. MIAMI L. REV. 577, 636-50 (1989).
Such a valuation is not absolutely necessary. The court may choose to await the secured party's actual foreclosure to see how much money is realized. The court could then determine the remaining unsecured claim without ever having to guess at the hypothetical value of the collateral. Courts may refuse to do this, however, if the trustee objects.\footnote{See In re Caraway, 95 Bankr. 466, 467 (Bankr. W.D. Ky. 1988) (Roberts, J.) (disapproving of post hoc process and insisting on court valuation before abandonment); see also In re Crowthers McCall Pattern, Inc., 120 Bankr. 279, 297 (Bankr. S.D.N.Y. 1990) (Buschman, J.) (explaining that to prove what creditors would have obtained in hypothetical liquidation, proponents of plan need not solicit offers because suggestion of liquidation might panic market place).}

(2) If the trustee proposes to retain the collateral in a reorganization plan, and if the secured creditor dissents from the plan, the plan can be confirmed over the secured creditor's opposition only if so-called "cram down" provisions are met.\footnote{See 11 U.S.C. § 1129(b)(2)(A) (1988) (requiring that creditor receive deferred cash payment which reflects full dollar amount of claim and which reflects present value of collateral).} Cram down provides various alternatives for dealing with dissenting secured creditors. Relevant here is the option of retaining the collateral and giving the secured party debt instruments with a present value of the collateral. The secured claim can be crammed down in this fashion only if the collateral equals or exceeds the secured claim. This version of cram down requires a valuation by the bankruptcy court.\footnote{See 11 U.S.C. § 1129(b)(2)(A) (1988) (setting forth rules for classifying creditors in anticipation of voting).} An undersecured party is entitled to vote both its fully secured claim (usually put in a unique class of claims) and its unsecured deficit (potentially classifiable with other unsecured claims).\footnote{In re Meadow Glen, Ltd., 87 Bankr. 421, 426-27 (Bankr. W.D. Tex. 1988) (Ayers, J.) (discussing voting rights of unsecured claim holder). The procedure and consequences of voting are set forth in 11 U.S.C. §§ 1126, 1129(a)(8), 1129(a)(10), 1129(b)(1) (1988).}

\footnote{11 U.S.C. § 506(a) (1988) (providing that claim is secured only to extent of value of creditor's interest in collateral; portion of claim that exceeds collateral is unsecured). In Ridgemont Apartment Assocs. v. Atlanta English Village, Ltd., 110 Bankr. 77, 81-82 (Bankr. N.D. Ga. 1989), Judge Vining upheld a decision refusing to set an exact value to the property, but instead establishing a range of value that was below the amount of the aggregate secured claims. Id. This would be fine if the court below had lifted the automatic stay, but the stay was continued. Id. at 82. A value range, however, is not good enough. A determinate secured claim is necessary unless the collateral is released to an oversecured creditor.\
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19. See In re Caraway, 95 Bankr. 466, 467 (Bankr. W.D. Ky. 1988) (Roberts, J.) (disapproving of post hoc process and insisting on court valuation before abandonment); see also In re Crowthers McCall Pattern, Inc., 120 Bankr. 279, 297 (Bankr. S.D.N.Y. 1990) (Buschman, J.) (explaining that to prove what creditors would have obtained in hypothetical liquidation, proponents of plan need not solicit offers because suggestion of liquidation might panic market place).}

\footnote{20. See 11 U.S.C. § 1129(b)(2)(A) (1988) (requiring that creditor receive deferred cash payment which reflects full dollar amount of claim and which reflects present value of collateral).}

\footnote{Id. § 1129(b)(2)(A)(i)(I); see also id. § 1325(a)(5)(B) (providing that court will confirm plan in which creditor's lien in collateral is preserved and valued at amount not less than allowed secured claim).}

\footnote{21. The text describes how the secured claim is crammed down, but an undersecured creditor will usually have a separate unsecured claim, which is subject to different cram down rules. See 11 U.S.C. § 1129(b)(2)(B) (1988) (setting forth rules for class of unsecured claims). The significance of this difference is described infra in the text accompanying notes 105-07.}


total claim is secured and what part is unsecured.\textsuperscript{25}

(4) The trustee, or perhaps the debtor, using section 506(d), may wish to disencumber the collateral from any lien associated with the undersecured party's unsecured deficiency claim. For example, suppose the collateral is worth $80, and, prior to bankruptcy, the secured party was entitled to collect $100 from the debtor or the collateral. Under section 506(a), the undersecured claim is bifurcated into an $80 secured claim and a $20 unsecured claim. Section 506(d) allows the trustee or the debtor to obtain a ruling that the collateral is encumbered by a lien that cannot exceed $80.\textsuperscript{26} Thus, if the collateral later increases in value to $85, the secured party remains limited to an $80 recovery from the collateral and a $20 unsecured claim.\textsuperscript{27}

(5) The debtor can redeem specified exempt personal property under section 722 for the value of the collateral.\textsuperscript{28} Since no sale of this collateral will occur, the court must value the collateral to determine the redemption price.\textsuperscript{29}

(6) A debtor who wishes to file in chapter 13 must have unsecured debts of less than $100,000.\textsuperscript{30} If some of the creditors are undersecured, valuation will determine the amount of unsecured debt that counts toward this limit.\textsuperscript{31}


\textsuperscript{26} Whether the debtor as well as the trustee can use section 506(d) is controversial. Compare Gaglia v. First Fed. Sav. & Loan Ass'n, 889 F.2d 1304, 1311 (3d Cir. 1990) (Hutchinson, J.) (holding that debtors could void undersecured portion of lien on real property) with Dewsnup v. Timm \textit{(In re Dewsnup)}, 908 F.2d 588, 592 (10th Cir. 1990) (per curiam) (finding that debtors could not avoid undersecured portion of lien), cert. granted, 111 S. Ct. 949 (1991). As one commentator has pointed out, all the cases on this issue miss a simple point. When a security interest for the unsecured deficit is avoided under section 506(d), it is simultaneously preserved for the benefit of the bankrupt estate. \textit{11 U.S.C. § 551} (1988). Thus, when the trustee abandons the collateral, the abandoned equity goes back to the debtor, and the avoided-but-preserved security interest for the unsecured deficit goes back to the creditor who previously owned it. See generally Note, \textit{An Individual Debtor's Right to Avoid Liens Under Section 506(d) of the Bankruptcy Code}, \textit{12 CARDOZO L. REV.} 263, 283 (1990). Because this is so, the debtor can never benefit from capping a lien under section 506(d). Id.


\textsuperscript{28} Cf. \textit{U.C.C. § 9-506} (1981) (providing that debtor has right to redeem collateral from secured party after default, but must pay full debt obligation, not just value of collateral, in order to redeem).

\textsuperscript{29} An undersecured creditor may receive even less than the value of the collateral if a plan has been confirmed and if the secured claim has been partially paid down under the plan. In such a case, under Bankruptcy Code section 722, the secured creditor can claim only the outstanding unpaid balance on the secured claim, even if the unsecured deficit claim is totally unpaid. \textit{In re Bunn}, 128 Bankr. 281, 283-84 (Bankr. D. Idaho 1991) (Pappas, J.).


\textsuperscript{31} See \textit{Brown & Co. Sec. v. Balbus \textit{(In re Balbus)}, 933 F.2d 246, 247 (4th Cir. 1991)} (Ervin, J.) (applying this principle to find party with total debt of $95,019 within chapter 13).
(7) An undersecured creditor can make the so-called section 1111(b) election, but not if that creditor's collateral is of "inconsequential value."\footnote{11 U.S.C. \S 1111(b)(1)(B)(i) (1988). The meaning of this election is most obscure.} Accordingly, a court may have to value collateral to see if the undersecured creditor's interest in it is consequential.\footnote{Tuma v. Firstmark Leasing Corp., 916 F.2d 488, 491 (9th Cir. 1990) (Ferguson, J.) (upholding valuation proceeding to determine significance of creditor's interest in stock.).}

(8) Finally, valuations are generally needed to perform some of the trustee's avoidance powers.\footnote{See generally \textit{In re Taxman Clothing Co.}, 905 F.2d 166, 170-71 (7th Cir. 1990) (Posner, J.) (finding that going concern value should be used to determine solvency in voidable preference case); Fortgang & Mayer, \textit{Valuation in Bankruptcy}, 32 UCLA L. Rev. 1061, 1107-08 (1985); Note, \textit{Bankruptcy Valuation Under Selected Liquidation Provisions}, 40 VAND. L. Rev. 177, 178-224 (1987). This essay will concentrate on the administration of valid security interests and will therefore omit any discussion of valuation for lien avoidance purposes.}

II. THE SUBJUNCTIVE NATURE OF VALUE

Value is a function of exchange.\footnote{See infra notes 145-51 and accompanying text.} Since a bankruptcy judge will determine value without the benefit of an historical exchange, the judge is required to hypothesize one. The rules for this speculation have never been spelled out. But this much can be said. Inevitably, valuation must invoke a picture of what a secured party could realize from the collateral if no bankruptcy had occurred. Otherwise, the security interest would be subject to the rules of bankruptcy in which an automatic stay is already in effect. If the automatic stay prevents foreclosure, the secured party could not foreclose at all and could realize nothing. Thus, if collateral is to have a value greater than zero, valuation invokes an alternative universe in which the bankruptcy petition was never filed and where no automatic stay exists to prevent repossession and foreclosure.

This hypothetical universe with its alternate history is governed by what one prominent philosopher calls "subjunctive information."\footnote{R. NOZICK, \textit{ANARCHY, STATE, AND UTOPIA} 152-53 (1974).} "What would have happened if . . . ?" is a natural question—one that is fundamental to human judgment and creativity and to the assignment of meaning itself. Unfortunately, historical claims in universes that never did exist are not verifiable propositions. Therefore, valuations and other subjunctive claims cannot count as objective facts in the rigorous sense of the word. Nor can
subjunctive claims disencumber themselves from objective truths. Subjunctive claims are designed to have normative purchase in the ethical marketplace, and this requires that they be plausible. What force they have is rhetorical.

Douglas Hofstadter illustrates the dependence of subjunctive claims on objective reality in a provocative essay on counterfactuals. He quoted a blooper reported by *The New Yorker* as follows: 
“If Leonardo da Vinci had been born a female the ceiling of the Sistine Chapel might never have been painted.” The editor of *The New Yorker* responded, “And if Michelangelo had been Siamese twins, the work would have been completed in half the time.”

Said Hofstadter,

The point of *The New Yorker*’s comment is not that such counterfactuals are false; it is more that anyone who would entertain such an idea . . . would have to be a little loony. Ironically, though, in the same issue, the following sentence, concluding a book review, was printed without blushing:

I think he [Professor Philipp Frank] would have enjoyed both of these books enormously.

Now poor Professor Frank is dead; and clearly it is nonsense to suggest that someone could read books written after his death. So why wasn’t this serious sentence also scoffed at? Somehow . . . the parameters slipped in this sentence do not violate our sense of “possibility” as much as in the earlier examples. . . . But why?

What is it about the way we classify events and people that makes us know deep down what is "sensible" to slip and what is silly? Unfortunately Hofstadter has no good answer, but undoubtedly the question is excellent.

Similarly, we may ask, “what makes one valuation plausible and the next completely unbelievable?” No answer to this question is currently available. All that can be said is that, if they wish to be upheld on appeal, judges must make their valuation analyses plausible. As Judge Bonney has pointed out, “[t]rue value is an elusive Pimpemel.” This is a good observation because, like the Scarlet Pimpemel, value is a fictional character, whose viability, if you can call it that, depends on whether we are persuaded to suspend our

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39. *Id.*
40. *Id.*
41. *Id.* at 642.
43. BARONESS EMMUSKA ORCZY, THE SCARLET PIMPERNEL (1905). The hero of this novel is a liberator of the rich and is best known for feats of bravery.
disbelief.44

Consistent with the above, the customary valuation exercise of bankruptcy judges is, "Well, had there been no bankruptcy, repossession would have occurred promptly, and a sale would have occurred within three months time for $X dollars."45 This scenario is plausible, but it does not logically exclude other equally plausible scenarios, such as: "If there had been no bankruptcy, then the debtor would have prevented foreclosure by deluging the courts with procedural objections and would have ultimately blown up the collateral with dynamite, so that the secured party's security interest has no value whatsoever."46 Both of these histories depend upon assertions of what creative human beings "would have done," and yet human beings are capable of anything! How can we choose which one is the "true" counterfactual?

One might say, for example, that the first hypothetical history reflects ordinary events and the second reflects extraordinary events. Between the two, pick the most ordinary counterfactual. But a retreat to abstractions of this sort amounts to the substitution of crude rules for contextual speculation.47 However reasonable the crude rule may seem, it is not the same as finding out what would have happened to the collateral that is actually before the court. This subjunctive exercise is the very soul of valuation.

44. According to Judge Lindsey:

Application and interpretation of the law is an art, not a science. The donning of a judicial robe confers authority and responsibility, not omniscience. This court can no more see into and predict the future with absolute certainty than can any of the parties or their expert witnesses. The Bankruptcy Code, however, favors providing debtors an opportunity to reorganize, to be given a fresh start, and unless the court can say with a greater degree of certainty than is possible here, that debtors' projections are unreasonable and cannot be met, these debtors should be afforded that opportunity.

In re Western Real Estate Fund, Inc., 75 Bankr. 580, 583 (Bankr. W.D. Okla. 1987). Notice that, according to Judge Lindsey, subjunctive uncertainty translates into a pro-debtor position. See also In re Crowthers McCall Pattern, Inc., 120 Bankr. 279, 297 (Bankr. S.D.N.Y. 1990) (Buschman, J.) (describing valuation as "an imprecise tool, perhaps the best we currently have, designed to reach a calculated decision on the basis of the hypotheses and assumptions in light of a set of facts"); In re Terrace Gardens Park Partnership, 96 Bankr. 707, 710 (Bankr. W.D. Tex. 1989) (Clark, J.) (arguing that "it is sheer arrogance for any bankruptcy court to maintain that it can, in the space of a few hours of hearing testimony, actually set values with binding collateral estoppel or res judicata effect").


46. One court held that, if a debtor would have imposed a lot of dilatory defenses, this must be considered in valuing the collateral. In re Asbridge, 66 Bankr. 894, 901-02 (Bankr. D.N.D. 1986) (Hill, J.). Extreme litigiousness is roughly analogous to blowing up the collateral with dynamite, in a lot of cases.

Alternatively, we can advertise our preferred vision of moral conduct by imagining a value based upon the secured party doing the most socially desirable thing.\(^\text{48}\) Thus, Judge Cyr valued inventory in a famous case on the basis of the *most* commercially reasonable sale, not just on a reasonably commercial sale.\(^\text{49}\) But in pursuing such visions, it should be noted that high values based on good commercial practice in a subjunctive universe enrich secured creditors in our actual universe, even if actual creditors cannot meet up to the high subjunctive standards upon which such a valuation is founded.\(^\text{50}\) If an undersecured creditor actually would have done a poor job in marketing collateral, then there is an argument for punishing that creditor in the subjunctive universe as well.

Thus, in *In re Waters*,\(^\text{51}\) Judge Clark considered the proper valuation of assets which the debtor wished to redeem under Bankruptcy Code section 722.\(^\text{52}\) He rejected a liquidation valuation on policy grounds because it calls for the creation of a "bankruptcy market" for exemption "fair market" valuations. This court sees no more reason to call such a marketplace into existence [a subjunctive note!] for redemption purposes. If anything, public policy militates against recognizing such a market, lest consumers be tempted to file chapter 7 bankruptcy solely to write down consumer debt to the detriment of the consumer credit industry. Consumer credit would either become prohibitively expensive (even more so than

\(^{48}\) For an example of such reasoning, see Note, *The Cost of Realization by the Secured Creditor in Bankruptcy*, 28 VAND. L. REV. 1091, 1106 (1975). The author of the Note considers a rule that limits the bankruptcy trustee to recovering from the secured party only the sales expense of collateral that the secured party would have incurred under state law. The author assumes that "what would have happened" was a peaceable surrender of the collateral. In the author's opinion the only "rational" reason for threatening to punch a reposessing secured party in the nose was if the secured party's lien was invalid. If the security interest was valid, no breach of the peace would have occurred. This view substitutes the objective rules of rationality for a more contextual form of counterfactual speculation, in which fists might fly under the influence of irrational passion. *Id.*


\(^{50}\) This is not only true for undersecured creditors who are more fully secured as value goes up, but it is also true of oversecured creditors, who may collect more postpetition interest if the equity cushion increases. 11 U.S.C. § 506(b) (1988).


it is already) or dry up completely were such a "marketplace" to be opened up by the bankruptcy courts of this nation.\textsuperscript{53}

Whatever the merits of the policy invoked by Judge Clark (and there are certainly grounds to criticize his functionalist assumptions),\textsuperscript{54} this substitution of a commercially reasonable valuation instead of a genuine subjunctive prediction of "what would have happened if no bankruptcy" radically changes the nature of valuations.\textsuperscript{55}

If abstract rules are not allowed, and if a court must discover what would have happened in the absence of bankruptcy, then no logical reason impels one alternative history over another. Rather, choices are edited on the basis of non-logical cultural criteria. This implies politics or aesthetics, but not logic and not empirically verifiable claims.\textsuperscript{56}

But this does not mean that bankruptcy valuations are unpredictable and subject to no restraints. Quite the contrary. If the law is indeterminate, bankruptcy judges are indeed predictable. They tend to be culturally and temperamentally homogenous and they do succeed in agreeing among themselves on what sorts of counterfactual speculations are acceptable and what sorts are unacceptable.\textsuperscript{57} For this reason, it can be said that the law is simultaneously indeterminate and reasonably predictable.\textsuperscript{58} Yet even if adequate protection decisions are usually predictable, it is important to recognize that construction of alternative histories is not the province of logic

\textsuperscript{53} See \textit{In re Waters}, 122 Bankr. at 301 (citations omitted). The reference to a "bankruptcy market" bears explanation. In one of Judge Clark's earlier cases, a debtor claimed that the proper valuation for section 722 redemption was the amount a bankruptcy trustee could realize for the collateral. \textit{In re Mitchell}, 103 Bankr. 819, 822-23 (Bankr. W.D. Tex. 1989) (Clark, J.). Judge Clark rejected the notion that for purposes of valuation there is a finite number of individuals, or "bankruptcy market," interested in buying only because of bankruptcy. \textit{Id.} Indeed, such an idea also violates the subjunctive premise—what would have happened if there were no bankruptcy. But to call liquidation value generally the same as a "bankruptcy market" seems unwarranted as well. Liquidation might constitute a valid "no-bankruptcy" subjunctive event.

\textsuperscript{54} Judge Clark's functionalist assumption that every change in law affects price is the hallmark of bad law-and-economics theory. There are economic reasons to support the idea that marginal debtor-creditor rules have no effect on the cost or availability of credit, such as when the cost of thinking about such rules outweighs the likelihood that such rules will actually harm the creditor. See generally Carlson, supra note 17, at 613-34.

\textsuperscript{55} Thus, Judge Clark rejects the secured party's claim that valuation should be based on what the secured party itself could recover for the property if it were to repossess and resell the furniture, arguing that it is uniquely positioned to realize a high resale value because it regularly resells repossessed furniture. That approach fails to balance the debtor's interests into the overall calculation, focusing solely on maximizing [the secured party's] return.

\textit{In re Waters}, 122 Bankr. at 302.

\textsuperscript{56} See Queenan, supra note 6, at 18, 43 (describing valuation as art).


\textsuperscript{58} \textit{Id.} at 917-45.
or fact, and therefore, in any given case, there is room for enormous free play.

III. LIQUIDATION VERSUS GOING CONCERN VALUE

The above sections have established that valuations are frequently (but not universally) necessary to administer secured claims, and that estimating the value of property is an art, not a science. Art demands some structure, and bankruptcy valuations are no different in this regard. Accordingly, courts seek to govern the counterfactual quality of valuations by means of some aphorisms.

At the highest level of generality, it is often said that a court "should make an informed projection as to the amount recoverable upon conversion of the collateral into cash in a commercially reasonable manner." Or, alternatively, fair market value is frequently defined as "what a willing seller . . . and a willing buyer . . . would agree upon after the property has been exposed to the market for a reasonable amount of time." Such formulations seem almost entirely without content, and so the choice for hypothesizing market exchanges is usually narrowed down to a choice of going concern value and liquidation value. Liquidation value is usually taken to imply what the creditor could realize in a forced sale under the rules of U.C.C. article 9, real estate mortgage provisions, or, even worse, under the rules of judicial execution. Such sales are notoriously poor in producing cash proceeds, and, if hypothetical liquidation is the standard, a court could easily justify a low figure by way of value.

Going concern value has been used in two senses. First, it might represent what a third party would pay for an entire business. Al-

59. This assumes that such a distinction between art and science is ever valid, a proposition some philosophers of science would deny. See generally P. FEYERABEND, SCIENCE IN A FREE SOCIETY (1978).


62. In re Markowitz Bldg. Co., 84 Bankr. 484, 487 (Bankr. N.D. Ohio 1988) (Speer, J.). For a list of various aphorisms that courts have used, see Butler, supra note 6, at 344.

63. Fortgang & Mayer, supra note 34, at 1063. But see In re Phoenix Steel Corp., 39 Bankr. 218, 226-27 (D. Del. 1984) (Schwartz, J.) (valuing collateral as splitting difference between liquidation and going concern value). For a case holding that the detailed liquidation procedures in the Agricultural Credit Act do not require the bankruptcy court to adopt a liquidation standard in farm credit cases, see In re Felten, 95 Bankr. 629, 632 (Bankr. N.D. Iowa 1988) (Melloy, J.).

64. For a good description of why this is so, see In re Robbins, 119 Bankr. 1, 6 (Bankr. D. Mass. 1990) (Queenan, J.).

65. In re T.H.B. Corp., 85 Bankr. 192, 195 (Bankr. D. Mass. 1988) (Queenan, J.). Going concern value might still be used even if it is thought that no one would buy the property in
ternatively, it might represent the selling price of inventory in the ordinary course of business and is therefore synonymous with retail value. Either way, in a reorganization proceeding, going concern value is supposed to exceed liquidation value.

The added content of such aphorisms, however, should not be overrated. Both going concern value and liquidation value can easily collapse into each other. For example, a liquidating secured party might be able to sell the collateral as part of a going concern, although it would require considerable help from the equity powers of a state court. Admittedly, this occurs infrequently, but the conceivable competes with the probable in subjunctive speculation.

Very frequently, courts choose going concern value in reorganization cases and choose liquidation value in liquidation cases. This question. In *In re* Raylin Development Co., 110 Bankr. 259, 260 (Bankr. W.D. Tex. 1989), Judge Clark substituted investors for buyers and then hypothesized an investment in the firm to determine value. This captures the value of an income producing asset even if no buyers of the asset are thought to exist. Id.


67. It is sometimes argued that secured parties ought to get a going concern value that is lower than or equal to liquidation value, because the debtor is an incompetent manager or irrational economic actor; this version of going concern value assumes, of course, that the debtor would continue to be in operation. Courts reject this argument and insist the property be valued according to its best use, not the suboptimal use that currently exists. *In re* Peerman, 109 Bankr. 718, 721-22 (Bankr. W.D. Tex. 1989) (Monroe, J.); *In re* Ehrich, 109 Bankr. 390, 391 (Bankr. D.S.D. 1989) (Hoyt, J.). In *Peerman*, it was the secured party, not the debtor, who argued for the low value. *In re* Peerman, 109 Bankr. at 719-20. The case involved "asset payment"—transfer of the collateral in satisfaction of antecedent debt. *Id.* The lower the value, the higher the secured party's remaining deficit claim would have been in bankruptcy. Meanwhile, if the valuation turned out to be too low, so much the better for the secured party who could later sell the collateral for the higher "correct" price and keep the profit.

68. *But see* Lincoln Nat'l Life Ins. Co. v. Craddock-Terry Shoe Corp. (*In re* Craddock-Terry Shoe Corp.), 98 Bankr. 250, 254 (Bankr. W.D. Va. 1988) (Anderson, J.) (denying that, at state law, secured party could reach going concern value of firm in pursuit of individual pieces of collateral). This view underestimates the equitable powers of a court to aid debt collection. Antiquarians will remember that, prior to the introduction of the reorganization chapters in the Depression, business reorganizations were executed entirely through the equitable powers of courts to appoint receivers on behalf of the creditors. These receivers very frequently worked for the benefit of secured creditors. *See Note, Corporate Receiverships and Chapter 11 Reorganizations*, 10 CARDOZO L. REV. 285, 291 (1988) (discussing procedure and criticism of consent receiverships).

69. *See, e.g., In re* Vitreous Steel Prods. Co., 911 F.2d 1223, 1232-33 (7th Cir. 1990) (Coffey, J.) (upholding choice of liquidation value in chapter 7 case); Bank Hapoalim B.M. v. E.I.I. Ltd., 42 Bankr. 376, 379 (N.D. Ill. 1984) (Bua, J.) (deciding liquidation value should be used for liquidation cases, and going concern value should be used for reorganization cases); American Universal Ins. Co. v. Dunlap (*In re* Microwave Prods. of Am., Inc.), 118 Bankr. 566, 572 (Bankr. W.D. Tenn. 1990) (Donald, J.) (using going concern value in reorganization case); Robinson Ranch, Inc., 75 Bankr. 606, 608-09 (Bankr. D. Mont. 1987) (Peterson, J.) (noting that chapter 12 requires use of fair market value and not liquidation value); *In re* Phoenix Steel Corp., 39 Bankr. 218, 226-27 (D. Del. 1984) (Schwartz, J.) (explaining that court was unsure whether debtor would liquidate or remain a going concern, so it averaged liquidation and going concern values); Downey Sav. & Loan Ass'n v. Helionetics, Inc. (*In re* Helionetics, Inc.), 70 Bankr. 433, 439 (Bankr. C.D. Cal. 1987) (Ryan, J.) (requiring going concern value in chapter 11 cases, absent unusual circumstances); L. LoPucki, STRATEGIES
rule has the dubious virtue of associational logic. In addition, as courts have recognized, section 506(a) seems to support a switch to going concern value by providing that value should be determined “in light of the . . . use of such property . . . .” This sentence contradicts the idea that value must be determined according to what would have happened in a subjunctive no-bankruptcy universe, since how property is used in reality does not necessarily affect how property would have been used in a non-existent universe.

The cases that routinely associate going concern value with reorganization proceedings are vociferously attacked by Judge Queenan in his learned essay on bankruptcy valuation. His position is simply that judges should always imagine a sale by a secured party, and therefore nothing about a chapter 11 going concern should determine a valuation standard (although it may provide evidence that can be used in subjunctive speculation). This position would provide a great deal more coherence to the law of valuation, but such a standard is inconsistent with section 506(a) which requires consideration of how the property is being used today.

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FOR CREDITORS IN BANKRUPTCY PROCEEDINGS 494 (1985) (noting preference for going concern value if debtor is going concern, but liquidation value if debtor decided to liquidate); Fortgang & Mayer, supra note 34, at 1087 (noting that court will use going concern value if appropriate in light of debtor's situation); see also Hearings on H.R. 31 and H.R. 32 Before the Subcomm. on Civil and Constitutional Rights of the House Comm. on the Judiciary, 94th Cong., 1st & 2d Sess., 495 (1975-76) (testimony of Patrick Murphy) (noting preference for going concern value if debtor is going concern).

70. As Judge Norton put it in a famous case:
Having declared itself to be a fish to be reorganized, it would be inconsistent for the court now to permit the debtor to declare itself a fowl to be liquidated for purposes of 'cramming down' a lower 'appraisal' value upon the secured creditors. Therefore, a liquidation value, i.e., a foreclosure value, is a procedure totally foreign to this matter and not a proper standard for valuation.

In re Pine Gate Assocs., 12 Collier Bankr. Cas. (MB) 607, 624, 3 Bankr. Ct. Dec. (CRR) 301, 309 (Bankr. N.D. Ga. 1977) (Norton, J.). Or, for another sportsman's aphorism, "the debtor cannot eat with the hounds and run with the hares." In re Crockett, 3 Bankr. 365, 367 (Bankr. N.D. Ill. 1980) (Eisen, J.). See also Pachulski, The Cram Down and Valuation Under Chapter 11 of the Bankruptcy Code, 58 N.C.L. REV. 925, 939 (1980) (stating that "[i]t is incongruous to value a business that is being reorganized on the basis of the price its assets could fetch on a piecemeal liquidation when the entire theory of the reorganization is that the debtor is being preserved as a going concern").

71. See In re Frost, 47 Bankr. 961, 963-64 (D. Kan. 1985) (Rodgers, J.) (citing legislative history of section 506(a) in noting provision’s preference for going concern value).


73. Queenan, supra note 6, at 32-34.

74. See In re Robbins, 119 Bankr. 1, 4 (Bankr. D. Mass. 1990) (Queenan, J.) (finding that "use of collateral by a debtor, even by one who has placed his house in financial order, is a neutral factor in establishing a standard of valuation"); In re T.H.B. Corp., 85 Bankr. 192, 196 (Bankr. D. Mass. 1988) (Queenan, J.) (advocating that "[t]he fact that the debtor is a going concern is no reason to value the collateral under the going concern standard unless it appears likely that the secured party will actually receive that value from its collateral through a pending sale").

75. See supra note 71 and accompanying text (noting section 506(a) preference for determining value in light of use of property).
Judge Queenan has offered two responses to the challenge that section 506(a) demands accounting for how a debtor actually proposes to use collateral. First, in his essay, he writes "[t]he debtor’s use of the collateral is relevant to valuation if the nature of that use physically affects the value of the collateral, either for good or bad." But historical events in the bankruptcy proceeding cannot so easily infect "what if" speculation. The "what if" game asks what would have happened if the bankruptcy never occurred; postbankruptcy use of property is therefore precisely what subjunctive reasoning demands to be excluded. At best it can serve as evidence of what would have happened to the collateral if no bankruptcy had occurred.

In a later opinion, Judge Queenan abandons this tactic and tries a new one based on the language of the Bankruptcy Code. In In re Robbins, a second mortgagee claimed it was not adequately protected and that, therefore, the stay ought to be lifted. Judge Queenan used this motion as an occasion to philosophize about valuing collateral for the purpose of determining whether the value of the secured party’s claim was eroding over time. In Robbins, Queenan points out that, whereas section 506(a) requires consideration of how the property is actually to be used, it also specifies that the thing to be valued is not the collateral itself, but rather the creditor’s lien on the collateral. According to Judge Queenan, “This wording is crucial . . . . The phrase ‘the value of such creditor’s interest’ is not equivalent to the value of the collateral.” This need to value the lien (and not the collateral) negates the requirement that actual, intended use of the collateral must be considered in valuation. Thus, because we must value the lien (not the collateral), we are

76. Queenan, supra note 6, at 33.
79. See id. at 3-6 (discussing valuation standard used to determine changing value of secured party’s claim).
80. Id. at 3; see also 11 U.S.C. § 506(a) (1988) (stating that “[a]n allowed claim . . . is a secured claim to the extent of the value of such creditor’s interest in the estate’s interest in such property . . . .”) (emphasis added).
82. Id. at 4. Judge Queenan explains:
   It makes no sense to attach independent significance to the Debtor’s use of the property. Use of collateral by a debtor, even one who has placed his financial house in order, is a neutral factor in establishing a standard of valuation. We are dealing here with valuation of a mortgage interest and not the property itself. Except to the extent that a sale at fair market value is a substantial possibility, a security interest is worth what it will bring at a commercially reasonable foreclosure.
   Id. The assumption that, but for a bankruptcy, a foreclosure sale would be commercially reasonable—a disputable proposition—is discussed supra in the text accompanying notes 47-55.
thrown entirely into the subjunctive universe of pure speculation with no need to consider how the property is actually being used. Liens, Judge Queenan implies, have meaning only in a foreclosure, and so we must ignore the debtor’s intent to retain the collateral and attend only to the imagined foreclosure.83

If Queenan is right, then the first part of section 506(a) requires us to imagine value in a no-bankruptcy world, while the second part of section 506(a) insists that we consider what is to become of the collateral in the real world. The second part of section 506(a) may be ignored, because the collateral actually used has nothing to do with the lien being subjunctively valued.84

Yet, inconsistently, Judge Queenan also indicates that he would have used the actual sales price in a case where the trustee sold the collateral.85 Thus, Queenan is not quite willing to commit himself totally to subjunctive reasoning. If he had been so committed, an actual sale would have been irrelevant. Instead, a potentially lower value could be assigned the collateral, and the trustee could keep a profit from selling the collateral for a higher price in the real world.86 Apparently, this arbitrage between real and subjunctive markets was even more than Judge Queenan, a dedicated subjunctivist, could bear.

In the end, the choice between liquidation or going concern value is based on whether you think that secured parties or general creditors should own the bonus that adheres to the idea of a going concern. Who deserves what property is a question on which we can all have intuitions,87 but logic alone cannot settle such questions in an uncontroversial manner.88

84. In reorganization cases, Judge Queenan implies that going concern value should not be used:

The purpose of this valuation sheds no light on the standard to be used. We are not concerned, for example, with a valuation under § 1129(a)(7) of property, which creditors would receive or retain in a liquidation, where liquidation value is perhaps most relevant.

In re Robbins, 119 Bankr. at 3. Section 1129(a)(7) is the “best interest of the creditors” test. Its implications for valuation are discussed infra in the text accompanying notes 89-107.
87. See In re Pullman Constr. Indus., 107 Bankr. 909, 939 (Bankr. N.D. Ill. 1989) (Schmetterer, J.) (finding that “[i]t is grossly inequitable and unfairly discriminatory to ‘cram down’ forced liquidation values in case that does not involve chapter 11 liquidating plan”).
88. See Pachulski, supra note 70, at 958 (stating that “[t]he philosophical question implicit in the battle over valuation methods in this situation is whether the secured creditor is entitled to a portion of the going concern bonus inherent in its collateral”).
A. The Implications of the "Best Interests of the Creditors" Rule

In choosing between going concern or liquidation value, we have seen that, through the power of simile, many courts have been led to use liquidation value in liquidation cases and going concern value in reorganizations. There is an interesting doctrinal argument in favor of liquidation value in chapter 11 cases, however. If accepted, it promises to shift massive wealth from partially secured creditors to unsecured creditors.

This argument uses the so-called "best interests of the creditors" rule in chapter 11 under which every dissenting creditor is entitled to get the same amount or more from the chapter 11 plan as from a hypothetical liquidation. The rule guarantees that everyone is either unaffected or better off with a going concern than with a liquidation or, to use a fancy term, that chapter 11 plans are pareto superior to liquidations. Since chapter 11 requires that the secured party get no less than she would have gotten in a chapter 7 liquidation, it might seem appropriate that the secured party's collateral be given its liquidation value. It certainly appears peculiar that, after hypothesizing what a liquidation would have brought in, a court might value the collateral as if the firm were a going concern. This argument is not entirely unfair either. If "what would have happened" without chapter 11 is a liquidation, then the undersecured party's participation in the largess of a chapter 11 plan could be viewed as pure windfall.

In such matters, it is always possible to argue the opposite. Accordingly, one commentator finds in the "best interests" rule the exact reverse implication from what has just been suggested. According to Isaac Pachulski, if the "best interests" test of Bankruptcy Code section 1129(a)(7)(A)(ii) requires a liquidation standard, then the separate "fair and equitable" rule of cram down must require

89. See 11 U.S.C. § 1129(a)(7)(A)(ii) (1988) (setting forth that "[e]ach holder of a claim or interest . . . will receive or retain under the plan . . . a value . . . not less than the amount that such holder would so receive or return if the debtor were liquidated under chapter 7 of this title").

90. See In re Robbins, 119 Bankr. 1, 3 (Bankr. D. Mass. 1990) (Queenan, J.) (implying that liquidation is mandated by section 1129(a)(7)); see also In re Jumpers Equities, Ltd., 4 B.C.D. 1269, 1270 (Bankr. D. Md. 1978) (Thomsen, J.) (holding liquidation value is constitutional minimum that secured parties must get and that going concern value is just bonus). This holding, however, is bad constitutional law. The Bankruptcy Code need not give anything to secured parties, although perhaps an argument can be made against retrospective application of bankruptcy legislation. See Carlson, supra note 17, at 585-89 (discussing constitutional difference between retroactive and prospective bankruptcy legislation).

91. See Pachulski, supra note 70, at 958-59.

92. See 11 U.S.C. § 1129(b)(1) (1988) (setting forth that "the court . . . shall confirm the plan . . . if the plan is fair and equitable with respect to each class of claims of interests . . . ").
something else. Otherwise, it is entirely redundant, and Congress is presumed never to act ineffectively.

The problem with such arguments is that they are defeated if some necessity can be found for the statutory provision accused of being redundant. As Puchulski recognizes, the cram down provision is not redundant because it serves to rule out the possibility that secured parties will be given equity securities for their collateral. By virtue of this demonstration of utility, it is now possible to use liquidation for both the “best interests” rule and the “fair and equitable” rule. Indeed, even Puchulski himself calls the sudden shifting of valuation standards in the middle of the bankruptcy proceeding “bizarre” (though he defends it).

The argument that section 1129(a)(7) compels liquidation value in a chapter 11 proceeding was rejected by Judge Baynes for a different reason in In re Yasparro. Yasparro involved general creditors only, but it nevertheless is relevant to the present discussion. In Yasparro, the individual debtor claimed that property with a “market value” of $203,750 had a liquidation value of $7,500, because most of the property would be exempt in a liquidation. The debtor aggressively proposed a plan in which the debtor would give $32,000 over ten years at 10% interest, an amount with a present value that exceeded $7,500. The debtor then would retain all other property.

The debtor’s plan clearly violated the absolute priority rule and could not be confirmed, as the debtor retained “property,” albeit exempt, while the general creditors had not been fully paid. Of interest for this discussion is a separate ground used to deny confirmation of the plan. “There is no dispute [that] the debtor’s plan meets the best interest of the creditor’s test,” wrote Judge Baynes. “That test, however, is not relevant to the ‘fair and equitable’ requirement under Section 1129(b)(2)(B).” Baynes then quoted Justice Douglas as stating, “[t]o hold that in a section 77B reorganization creditors of a hopelessly insolvent debtor may be forced to share the already insufficient assets with stockholders because apart from rehabilitation under that section they would suffer a worse

93. Puchulski, supra note 70, at 949-50.
94. Id. at 965.
95. 100 Bankr. 91 (Bankr. M.D. Fla. 1989) (Baynes, J.).
97. Id. at 94-95; see also In re Johnson, 101 Bankr. 307, 309 (Bankr. M.D. Fla. 1989) (Paskay, J.) (holding that absolute priority rule is violated if exempt property is retained).
98. In re Yasparro, 100 Bankr. at 94.
99. Id.
fate, would disregard the standards of fairness and equity . . . ."¹⁰⁰ According to Judge Baynes, this quotation implies that cram down must use going concern value, or else juniors will obtain value.¹⁰¹ But that is not what Justice Douglas meant in the above quotation. Justice Douglas meant only that it is not equitable for shareholders to get anything when the creditors are not fully paid.¹⁰² He does not address whether creditors have a right to a going concern valuation, though he did so two years later in Consolidated Rock Products Co. v. Du Bois.¹⁰³ Yet, as one commentator argues, Justice Douglas' association of going concern value with the absolute priority rule is assertory rather than logical.¹⁰⁴ It does not appear that anything can be learned about valuation of secured claims from the absolute priority rule. Indeed, the absolute priority rule has only an indirect relationship with secured claims.¹⁰⁵ Under the cram down provisions, secured claims must be paid in full (albeit by uncertainly valued debt instruments).¹⁰⁶ If liquidation value were to be used, an otherwise fully secured creditor might become an undersecured creditor with a secured claim and an unsecured deficit. While the secured part of the claim must be paid in full, the unsecured deficit now qualifies for the absolute priority rule. Under the rule, if the undersecured party dissents, the secured party must be paid in full before the shareholders can receive anything. All of this can occur even though liquidation, not going concern value, is used to diminish the collateral of the secured party. That is, if the secured party is driven underwater by liquidation value, it is still true that the unsecured portion of the claim must be paid in full before the junior parties can receive anything in the

¹⁰⁰. Id. (quoting Case v. Los Angeles Lumber Prods. Co., 308 U.S. 106, 124 (1939)).
¹⁰¹. See id. (rejecting argument that cram down provision is satisfied by meeting best interests test).
¹⁰². See Case, 308 U.S. at 126.
¹⁰³. 312 U.S. 510, 526 (1941).

Justice Douglas never fully justified this view, but he seemed to acknowledge that the Chapter X creditor loaned on the faith of the normally higher going concern value, and that if the business is to continue after reorganization, then the creditor ought to be able to look to value at least equal to the value in which he had an interest before the reorganization.

Id. at 1000 (footnote omitted).

This premise of justifying the law based on what creditors expect can be criticized for being circular, since the creditors expect precisely what the law allows.

plan. Hence, it cannot be said that Judge Baynes has shown that the absolute priority rule compels the use of going concern valuation.107 Rather, the absolute priority rule works even if liquidation value is used.

B. The Implications of Opportunity Costs as Part of Adequate Protection

If some courts imply that in reorganization cases going concern value might be chosen, others go further to imply that going concern value must be chosen, regardless of what would have happened in the absence of bankruptcy. These arguments have been deduced from the principle that a secured creditor's opportunity costs (in the guise of postpetition interest) are not part of the adequate protection to which an undersecured party is entitled, a principle recently endorsed by the Supreme Court.108

In the course of denying undersecured parties postpetition interest as part of adequate protection, Judge King implies that going concern valuations are the quid pro quo that justifies forced interest-free reinvestments of collateral that, but for bankruptcy, the undersecured party would have controlled.109 So expressed, the mode of valuation is not a function of imagining "what would have happened if there had been no bankruptcy," but instead has a much more ostensible political content—compensation for a valuable right that undersecured parties have lost.

In contrast, Judge Mabey has claimed that going concern valuation is logically, not politically, connected to the inability of an undersecured party to get postpetition interest. In a much-cited opinion on whether undersecured parties should get postpetition interest as part of adequate protection, Judge Mabey wrote "one cannot consistently ask for going concern valuations and opportu-

107. One possible embarrassment for the conclusion in the text—that the absolute priority rule determines nothing about the standard of valuation—involves nonrecourse secured parties, who would seem to get no unsecured deficit claim. But, as it turns out, chapter 11 changes nonrecourse lenders into recourse lenders if they elect to be so and if the collateral is not to be sold under the plan. 11 U.S.C. § 1111(b)(1) (1988) (setting forth that "[a] claim secured by a lien . . . shall be allowed or disallowed . . . as if the holder of such claim had recourecase against the debtor"); see Carlson, supra note 86, at 279-82 (discussing application of section 1111(b) to nonrecourse secured claims). Hence, the absolute priority rule protects even nonrecourse lenders indirectly through the unsecured deficit.


109. See United Sav. Ass'n of Texas v. Timbers of Inwood Forest Assocs., 808 F.2d 363, 373 (5th Cir. 1987) (en banc) (maintaining that goal of Bankruptcy Code is to benefit creditor of chapter 11 debtor by preserving going concern values and thus increasing amounts recoverable by all creditors), aff'd, 484 U.S. 365 (1988) (Scalia, J.).
nity costs as adequate protection." 110 In other words, postpetition interest cannot be given as part of adequate protection because doing so would rule out going concern valuation in chapter 11, a conclusion Judge Mabey found intolerable. The idea that opportunity costs are part of adequate protection, he reasoned, comes from the idea that the secured party would realize cash from the sale of the collateral and would reinvest it, thereby earning interest. 111 This subjunctive exercise would rule out the use of any going concern value elsewhere in chapter 11.

Now that the Supreme Court has ruled out postpetition interest as part of adequate protection, 112 this logic may seem to require the use of going concern valuations in chapter 11. But this does not necessarily follow. Counterfactual speculation being what it is, one can easily think up a story in which there is going concern value and postpetition interest for undersecured parties. For example, if there had been no bankruptcy, the debtor would have sold the firm as a going concern. These proceeds would then have been remitted to the secured party. Thereafter, the secured party would have reinvested the proceeds and would have started earning interest. 113 Therefore, it is plausible to argue simultaneously for an interest entitlement and a going concern valuation. Accordingly, the rule on postpetition interest does not determine what valuation standard should be used in reorganization cases.

A slightly different argument against using going concern value in all chapter 11 cases is that approximately ninety percent of reorganizations actually end up being converted into chapter 7 liquidations. 114 On the strength of these dismal numbers, Judge Queenan thought that liquidation value might be used in a chapter 11 case where the secured party sought to have the automatic stay lifted for lack of adequate protection. 115 This reasoning, however, has its ironic side. Because chapter 11 proceedings are rarely successful, the secured party is deemed to have a small secured claim and a large unsecured deficit claim. As a result of this valuation, the chapter 11 proceeding is more likely to perpetuate control of the collateral. That is, chapter 11's poor track record increases the chances

111. *Id.* at 1002.
113. *See* Fortgang & Mayer, *supra* note 34, at 1085 (telling similar rule).
115. *Id.*
that chapter 11 proceedings will succeed. This is a little like the parricide asking for mercy on the grounds of being an orphan.

C. Changing Valuation Procedures in the Middle of the Proceeding

The Bankruptcy Code pushes secured parties to favor going concern value at some times, and liquidation value at other times. Hence, the same creditor has the incentive to argue for different valuations in the very same proceeding, while the debtor will argue obversely from whatever the secured creditor favors.

For example, if the secured party wants a valuation of the collateral to set the maximum amount of the secured claim\(^{116}\) or if she wants postpetition interest, the secured party prefers going concern value. But if the secured party is demanding adequate protection or a lifting of the automatic stay because there is no equity in the property, she will prefer a lower liquidation value. *In re Keystone Camera Products Corp.*\(^{117}\) is an example of secured parties arguing for liquidation value. In that case, the debtor sought postpetition financing by means of a superpriority lien under Bankruptcy Code section 364(d)(1)\(^{118}\). Such a lien is permissible only if the soon-to-be-subordinated secured parties are adequately protected in their liens. Thus, a superpriority lien is permitted when the debtor equity is so large that, even after the superpriority lien attaches, there is plenty left for the existing secured parties. Here is a case in which a secured party will argue strongly for liquidation value, in order to minimize the size of the superpriority lien that can be granted. If a going concern value is awarded and the chapter 11 debtor later collapses, the secured party could be driven seriously under water.\(^{119}\)

Accordingly, Judge Tuohey made the sensible decision to estimate whether a reorganization plan was likely to be confirmed. If

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116. That is, when the secured party is undersecured, a going concern value will help increase the secured claim and reduce the unsecured deficit when the undersecured claim is split in two pursuant to section 506(a).
119. A secured party would still have the remedy of a deficit judgment, which would carry a superpriority under section 507(b). This priority is higher than that of the trustee and her lawyers, but it depends on there being unencumbered assets in the estate once the deficit judgment arises.

For another case in which a secured party argued for a low liquidation value, see Brown & Co. Securities v. Balbus (*In re Balbus*), 933 F.2d 246 (4th Cir. 1991). In *Balbus*, the secured party argued that the value of its secured claim should be reduced to reflect the hypothetical transaction costs of disposing of the collateral. *Id.* at 248. If this had been accepted, the debtor would not have qualified for chapter 13, because he would have had too much unsecured debt. The court opted for a valuation in which transaction costs were *not* deducted, so the chapter 13 proceeding could continue.
so, he was willing to use going concern value to further postpetition credit. But if not, he was unwilling to impose risks on existing secured creditors by inflating the equity through such a valuation. Because he found reason to doubt the ability of the debtor to reorganize, Judge Tuohey chose liquidation value.

This reversal of incentive raises the issue of whether, having chosen liquidation or going concern value, a court may change standards later on. For example, could a court choose liquidation value for adequate protection purposes, and perhaps eliminate debtor equity and the consequent right to postpetition interest under section 506(a), and then switch to going concern value in a chapter 11 plan? Section 506(a) certainly suggests so. Some courts have justified the switch of standards on the theory that, prior to the reorganization plan, a debtor deserves “breathing space” and hence a low value for adequate protection, whereas in the plan itself, going concern value is appropriate.

This practice seems arbitrary and open to manipulation. The early use of liquidation value, so benignly called giving a debtor “breathing space,” translates into eliminating the secured party’s right to postpetition interest. But value is supposed to be an objective, unquestionable thing. A change of standards to serve pro-debtor or pro-creditor politics belies the objectivity that valuations are supposed to represent. It would be better if a single valuation standard was adopted for an entire bankruptcy proceeding.

Keeping in mind that ninety percent of chapter 11 proceedings fail, the consequences of sticking to one valuation theory—espe-

120. Once again, the last sentence of that provision states: “Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor’s interest.” 11 U.S.C. § 506(a) (1988).

121. In re Valley Park Group, Inc., 96 Bankr. 16, 23-24 (Bankr. N.D.N.Y. 1989) (Gerling, J.) (determining that court is not bound by valuation method selected 17 months earlier when case had commenced). In In re Fairfield Plaza Assocs., 115 Bankr. 358 (Bankr. N.D. Fla. 1990) (Killian, J.), the parties agreed liquidation value was appropriate at a section 362(d) hearing to lift the automatic stay. The stay was then kept on because the secured party was adequately protected and because a reorganization, within the meaning of Bankruptcy Code section 362(d), was feasible. Id. at 359. The debtor later tried to use liquidation value for the purpose of limiting the secured party’s entitlement in the chapter 11 plan. Id. at 359-60. Judge Killian chose going concern value because he thought it unfair if “[a]fter having written down the secured debt the debtor comes into confirmation with very rosy income projections.” Id. at 360.

122. See Queenan, supra note 6, at 28 (arguing that purpose of valuation is to be “neutral” factor unrelated to wishes of debtor or creditor).

123. To be distinguished is the issue of whether, given a single standard of valuation, numerous “second looks” at the value of collateral might be taken. I cover this difficult issue in Carlson, supra note 86.

cially a going concern theory—throughout the proceeding are significant. If a creditor is undersecured at the start of the proceeding, a going concern valuation for such issues as adequate protection upholds the principle of Bankruptcy Code section 362(d)(2)(B), wherein the debtor’s retention of the collateral is premised on its role in an effective reorganization. According to the Supreme Court, “effective” means a reorganization in which a plan is likely to be confirmed. Hence, a consistent going concern valuation theory deters the debtor from retaining the collateral unless an effective reorganization really is possible. More adequate protection up front is consistent with what a confirmable plan will eventually require. If this adequate protection fails, the remedy is a superpriority under Bankruptcy Code section 507(b), a priority that outranks the debtor’s own administrative claims against the bankrupt estate. If the debtor’s own compensation is placed at risk, the debtor is more likely to attend to the requirement that the chances for a confirmed plan must be good. Finally, a higher going concern valuation may turn the secured creditor from an undersecured to an oversecured creditor, justifying a postpetition interest award to the secured creditor. This transformation mitigates the injustice of the debtor’s power to deprive undersecured creditors of their opportunity costs. These observations are consistent with Judge King’s observations in Timbers, in which she thought that going concern valuations are a required quid pro quo for no postpetition interest entitlement.

IV. PROBLEMS INVOLVING GOING CONCERN VALUE

A. Individual Pieces of Collateral in the Going Concern

Suppose a firm has a positive going concern value. Can this value be attributed to individual pieces of collateral held by secured parties? This approach is comparatively easy when the collateral is in-

126. Two other commentators, Chaim Fortgang and Thomas Mayer, have suggested that going concern value could be used early in a chapter 11 case. If the case collapses and liquidation ensues, however, the secured creditor must be awarded a large superpriority under section 507(b) for failed adequate protection. Fortgang & Mayer, supra note 34, at 1084-85.
128. Id.
ventory made to be sold. More difficult is the valuation of equipment used in the going concern.

Once again, our subjunctive formula for calculating value is indeterminate. Absent bankruptcy, a secured party might repossess the collateral and get only its liquidation value. But it is conceivable that a secured party might also obtain a receivership or other equitable help in reaching the going concern of an entire firm.\textsuperscript{130} Therefore, although attribution of going concern value of the firm to specific pieces of collateral will require the imposition of some accounting fictions,\textsuperscript{131} it does not seem ruled out as a means of valuation.

The notion of a going concern value for individual pieces of collateral has been attacked by Professor Douglas Baird and Dean Thomas Jackson.\textsuperscript{132} Their attack, however, is only partial. Baird and Jackson support a rule that individual pieces of inventory might be sold together by a single creditor to capture synergistic properties of collateral itself, provided one secured party owns all pieces of collateral.\textsuperscript{133} Nothing in their article opposes the notion of valuing inventory as if it were sold in the ordinary course of business. Instead, their main objection is to the allocation of a share of going concern value of an entire firm to individual pieces of collateral used by managers in the business.\textsuperscript{134} In their example, a piece of equipment such as a computer might be valued as if sold in the ordinary course of the secured party's or the debtor's business, but no part of the total going concern value of the firm could be allocated to the computer.\textsuperscript{135} The reason for this is that the extra value is allocable to management and not to the equipment used by management.\textsuperscript{136}

\textsuperscript{130. See Bowman & Thompson, supra note 47 and accompanying text (discussing use of contextual speculation in valuation hypotheticals).}

\textsuperscript{131. See Queenan, supra note 6, at 54 (calling "entire process . . . a nightmarish prospect" and urging that it be ignored "for reasons of simplicity alone"). Judge Queenan's remark, however, overlooks how breathtakingly simple accounting assumptions can be, and how soundly accountants can sleep after making them.}

\textsuperscript{132. See Baird & Jackson, Bargaining After the Fall and the Contours of the Absolute Priority Rule, 55 U. Chi. L. Rev. 738, 782-87 (1988) (discussing problems of courts using going concern valuation).}

\textsuperscript{133. Id. at 786-87.}

\textsuperscript{134. See id. at 782-85; see also Lincoln Nat'l Life Ins. Co. v. Craddock-Terry Shoe Corp. (In re Craddock-Terry Shoe Corp.), 98 Bankr. 250, 254 (Bankr. W.D. Va. 1988) (Anderson, J.) (finding that going concern value does not mean "value added by the collateral to a sale of the entire business").}

\textsuperscript{135. Baird & Jackson, supra note 132, at 782-83.}

\textsuperscript{136. Id. at 783 n.3. Because they think management always "causes" the going concern bonus, Baird and Jackson attack Judge King's assertion that going concern value is mandated by a political quid pro quo whereby, in exchange for no postpetition interest entitlement, undersecured parties get higher going concern valuations. This view is described supra in the text accompanying note 90.}
This explanation may suffice when management is not fungible, but it fails if management is easily replaced. Instead, sometimes going concern value can be attributed to the strategic position of the hard assets themselves. Furthermore, this assessment may suffer from the “sunk cost” fallacy: management may have been brilliant in setting up a system that works by itself, but once that brilliance is embedded in the system, a lower-level management can keep the system going. Indeed, idiot-proof systemics are themselves a hallmark of good management. If so, management is more akin to a sunk cost or prepaid expense and cannot be deemed causally necessary to future profits.

In the end, an allocation of going concern value to specific assets cannot be resolved by uncontroversial assertions of causation. Indeed, one of the more clever insights of the Coase Theorem—that fount of law and economics wisdom—is that causation is not a natural phenomenon at all, but is a legal question to be settled by economic analysis. Therefore, Baird and Jackson are being entirely circular when they appeal to a legal issue—causation—to settle a legal issue—proper valuation standards.

The exact opposite causal assertion, that an income stream comes totally from the tools and not from human talent, seems equally inappropriate. In re Cook, is a chapter 13 case where the secured party claimed that a car should be valued at its replacement, not its wholesale, value. Judge Clark wrote:

137. The explanation may fail even if management is unique. If, for example, a telephone system or other vital equipment is repossessed from an insolvent company, going concern value may disappear faster than if the managers quit.

138. See Queenan, supra note 6, at 57-58 (acknowledging that “in place” value is possible, though not likely). The classic judicial account of going concern value does not even mention management as a factor. See In re Brown, 242 N.Y. 1, 7, 150 N.E. 581, 583 (1926) (Cardozo, J.) (listing continuity of place and name as chief elements of “good will”).


140. In a more recent article, Douglas Baird has relented and admitted that, when management is fungible, management does not cause going concern value. Baird & Picker, A Simple Noncooperative Bargaining Model of Corporate Reorganizations, 20 J. Legal Stud. 311, 327 (1991). This undercuts his earlier assertion that a secured creditor claiming equipment cannot share in the going concern value of a debtor-in-possession. Baird & Jackson, supra note 132, at 782-83.


142. This position was taken in Sprecher v. Bank of Yates City (In re Sprecher), 65 Bankr. 598, 601 (Bankr. C.D. Ill. 1986) (Aitlenberger, J.) (determining replacement value of farm equipment and livestock appropriate because debtor intended to continue farming) and In re Courtwright, 57 Bankr. 495, 497 (Bankr. D. Ore. 1986) (Hess, J.) (using replacement value where debtor intends to retain property).

Going concern value may mean that the debtor can use the property to generate income greater than the price for which the property could be sold. An example of this meaning could be tools used by a mechanic to produce income greater than the price which could be obtained at a sale in the used car market. . . . Using this meaning when valuing a consumer’s car, however, is artificial. It is not use of the car that generates income for a chapter 13 debtor who uses the car to drive to and from work. It is the services of the debtor unrelated to the use of the car that generates income. Thus, to say that a car used to drive to and from work has a going concern value makes little sense.144

One can hardly disagree with this observation. The best that can be said is that causation is not an uncontroversial fact in the world to which we can appeal. Rather, it is a legal conclusion that must be reached in pursuit of other goals and visions.

B. Use Versus Exchange Value

There is another distinction to account for within the realm of going concern value. This is the distinction between use value and exchange value. Use value is the amount a possessor of property would charge to part with it, or alternatively the amount the possessor would pay to prevent the property from being taken away. Roughly speaking, use value can be equated with replacement value.145 Exchange value is the amount a buyer would pay for the property.146 Ordinarily, when exchange value exceeds use value, the owner of property will sell. If use value exceeds exchange value, the owner of property will retain the property and not sell.

As regards a going concern, we must not be tempted to conclude that, if the debtor has not yet sold property, the use value exceeds exchange value. Such a criterion assumes the debtor is rational in retaining and not selling collateral. Or, it might assume that the market is perfect when in fact it is highly defective. In corporate

144. In re Cook, 38 Bankr. 870, 875 n.11 (Bankr. D. Utah 1984) (Clark, J.); see also Valley Nat'l Bank v. Malody, 102 Bankr. 745, 749 (Bankr. 9th Cir. 1989) (Russell, J.) (finding that retained vehicles are not essential to debtors' plan, and thus do not generate income).

145. This equation is inexact, however. Replacement value would appear to be what the debtor would pay for an item with comparable use value. This price would include transaction costs absorbed by the seller. Since no replacement is planned, the opportunity cost of retaining the item in real life is less than the hypothetical replacement cost. Also, even if adjusted for transaction costs, the replacement cost could still exceed the use value to the debtor, who, in real life, would decline to replace the item in question. Both of these differences between replacement value and use value could exist while, simultaneously, the exchange value—what the debtor could sell the item for—would be less than both replacement and use values.

146. See Queenan, supra note 6, at 19 (referring to amount buyer would pay as retail value).
cases, agency costs\(^{147}\) might mean that use value is actually lower than exchange value.

Finally, in cases where the debtor is the highest valuing user of collateral, use value holds the debtor’s own special expertise hostage to creditor entitlements. That is, if use value is high, the debtor’s special competence is the cause. When this surplus is awarded to a secured creditor, the debtor is being punished for her expertise. Yet this kind of postbankruptcy expertise is the core of the fresh start that debtors are supposed to get in bankruptcy. On this reasoning, at least in consumer cases, exchange value seems a better standard than use value.\(^{148}\)

In chapter 13, use value is often asserted in the form of “replacement” value. That is, secured parties assert that the value of the collateral ought to be enhanced from wholesale value by the idea that the debtor would have to replace the collateral in question.\(^{149}\) Judge Queenan has indicated that the argument in favor of use over exchange value has been almost uniformly rejected by the courts because it is the creditors’ interest in the collateral (i.e., the exchange value) rather than the debtors’ interest in the property which should be protected.\(^{150}\) One implication would follow when use value is higher than exchange value. If the debtor-in-possession is the highest valuing user who should not sell the assets, then no transaction costs will be necessary to sell the collateral because these costs would not exist even absent the bankruptcy. On the other hand, if exchange value is used, then transaction costs will be entailed because the hypothetical exchange would involve these costs. This observation raises the issue of whether the valuation should be affected by expected transaction costs, a subject discussed later.\(^{151}\)

V. Problems Involving Liquidation Value

A. Bid-in Sales

One argument for maximizing liquidation value, by using a

\(^{147}\) That is, the costs imposed by self-serving managers who do not act to maximize the position of the owners.


\(^{150}\) Queenan, supra note 6, at 30. For an eloquent denunciation of replacement value, see In re Cook, 98 Bankr. 870, 872-76 (Bankr. D. Utah 1984) (Clark, J.).

\(^{151}\) See infra notes 173-207 and accompanying text.
counterfactual "what would have happened" procedure, is for the creditor to claim that, but for the bankruptcy, it would have bid in its claim at a poorly attended auction and then would have sold the collateral at a high price in the ordinary course of business.\textsuperscript{152} Taken to an extreme, such an argument would produce a high value beyond the amount of the secured claim which, in the hypothetical universe, would never belong to the debtor. This value beyond the amount the creditor could collect constitutes a profit creditors can make by arbitraging between poorly attended liquidation sales and later sales in the ordinary course. This hypothetical scenario, a bid-in sale followed by an ordinary course sale, would produce a windfall for secured parties in a manner that is totally consistent with what commonly happens in nonbankruptcy practice. For example, suppose a secured party claims $100 against collateral worth $120 if sold in the ordinary course of business. The liquidation value, however, is only $90. The secured party might claim that she would bid in $90 at foreclosure and receive $120 at a later commercial resale, so that rights in the collateral actually exceed the secured claim itself! Being an appeal to hypothetical history, who can disprove such a claim?

The trouble with this argument is that the practice of creditor arbitrage between ordinary course and foreclosure sales is unsavory. Creditors cannot be bothered to maximize the price when the debtor benefits, but when the creditor benefits suddenly the sales effort gets sophisticated and state-of-the-art. Indeed, under the doctrine of \textit{Durrett v. Washington National Insurance Co.},\textsuperscript{153} the differential in an actual sale, if sufficiently large, can be a fraudulent conveyance.\textsuperscript{154} It is a brave judge indeed who would hypothesize that the secured party would have captured a high value through a practice that amounts to a fraudulent conveyance.

On the other hand, the Bankruptcy Code itself authorizes the practice of bidding in.\textsuperscript{155} This protection is designed to insure se-
cured parties against trustee misbehavior. If the trustee fails to maximize the price, secured parties can capture the lost value by bidding in the amount of their secured and unsecured claims. Can we rule out a bid-in in a hypothetical universe when the Bankruptcy Code itself sanctions the practice? Of course, in a hypothetical universe, we can do anything we want, but nevertheless a reasoned answer may still be given: bid-ins may be allowed in bankruptcy as a defense mechanism for creditors, but this fact should not countenance affirmative creditor abuse, even in a hypothetical universe.

Bid-ins may be the only practical way to proceed. In Norwest Bank Worthington v. Ahlers, the court noted that third party bidders hardly ever appear in Minnesota farm foreclosures. In this circumstance, the only hope of a recovery is for the secured party to bid in the amount of the claim and resell after the lengthy redemption period (during which time all rent and income belongs to the farmer).

Yet if it is really true that no third party would bid for the collateral, disallowing hypothetical bid-ins in a hypothetical liquidation means that the collateral is worth near to nothing—an unjust result for secured parties. A fair rule, then, would bar the secured party from capturing debtor equity beyond the amount of the secured claim. In a hypothetical universe, capturing this debtor equity is close to obtaining a fraudulent conveyance. Such a compromise would guarantee some extra value to the secured party while not allowing the secured party to generate value through hypothesizing a potentially fraudulent transaction.

156. 794 F.2d 388 (8th Cir. 1986) (Heaney, J.), rev’d and remanded on other grounds, 485 U.S. 197, vacated and remanded, 844 F.2d 587 (8th Cir. 1988).


158. Durrett is sometimes taken to specify that any price paid for collateral that is 70% or more of the “true” market value is not a fraudulent conveyance. See Federal Nat’l Mortgage Ass’n v. Wheeler (In re Wheeler), 34 Bankr. 818, 821 (Bankr. N.D. Ala. 1983) (Wright, J.) (finding 62.7% of fair market yield insufficient); Berge v. Sweet (In re Berge), 33 Bankr. 642, 649-50 (Bankr. W.D. Wis. 1983) (Martin, J.) (holding 68.5% insufficient); cf. Home Life Ins. v. Jones (In re Jones), 20 Bankr. 988, 994 n.25 (Bankr. E.D. Pa. 1982) (Goldberg, J.) (rejecting 70% bright line rule in favor of case-by-case standard); see generally Note, Bankruptcy Valuation Under Selected Liquidation Provisions, 40 VAND. L. REV. 177, 208-09 (1987) (discussing Durrett rule’s impact on foreclosure proceedings). This leeway suggests that a secured party may hypothesize a bid-in and later ordinary course sale that yields a nonfraudulent 142.8% (100/70) of the bid-in amount.

159. Cf. Queenan, supra note 6, at 59-62. Judge Queenan approves the idea of hypothesizing bid-ins, but apparently has in mind an undersecured party using bid-ins to advance to a fully secured state. Id. at 59-60. He does not explicitly address the possibility of a bid-in as a means of capturing more than the amount of the undersecured party’s total claim. This ability to overcollect the debt is the abuse that the text means to denounce.
B. The Debtor’s Fear of Losing Going Concern Value in a Foreclosure Sale

Another reason a security interest might exceed the value of the collateral itself is that, in a no-bankruptcy world, a debtor might actually pay an undersecured creditor rather than suffer a foreclosure sale. In so doing, the debtor is motivated by the thought that the collateral as a going concern has a greater value than the liquidation value implied by the foreclosure sale. If so, the value of the security interest might exceed the value of the collateral. This scenario is one of many, then, that conflates liquidation value and going concern value.

Judge Queenan, a great champion of conducting valuations in a strict no-bankruptcy world, raises and dismisses this possibility. He states:

Normally, outside of Chapter 11 . . . [a] mortgagor typically wishes to honor his obligation in order to avoid foreclosure, without regard to whether or not some of the mortgage debt may in fact be unsecured. But that consideration is not present in any degree here because of the Debtor’s ability to obtain confirmation of a “cram down” plan proposing a payment schedule having a present value equal only to [a secured party’s] “interest in the estate’s interest in such property.” Thus the value of the . . . mortgage can never rise above the value of its property interest aspects at the time of confirmation.160

In other words, Queenan dismisses the hypothetical possibility that a security interest might exceed the value of the collateral because a bankruptcy rule prevents that result. This violates the premise that we are supposed to imagine what would have happened if there were no bankruptcy petition.

Meanwhile, Judge Queenan’s speculation that the security interest might be worth more than the collateral is not precluded by the subjunctive rules governing valuation. Certainly one of the bargaining chips a secured party has over a debtor is that the debtor will lose value if the foreclosure sale is allowed to go forward. Nothing would preclude Judge Queenan’s suggested valuation technique from a strict no-bankruptcy perspective. It does, however, stray from the notion that, absent a bankruptcy, the secured party would foreclose. Rather, it presupposes the debtor would keep the secured claim current in order to prevent the loss of going concern value. As such, the speculation suggested by Judge Queenan is a

mode of capturing going concern value of the collateral in the absence of a chapter 11 petition.

C. Buyback Arrangements

Sometimes a secured party who buys chattel paper\textsuperscript{161} has a contractual right to force the seller to take back the chattel paper and pay the account debtor’s unpaid balance. This arrangement—similar to a “put”\textsuperscript{162}—can provide a secured party with a greater sum of money than the amount another buyer would pay for the collateral. With regard to bankruptcy valuations, the issue arises as to whether the secured party should have a claim equal to the chargeback right or the lesser amount an abstract buyer would pay for collateral.\textsuperscript{163}

Suppose, for example, that a car dealer sold a car to a consumer for a price that includes $5000 in credit, for which the dealer took a purchase money security interest in the car. Suppose further that the dealer sells the chattel paper to a bank on the promise to pay the bank whatever balance the consumer cannot pay in the event of default. If the consumer goes bankrupt, the collateral must be valued. Assuming that the bank could get back $4000 from the dealer but could sell the car for only $3000 on a wholesale basis, what value should be assigned to the collateral?

Here the indeterminacy of the “what if” test is very severe. If the question is “what would the secured party have received if there had been no bankruptcy?,” the secured party would be entitled to the higher chargeback value because the dealer was obligated to pay this much. But if the question is “what could the secured party have sold the car for?,” the secured party would only be entitled to the lower wholesale value. Complicating the matter is the fact that the dealer in this situation might be able to get a retail price for the car, while the bank could only get a wholesale price.

From the bankruptcy trustee’s standpoint, the secured party’s right to receive the unpaid balance from the dealer has no necessary relation to the original collateral—in this instance, the car. If this chargeback value is used, the trustee is faced with a value that is

\textsuperscript{161} See U.C.C. § 9-105(b) (1990) (defining chattel paper as “a writing or writings which evidence both a monetary obligation and a security interest in or lease of specific goods. . . .”).


\textsuperscript{163} See 3 COLIER ON BANKRUPTCY (MB) 506.04[2], at 506-35 (15th ed. 1991) (discussing how presence of repurchase agreement between dealer and secured party can affect valuation process).
potentially too high. Indeed, the chargeback right can effectively transform the sale of chattel paper into a loan from the bank to the dealer, which is not a sale at all. The result is that the dealer’s personal obligation to pay the bank if the account debtor defaults is not connected with a price of the collateral.

Only one reported case uses the chargeback value based on what the dealer would be obligated to pay the secured party under a repurchase agreement. Other courts have roundly rejected this approach and have favored the debtor in this regard. The pro-debtor position is especially appropriate if the secured party’s relation to the dealer is the usual one of principal and surety. Even if the automatic stay prevents the secured party from repossessing the car, the secured party should still have its chargeback right against the dealer, who, as subrogee, then stands in the shoes of the secured party and takes over the security interest. This arrangement has nothing to do with the value of the collateral. In essence, the surety is buying the secured claim, not the collateral.

On the other hand, suretyship might have an indirect effect on valuation. Suppose the secured party can obtain only wholesale value while the dealer can obtain retail value. If so, it would seem fair to use retail value because the dealer, as a subrogated secured party, could actually realize this amount if there were no bankruptcy.

If the chargeback right is not a suretyship, so that a buyer has no subrogation rights against the debtor, then it might be a genuine sale of the collateral, not a sale of the secured claim. On this prem-

164. See id. (stating that repurchase agreement’s price often exceeds price that could be obtained in arm’s length transaction, whether wholesale, resale, or private).

165. In re Stumbo, 7 Bankr. 939 (Bankr. D. Colo. 1981) (Keller, J.). Stumbo and some of the early cases involved an odd standard form produced by Chrysler Credit Corporation. In Stumbo, Judge Keller described this particular contract as follows:

[T]he dealer in turn assigned the paper to Chrysler Credit Corp. pursuant to a provision which requires that if repossession occurs within 90 days after the maturity of the earliest installment of the contract then unpaid, the dealer will repurchase the contract at a specific dollar amount regardless of its condition. The 90-day period is stayed by the filing of litigation.

Id. at 940 (emphasis added); see also In re Beranek, 9 Bankr. 864, 866 (Bankr. D. Colo. 1981) (Clark, J.) (finding that Chrysler could pursue dealer only if estate surrendered the car). Two commentators assume that the secured party could charge back its loss to the dealer only if a repossession were achieved. Bowman & Thompson, supra note 47, at 576-77. In case the account debtor is bankrupt, no chargeback right would be possible. They suggest that these contracts should have been written as straight suretyships. Id.

ise, In re Oklahoma City Broadcasting Co.\textsuperscript{167} was wrongly decided.

In Oklahoma City Broadcasting, the secured party had a $3 million "put" option that would yield more than the liquidation value of the debtor.\textsuperscript{168} Characterizing the difference between the higher put option value and the liquidation value as an anticompetitive "bounty" paid to shut down a competitor, Judge TeSelle refused to adopt the value of the buyer's offer.\textsuperscript{169} Judge TeSelle's justification for this refusal was fanciful, to the point of being incomprehensible.

Judge TeSelle cited a case in which it was held that an agreement by a landlord to buy out a tenant's leasehold was not a general intangible within the meaning of article 9.\textsuperscript{170} "Therefore," reasoned Judge TeSelle:

the creditor with a security interest in debtors' general intangibles was not entitled to payments made to debtors in exchange for debtors' termination of the lease. Likewise, in this case, where the Bounty is being offered to take Debtor off the air, it is not a general intangible within the purview of [the secured party's] security interest, and thus not a part of [the secured party's] Collateral.\textsuperscript{171}

The thrust of this argument is that the secured party does not own the right to collect the so-called bounty that a buyer was willing to pay for the collateral. Judge TeSelle has forgotten, however, that the sales price agreed upon was a contract in anticipation of a foreclosure sale. The $3 million in question was not collateral, but a buyer's payment for collateral. As such, the "bounty" would be cash proceeds from the disposal of collateral within the meaning of section 9-504(1) of the U.C.C. and would clearly belong to the secured party.

Here is a case in which the put price should have been used for valuation purposes. Although Judge TeSelle was properly concerned with the anticompetitive quality of the put option, nevertheless if the sale was legal under our (recently degraded) antitrust laws and if the buyer actually would have paid this price, it would appear that the put option would be sound evidence of what the secured


\textsuperscript{169.} Id. at 429-30.

\textsuperscript{170.} Devine v. Swartz (In re Swartz), 62 Bankr. 88, 90 (Bankr. D. Neb. 1986) (Mahoney, J.). In this case, a secured creditor held a leasehold as collateral. The tenant filed for bankruptcy. In order to prevent the assumption of this lease, the landlord offered to pay the tenant's trustee $100,000. This obligation to pay $100,000 was held not to be a general intangible under article 9. Rather, it was connected to the lease and had to be perfected under real estate law. Since only article 9 perfection existed, the trustee took the $100,000 free and clear of the secured creditor's security interest. Id. at 89-90.

\textsuperscript{171.} In re Oklahoma City Broadcasting Co., 112 Bankr. at 430.
party would obtain if it sold the collateral.172

VI. THE RELATION BETWEEN TRANSACTION COSTS AND VALUE

In general, the value of property to a buyer and to a seller is different by virtue of the costs of the transaction. What the buyer pays is not necessarily the same as what the seller realizes from the sale. It is important for judges to be aware of the relation between market value and expected transaction costs because it is all too easy to modulate between choosing a price that the buyer will pay (before transaction costs are covered by the seller), or the price the seller will receive (after transaction costs are covered). Thus, we are faced not only with a terminological confusion, but a substantive property entitlement confusion when presented with the notion of the "value" of collateral.

Defining the value of collateral as what a buyer would pay minus the transaction costs of the sale173 comports with the subjunctive exercise of figuring out how much a secured party would get if there had been no bankruptcy and the secured party had to foreclose itself. Outside of bankruptcy, a secured party would bear the transaction costs if undersecured, but, if oversecured, she can make the debtor bear these costs.174 The deduction of transaction costs in the valuation determination is also supported by section 506(c) of the Bankruptcy Code, which provides that if sales or maintenance expenses are actually incurred, the trustee may recover those costs from the collateral.175 Furthermore, the Supreme Court has supported this definition of value.176

172. Judge TeSelle’s reliance on In re Swartz is inapposite for another reason. In Swartz, the landlord’s obligation to pay was owed to the debtor. Devine v. Swartz (In re Swartz), 62 Bankr. 88, 89 (Bankr. D. Neb. 1986) (Mahoney, J.). In Oklahoma City Broadcasting, however, the buyer owed its obligation to the secured party, not to the debtor. Hence, it was appropriate to use the put price as evidence of what a buyer would pay for the collateral.

Instead of using this price or a going concern value, Judge TeSelle eventually chose an appraised liquidation value for the collateral in question. In re Oklahoma City Broadcasting Co., 112 Bankr. 425, 430 (Bankr. W.D. Okla. 1990).


174. See U.C.C. §§ 9-504(1)(a), (b) (1972) (setting forth that proceeds of collateral applied first to transaction costs and only thereafter to secured claim).

175. See 11 U.S.C. § 506(c) (1988) (setting forth that trustee may recover costs and expenses of preserving or disposing of property to extent of any benefit to holder of secured claim); see also In re Trim-X, Inc., 695 F.2d 296, 301 (7th Cir. 1982) (Swygert, J.) (stating that trustee’s expenses for preserving assets will be recoverable from secured creditor).

Defining value as what the secured party takes out, not what the buyer pays in, contradicts the Bankruptcy Code in one respect. Under this view, collateral will always have an equity cushion at the time of valuation, although it may disappear through depreciation. According to section 362(d)(2)(A), a secured party is entitled to have bankruptcy’s automatic stay lifted if the debtor has no equity in the collateral. If the definition of value always includes debtor equity, then section 362(d)(2)(A) is wrongfully deprived of its necessity.

It is a rule of statutory construction that no statutory language should be rendered useless by a particular interpretation of other statutory language. Thus, in United Savings Association of Texas v. Timbers of Inwood Forest Associates, Justice Scalia denied that postpetition interest was part of adequate protection because, if so, section 362(d)(2) would be rendered superfluous. While Scalia’s argument is a failure, Timbers nevertheless stands for the potential efficacy of such arguments in general. Thus, a definition of value that always guarantees a debtor equity should be ruled out by such an argument.

On the basis of this dilemma, Judge Smallenberger, who implicitly

(stating that “if a $50,000 claim were secured by a lien on property having a value of $75,000, the claim would be oversecured, provided the trustee’s costs of preserving or disposing of the property were less than $25,000.”). 177. See Overholt v. Farm Credit Servs. (In re Overholt), 125 Bankr. 202, 215 (S.D. Ohio 1990) (Kinneary, J.) (stating that “the creditor’s interest in the property is in a sense, always less than the fair market value of the disputed property”). 178. 11 U.S.C. § 362(d)(2)(A) (1988). In addition, the property must not be necessary for an effective reorganization. Id. § 362(d)(2)(B). 179. See Rosado v. Wyman, 397 U.S. 397, 415 (1970) (Harlan, J.) (noting that courts should construe all statutes to give them some meaning); Bird v. United States, 187 U.S. 118, 124 (1902) (McKenna, J.) (stating that presumption exists against construction that would render statute ineffective); In re Tom Carter Enters., 49 Bankr. 243, 245 (Bankr. C.D. Cal. 1985) (Pagter, J.) (stating that it cannot be assumed that Congress passed meaningless legislation). 180. 484 U.S. 365 (1988) (Scalia, J.). 181. See United States Sav. Ass’n v. Timbers of Inwood Forest Assocs., 484 U.S. 365, 374-75 (1988) (Scalia, J.) (stating that proposed interpretation of section 362(d)(1) would render section 362(d)(2) null). 182. Such arguments can be defeated merely by thinking up some use for the statute that is alleged to be superfluous. Therefore, if secured parties are paid opportunity costs as part of adequate protection, a secured party still has the incentive to use section 362(d)(2) whenever the secured party believes the court’s valuation is too low or if the interest compensation is inadequate. Carlson, supra note 17, at 608-09. 183. See In re Felten, 95 Bankr. 629 (Bankr. N.D. Iowa 1988) (Mello, J.). In Felten, the debtor argued that the secured party’s collateral should be valued according to what a secured party would get (after transaction costs) at a foreclosure sale. Id. at 629-30. The court rejected this standard and instead chose the “fair market value,” which is “the price which a willing seller under no compulsion to sell and a willing buyer under no compulsion to buy would agree upon . . . .” Id. at 630 (citing In re Robinson Ranch, Inc., 75 Bankr. 606, 608 (Bankr. D. Mont. 1987)). By this, the court seemed to mean a standard based on what a buyer pays in, not on what a seller clears after transaction costs.
adopted the view that value is always ex hypothetical transaction costs, was forced to rule that a secured party was entitled to have the automatic stay lifted even if the collateral was worth more than the secured claim. Judge Smallenberger noted that "the law has never meant that there must be absolutely no equity in property, because the secured creditor needs some cushion in order to pay the costs of foreclosure in state court." Hence, Judge Smallenberger was able to save a definition of value that deducts hypothetical transaction costs, but only at the expense of re-writing section 362(d)(2)(A) to mean that the stay can be lifted even if debtor equity exists.

A great many cases try to wring section 506(a) for answers to the question whether hypothetical transaction costs should be deducted. It is commonly said that the first and second sentences of section 506(a) are in contradiction. The decision as to whether to deduct hypothetical transaction costs is therefore seen as a matter of privileging one of these sentences over the other.

One line of cases chooses the first sentence. According to Judge Hill, "[t]he first sentence ... suggests that since it is the creditor's interest that is being valued and not the collateral itself, it should not make any difference whether the debtor is retaining the property." This comment is identical to an argument Judge Queenan made in a different context. Queenan attempted to establish that, in a reorganization case, a secured creditor could be awarded only liquidation value in spite of the second sentence of section 506(a). He also emphasized that the first sentence referred to the "creditor's interest," which supposedly excused him from applying the second sentence. Here too Judge Hill seems to be suggesting that, since

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185. Id. at 502.
186. The first sentence reads: "An allowed claim of a creditor secured by a lien on property ... is a secured claim to the extent of the value of such creditor’s interest in the estate’s interest in such property ..." 11 U.S.C. § 506(a) (1988).
188. In re Claeyes, 81 Bankr. at 990; see also In re Ward, 13 Bankr. 710, 712 (Bankr. S.D. Ohio 1981) (Sidman, J.) (stating that "[t]he distinction to be drawn is between the value of the property and the value of the creditor's interest in such property").
189. See supra notes 77-88 and accompanying text.
the creditor has a lien, transaction costs must always be deducted, even when the debtor does not intend to sell the collateral. Hence, Judge Hill's argument effectively establishes liquidation value in reorganization cases, as well as the more modest principle that hypothetical transaction costs should be deducted from the value assigned to a secured claim.190

A second line of authority privileges the second sentence of section 506(a), holding that, where the debtor does not intend to sell collateral, hypothetical transaction costs should not be deducted.191

Judge Scholl uses the following argument to establish the supremacy of the second sentence over the first:

The first sentence requires that the court value the creditor's interest in the estate interest in the secured property. Thus, the creditor's interest can be ascertained only after the estate's interest is ascertained. As the second sentence dictates, the estate's interest must be measured in light of the disposition and use of the property articulated in the debtor's plan. Therefore, if the debtor plans to retain the property valued under § 506(a), we do not believe that it is proper to factor in hypothetical sale costs.192

In other words, the first sentence defers to the second. Under the second sentence, the collateral is valued on the assumption that the debtor is retaining the collateral. This valuation theory eliminates

190. See In re Courtright, 57 Bankr. 495, 497 (Bankr. D. Or. 1986) (Hess, J.) (recognizing that this argument commits judge to liquidation value generally in reorganization cases).

191. See In re Brown & Co. Sec. Corp. v. Balbus (In re Balbus), 933 F.2d 246, 251-52 (4th Cir. 1991) (Ervin, J.) (arguing that since debtor would retain house, section 506(a) requires no deduction of transaction costs); In re Landing Assocs., 122 Bankr. 288, 294 (Bankr. W.D. Tex. 1990) (Clark, J.) (reasoning that when debtor intends to keep property and creditor is not getting it, it would be artificial to deduct costs that creditor will not incur, so that creditor's interest should be determined without consideration of hypothetical liquidation costs); Cobb v. Mortgage Default Servs. (In re Cobb), 122 Bankr. 22, 26 (Bankr. E.D. Pa. 1990) (Scholl, J.) (rejecting debtor's suggestion that foreclosure costs should be deducted from property's market value because debtor intended to retain property rather than sell it); Usry v. United States Small Business Admin. (In re Usry), 106 Bankr. 759, 761 (Bankr. M.D. Ga. 1989) (Laney, J.) (relying on section 506(a)'s direction that value should be determined in light of collateral's intended use in agreeing with cases holding that if debtor maintains possession of collateral, hypothetical liquidation costs should not be deducted from collateral's value); Wolk v. Goldome Realty Credit Corp. (In re 222 Liberty Assocs.), 105 Bankr. 798, 803-04 (Bankr. E.D. Pa. 1989) (Scholl, J.) (stating that issue of whether sale costs should be deducted depends on debtor's intended future use of property, and finding that because debtor intended to retain home, valuation should not deduct hypothetical sales costs); In re Balbus, 104 Bankr. 767, 769 (Bankr. E.D. Va. 1989) (Tice, J.) (finding no hypothetical foreclosure costs when debtor intends to retain collateral); In re Bellman Farms, Inc., 86 Bankr. 1016, 1019 (Bankr. D.S.D. 1988) (Ecker, J.) (citing second sentence of section 506(a) for proposing that hypothetical liquidation costs should not be deducted from collateral’s value); In re Courtwright, 57 Bankr. 495, 497 (Bankr. D. Or. 1986) (Hess, J.) (concluding that there is no reduction for costs of foreclosure when debtor intends to retain and use property).

hypothetical transaction costs.193 Hence, by the time the first sentence can have its effect, the question of transaction costs has already been decided.

Another court found inspiration from United States Savings Association v. Timbers of Inwood Forest Associates,194 where Justice Scalia said, "[t]he phrase 'value of such creditor's interest' in § 506(a) means 'the value of the collateral.'"195 Hence, the first sentence of section 506(a) merely replicates the second sentence; the sentences are not in contradiction, and it is appropriate to consider the fact that, in a reorganization case, the collateral will be retained by the debtor, rather than sold.196

The view that refuses to deduct hypothetical transaction costs when the debtor will retain the collateral violates the subjunctive rule that the secured claim should equal what the secured creditor would have received had there been no bankruptcy, at least in those circumstances where, upon default, the secured party would actually foreclose and incur transaction costs. Additionally, this view is not mandated by a going concern valuation because going concerns can be sold, in which case transaction costs would be incurred.197 Nothing inherent in the idea of going concern value, therefore, dictates a rule that transaction costs ought to be left out of valuations.

A compromise between the above two positions—hypothesize a sale versus ignore the sale in reorganization cases—can be found in a view that hypothesizes a sale whenever the collateral is incidental to the reorganization. In In re Coby,198 Judge Riegle finds this standard by misreading another case199 in which the court simply pointed out that the replacement value of a car should not be assigned in a chapter 13 case when the car was "incidental" to the debtor's earning ability.200 Nevertheless, Judge Riegle's standard is a good one in

193. Id. at 803-04.
195. United States Sav. Ass'n v. Timbers of Inwood Forest Assocs., 484 U.S. 356, 372 (1988) (Scalia, J.). This remark occurs in Scalia's disposition as to what the identical words in section 361 mean. By emphasizing that section 506(a) requires the valuation of the collateral, he argued that the value of the secured claim is excluded from the meaning of the phrase. Hence, he ruled, undersecured creditors do not deserve interest compensation for their secured claims, when the claim is not paid during the pendency of a bankruptcy proceeding. Id. at 372-73.
197. See supra notes 65-66 and accompanying text (explaining concept of going concern valuation).
200. Id. at 749.
chapter 11 cases, where the secured party could obtain relief from the automatic stay in any case where the collateral is "not necessary to an effective reorganization."\(^{201}\) Where this is the case, a hypothesized sale seems appropriate because the stay in theory could be lifted. However, this rationale would not work in a chapter 13 case where the debtor keeps possession of all property of the estate throughout the proceeding.\(^{202}\)

In going concern cases involving a retail business, even assuming that transaction costs should not be deducted because there will be no sale, it is still appropriate to deduct the debtor's costs of doing business, at least where inventory is the collateral.\(^{203}\) This invites a bankruptcy court to lower the value of collateral by hypothetically allocating to it all the debtor's administrative expenses,\(^{204}\) something that section 506(c) allegedly does not permit to be allocated.\(^{205}\) And yet, at least in inventory cases, if we refuse to allocate the debtor's overhead expenses to individual pieces of inventory, we commit ourselves to the idea that the going concern exists separately from the inventory, when, in fact, the inventory is the business. For that reason, excluding debtor overhead and the like from hypothetical transaction costs in determining the value of collateral ends up being arbitrary.

If the value of collateral is to be reduced by the seller's expected transaction costs, the issue remains as to whether the bankruptcy court should deduct the sales expense that would have occurred under state law if the secured party had repossessed without interference from bankruptcy, or whether the court should deduct the sales expense that a trustee would incur in bankruptcy.

The former solution—imagine the expenses that would have occurred if no bankruptcy—is more consistent with the subjunctive


\(^{202}\) 11 U.S.C. § 1306(b) (1988). \(\text{But see Brown & Co. Sec. Corp. v. Balbus (In re Balbus), 933 F.2d 246, 253 (4th Cir. 1991) (Murnaghan, J., dissenting) (urging that hypothetical transaction costs should be applied even in chapter 13 when collateral is irrelevant to producing income).}\)

\(^{203}\) See Queenan, supra note 6, at 33 (favoring reducing value of inventory by allocated cost of some overhead items); Pachulski, supra note 70, at 962 (arguing same).

\(^{204}\) See McQuinn v. Dial Fin. Co. (In re McQuinn), 6 Bankr. 899, 900 (Bankr. D. Neb. 1980) (Crawford, J.) (reducing car's value from $2,800 to $1,800 because of costs such as dealer overhead, salesman's commission, and profit which debtor should not be required to pay). The deduction of profit seems dubious here. The standard should be what a buyer would pay minus transaction costs. This amount would include a profit for the dealer.

\(^{205}\) For the standards under which actual transaction costs can be charged to a secured party, see Carlson, Secured Creditors and the Expenses of Bankruptcy Administration, (to be published in North Carolina Law Review). Here, of course, we are talking about hypothetical transaction costs, and whether they are part of the valuation standard.
"what if" standard. This standard, however, is subject to the usual indeterminacy.

Article 9 of the UCC provides for very cheap self-help remedies for the secured party. If it is assumed that a secured party would have access to a peaceful repossession and private sale, then the expected transaction costs to be deducted from the value of the collateral will be quite low, and the secured party's claim will be concomitantly high. But it does not follow that self-help will be available. If the debtor threatens a breach of the peace, a secured party is required to abandon self-help remedies and use judicial process, which may be expensive. If these are the facts imagined, then the transaction costs will be high, and the creditor's secured claim in bankruptcy will be lower. Thus, if the court perceives the debtor to be a good citizen who does not threaten violence, then, under the subjunctive premise of imagining what would have happened, the secured party benefits. But if the debtor is nasty and boorish, then the debtor (or at least the debtor's general creditors) will be enriched. The result is a definition of value that punishes people for our good opinion of them and rewards people for our contempt. But such a result is mandated if we are to emulate what would have happened in a subjunctive market.

Using state law transaction costs to define value is consistent with imagining what would have happened had no bankruptcy occurred, but this approach denies the reality of the bankruptcy proceeding itself where the trustee's sales expense is sure to be higher than article 9's cheap self-help remedies.206 Thus, if a buyer would pay $100 for the collateral, and if the most efficient trustee imaginable would still incur $10 in sales expense, it is tempting to conclude that the secured party's maximum secured claim in bankruptcy ought to be $90, even if the secured party would have realized $95 under state law. Yet to succumb to this temptation is to violate the premise of "what would have happened if there had been no bankruptcy."

Regardless of whether value is reduced by expected state law ex-

206. According to the Congressional Commission on the Bankruptcy Laws of the United States:
The procedures required by the Act in the sale of property of a bankrupt estate have been much criticized for the inordinate administrative detail and expense. The trustee must ordinarily obtain court approval in the form of an order permitting the sale; creditors must ordinarily be notified of any proposed sale; the property must ordinarily be appraised; the sale must ordinarily be a public sale, and the trustee's sale is subject to approval or disapproval by the court. Not only are such procedures not conducive to getting the best price, but the expenses frequently consume a substantial part of the proceeds obtained from the sale.

penses or federal expenses, this practice of valuing collateral ex
transaction costs poses a conceptual difficulty if the trustee aban­
don the collateral without ever having spent anything. Suppose, in
the example just used, that the trustee chooses to abandon the col­
lateral because the debtor has no equity and the property is not
needed in a reorganization. Suppose further that the secured
party's total claim is $100, so that, under the rule of section 506(a),
the secured party has a perfectly secured claim of $90 (pursuant to
the definition of value under consideration) and a perfectly un­
secured claim of $10. If the trustee abandons property, the secured
party can realize $95. To avoid overcompensating the secured
party, a court must be prepared to adjust downward the secured
party's unsecured claim from $10 to $5, a process that is sure to
complicate the administration of bankrupt estates. Such a practice
requires a liberal approach toward “second look” doctrines that al­
low the bankruptcy court to shift the value of collateral up or down
depending on the circumstances. 207

VII. Conclusion

While the bankruptcy process absolutely depends on the concept
of collateral having a value, the legal and even philosophical status
of that concept is far from clear. It is not clear when a court should
use a high going concern value or a low liquidation value. It is not
even clear what these terms mean in their own right. It is equally
unclear whether a bankruptcy court should be allowed to change
valuation standards in the middle of the proceeding, depending on
the pro- or anti-debtor sentiments of the court. Neither is it clear
whether valuations based on creditor bid-ins are allowed when liqui­
dation value is used or whether valuations should be reduced for
probable transaction costs.

The answer to these questions profoundly affects substantive
bankruptcy rights. Yet, important as the answers are, they will per-

207. This is a difficult subject which I have addressed elsewhere. Carlson, supra note 86.
The point in the text concerns adjusting valuations in light of abandonment so that the se­
cured party does not have to pay transactions costs twice—once hypothetically in the valu­
ation and once actually after the collateral is abandoned. This proposition is supported by In re
Trim-X, 695 F.2d 296, 301 (7th Cir. 1982) (Swygert, J.), where the trustee incurred actual
expenses in dealing with the collateral and thereafter abandoned the property. After aban­
donment, the trustee sought to charge the secured party for all relevant expenses under sec­
ction 506(c). The court ruled that the expenses before abandonment (in anticipation of using
the property in a reorganization) could not be charged to the secured party, since it provided
no “benefit” to it. But expenses involved in the act of abandoning itself could be charged to
the secured party. Thus, the court insisted on relieving the secured party of actual expenses
before abandonment. Id. One may therefore infer that the court would also support relief
from hypothetical expenses that brought down the valuation.
haps inevitably be arrived at in an unsystematic manner because of the subjunctive quality of valuations. Subjunctivity is neither subjective nor objective, but is rather a third kind of knowledge constituted by mysterious combinations of subject and object.

The difficulty in dealing with these conditions, however, does not mean valuation in bankruptcy is unreliable or worthless. The subjunctive speculation on which valuations are based is the foundation of judgment itself. We are constantly equating one thing with another, even though to do so is an act of violence to the things being equated. This is what Hegel called our condition of finitude. To condemn valuation as proof of bankruptcy's deficiency is to dismiss communication itself as an impossibility. Fundamental to any thought system, subjunctive speculation cannot be banished from the Bankruptcy Code. Accordingly, it behooves us to understand the nature of this mode of reasoning.

209. See Rosenfeld, Deconstruction and Legal Interpretation: Conflict, Indeterminacy and the Temptations of the New Legal Formalism, 11 Cardozo L. Rev. 1211, 1221-27 (1990) (asserting that interpretation and communication themselves involve valuation and analogizing these semantic valuations to economic valuations of market exchanges).