

28 Allocation of Expenses of Sale

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¶ 28.01 INTRODUCTION TO § 506(c)

Although as a general rule a secured creditor’s collateral is not subject to surcharge for payment of expenses of a bankruptcy estate, § 506(c) of the Bankruptcy Code (the Code) provides a limited exception to this rule.¹ Section 506(c) provides:

[a] trustee may recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim.²

Section 506(c) is intended to codify case law that developed under the

¹ See *In re River Processing*, 145 F.3d 1340, 1340 (unpublished disposition), 1999 WL 279395 (9th Cir. 1998).

² 11 U.S.C. § 506(c).

Bankruptcy Act of 1893³ that allowed a debtor, receiver, or trustee to charge to or against collateral funds expended to preserve or sell that collateral, such as storage and auction costs.⁴ In fact, the concept that a functionary can surcharge collateral for reimbursement of expenses of preservation and sale is generally accepted as part of common law in nonbankruptcy proceedings, such as state court receiverships.⁵

It would seem that a concept that appears on its face to be so logical, and that has such powerful historical antecedents, would be noncontroversial in application. Unfortunately, the application of § 506(c) has engendered significant controversy and seemingly irreconcilable decisions.

In the context of a sale of collateral, a § 506(c) dispute normally concerns who should bear particular costs of an asset disposition in the allocation of expenses between the estate and an undersecured creditor. Example B in Table 28-1 illustrates the treatment of the undersecured creditor. Section 506(c) issues will ordinarily not arise where a creditor is fully secured (i.e., has collateral equal to or greater than its underlying claim and the costs of preservation or sale) because, typically, a fully secured creditor is entitled, in accordance with its documentation, to add costs of preservation and sale to its debt. This right of the fully secured creditor, shown as Example C in Table 28-1, is incorporated into § 506(b) and thereby is recognized in bankruptcy proceedings.⁶ The fully secured creditor does not receive any economic benefit from the efforts of the trustee because the claim will be paid in full irrespective of any action by the trustee.⁷ Nonetheless, because § 506(c), by its terms, does not restrict allocation of expenses to undersecured creditors, the rare case may occur where such an allocation is made to an oversecured creditor.⁸ For example, § 506(b) does not recognize any right of a secured party to add expenses to its debt unless the secured party's documentation provides for such right. Therefore, if the secured party's documentation does not pro-

³ Bankruptcy Act of 1898, as amended (former 11 U.S.C. § 1 et seq.). See H.R. Rep. No. 595, 95th Cong., 1st Sess., 357 (1977); S. Rep. No. 989, 95th Cong., 2d Sess. 68 (1978). The Supreme Court in *Hartford Underwriters Insurance Company v. Union Planters Bank, N.A.*, 530 U.S. 1, 6 (2000) suggests that the rights under § 506(c) are more limited than under prior law in that the rights under § 506(c) may be exercised by a trustee or debtor-in-possession, but not directly by an administrative claimant.

⁴ See *In re Visual Indus.*, 57 F.3d 321, 324 (3d Cir. 1995); *Textile Banking Co., Inc. v. Widener*, 265 F.2d 446, 453 (4th Cir. 1959); 4 *Collier on Bankruptcy* § 506.04, at 508-49 (15th ed. 1996).

⁵ 66 Am. Jur. 2d *Receivers* § 282, n.81.

⁶ 11 U.S.C. § 506(b) provides:

to the extent that an allowed secured claim is secured by property, the value of which, after any recovery under subsection (c) of this section, is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement under which such claim arose.

⁷ *In re Wiltwyck School*, 34 B.R. 270, 274 (Bankr. S.D.N.Y. 1982); *In re Codesco, Inc.*, 18 B.R. 225, 228-9 (Bankr. S.D.N.Y. 1982); *Matter of Robertson*, 14 B.R. 706, 709 (Bankr. N.D. Ga. 1981). See also *In re Central Foundry Co.*, 45 B.R. 395, 405 (Bankr. N.D. Ala. 1984); *In re Elmwood Farm*, 19 B.R. 338, 342 (Bankr. S.D.N.Y. 1982).

⁸ *Matter of Trim-X, Inc.*, 695 F.2d 296, 298-9 (7th Cir. 1982).

vide for recovery of expenses, some allocation of benefit of the costs of the sale may have to be made between even an oversecured party and the estate.⁹

Table 28-1 illustrates how these principles work:¹⁰

TABLE 28-1

<i>Example</i>	<i>Secured Creditor's Claim(\$)</i>	<i>Sale Price of Collateral (\$)</i>	<i>Cost of Sale and Preservation Incurred by Bankruptcy Estate (\$)</i>	<i>Comments</i>
A	100	100	25	The secured creditor receives \$75. The secured creditor is entitled to the sale price of the collateral, less the cost of sale and preservation incurred by the bankruptcy estate.
B	100	50	25	The secured creditor receives \$25. The secured creditor is entitled to the sale price of the collateral, less the cost of sale and preservation incurred by the bankruptcy estate.
C	100	150	25	The secured creditor receives \$100, the full value of its claim. Since the costs of sale and preservation incurred by the bankruptcy estate are covered by the sale price of the collateral there is no deduction from the secured claim for such items. If the secured creditor had directly incurred the cost, it would have been able to add it to the amount of the secured claim and the result would have been the same, i.e. \$100 net of cost to the secured creditor, plus \$25 in costs chargeable to the estate.
D	100	115	25	The secured creditor receives \$90; the sale proceeds are reduced by the \$25 of costs.

⁹ Another example was set forth in *In re Debbie Reynolds Hotel & Casino, Inc.*, 238 B.R. 831, 838 (9th BAP 1999), in which the 9th Circuit BAP stated, *in dicta*, that an oversecured creditor may be surcharged for expenses directly associated with preserving or improving going concern value where the creditor would have otherwise become undersecured. This is an expansive view in light of *Associates Commercial Corporation v. Rash*, 520 U.S. 953 (1997), where the Supreme Court determined that, at least for plan confirmation purposes, the value of collateral is determined by its actual use by the debtor rather than its foreclosure value in the hands of the secured party. The Ninth Circuit took a restrictive view of the reach of § 506(c) in *In re Compton Impressions, Ltd.*, 217 F.3d 1256 (9th Cir. 2000). There, the Ninth Circuit found that a creditor should not be surcharged under § 506(c) if it could have received the full value of its collateral had it foreclosed at the inception of the case.

¹⁰ It should be noted that a trustee often will be able to negotiate a better result for the estate when the secured creditor is to be surcharged and will receive less than the full value of its claim, as shown by Example D in Table 28-1. Unless there is an equity cushion that more than covers the cost of sale and preservation, the trustee could simply abandon the asset since all unencumbered proceeds from the sale will be consumed by expenses. If the secured creditor would rather have the trustee sell the asset, the creditor may agree to an allocation of expenses that benefits the estate. In this event, the parties need to address what commissions the trustee will earn from the proceeds of sale otherwise distributable to the secured creditor.

In calculating the extent to which a claim is fully secured, the Code itself breaks tradition by placing the § 506(c) surcharge ahead of certain amounts that would ordinarily be used to calculate the amount of the secured claim. Under § 506(b) of the Code, postpetition interest and reasonable fees, costs, and charges (if provided for in the prepetition contract between the debtor and the secured party) may be added to a secured claim if the collateral value is sufficient to support such additions. For example, if the claim is \$10 and the collateral is worth \$10, postpetition interest and costs cannot be added. If, however, the collateral is worth \$15 and the original secured claim is \$10, then up to \$5 of postpetition interest and costs may be added to the secured claim. In calculating the amount of the secured claim to which such additional charges may be added, § 506(b) specifically includes § 506(c) expenses as part of the initial claim. In the previous example, if the secured claim is \$10, the cost of disposition is \$2, and the sales proceeds are \$15, then the secured creditor would be able to add only \$3 of postpetition interest and costs to the secured claim.¹¹

¶ 28.02 STANDARD FOR RECOVERY OF EXPENSES

A party claiming a right to a § 506(c) surcharge must make a “relevant showing as to the basis of his request consistent with the requirements of [§ 506(c)].”¹² The requirements of § 506(c) governing the right to recover expenses inquire as to whether the expenses were reasonable and necessary and the extent to which the expenditure benefited the secured party.¹³ Case law recognizes these restrictions.¹⁴ The party seeking the recovery of expenses has the burden of establishing the criteria set forth in § 506(c).¹⁵

1. *Reasonable.* The term “reasonable” would, in accordance with its ordinary meaning, seem to refer to an analysis of whether the price paid for a particular necessary cost was appropriate. Some courts measure such prices by limiting them to what it would have cost had the creditor proceeded in

¹¹ 4 Collier on Bankruptcy § 506.55[3] at 506–129 (15th ed. 1996); See also *In re H.P. Tool Mfg. Corp.*, 12 B.R. 600, 601 (Bankr. E.D. Pa. 1981); *In re Chateau Royale, Ltd.*, 6 B.R. 8, 13 (Bankr. N.D. Fla. 1980).

¹² *Halverson v. Estate of Cameron* (In re Mathiason), 16 F.3d 234, 240 (8th Cir. 1994). See also, *In re Compton Impressions, Ltd.*, 217 F.3d at 1260; *In re Toy King Distributors, Inc.*, 256 B.R. 1, 194 (Bankr. M.D. Fla. 2000); *In re Demert & Dougherty, Inc.*, No. 96-B-00851, 1999 WL 1140859 at *4 (Bankr. N.D. Ill. Dec. 13, 1999).

¹³ Section 506(c) was not intended as a substitute for the recovery of administrative expenses that are appropriately the responsibility of the debtor’s estate. See *In re Golden Plan of Cal.*, 829 F.2d 705, 712–3 (9th Cir. 1986); *Brookfield Prod. Credit Ass’n v. Borron*, 738 F.2d 951, 953 (8th Cir. 1984).

¹⁴ See, e.g., *In re River Processing*, 145 F.3d 1340 (unpublished disposition), 1998 WL 279395 (9th Cir.) at **2; *In re Ferncrest Court Partners*, 66 F.3d 778, 782 (6th Cir. 1995); *In re Delta Towers, Ltd.*, 924 F.2d 74, 76 (5th Cir. 1991); *In re Lockwood Corp.*, 223 B.R. 170, 175 (8th Cir. B.A.P. 1998).

¹⁵ See *Halverson v. Estate of Cameron* (In re Mathiason), 16 F.3d at 240; accord *In re Ferncrest Court Partners, Ltd.*, 66 F.3d at 782.

state court.¹⁶ The rationale for this limitation is that the secured creditor is relieved from the expense of enforcing its lien in state court when the trustee sells the encumbered property. Under this restrictive view, this cost saving equals the benefit to the secured creditor and should set the limit to determine the reasonableness of the surcharge.¹⁷ Another view of reasonableness requires a comparison of the nature and complexity of the service rendered with the cost incurred.¹⁸ In this regard, at least one court has specifically found that a surcharge under § 506(c) is not limited to the cheapest method of foreclosing against collateral.¹⁹

2. *Necessary.* There is no basis for surcharging an undersecured creditor for expenses that are not necessary for the preservation or sale of the collateral. For example, if the asset has no equity and should be abandoned, an expenditure might not be deemed necessary because the estate should not be holding the property.

Once the trustee determines that certain assets hold no equity for the estate and notifies creditors of its intent to abandon the assets, and no party objects, the trustee cannot recover from the creditor expenses incurred in preserving the assets after the trustee was free to abandon them.²⁰ The Court of Appeals for the Seventh Circuit,²¹ decided that under § 554(a),²² the trustee is free to abandon the assets without judicial involvement “if no party in interest objects to the action.”²³ The reason for this rule is that expenses incurred after the trustee could have abandoned the assets are not necessary.²⁴ The scope of expenditures that are necessary will depend on the facts and circumstances of each case. Necessity is viewed in the broadest scope where the collateral is of a type that requires the continued operation of a business or completion of a project to preserve value. In such instances, a larger amount of the expenses incurred in the operation and preservation may be deemed necessary.²⁵

¹⁶ E.g., *In re Codesco, Inc.*, 18 B.R. 225, 228 (S.D.N.Y. 1982); *In re Iberica*, 180 B.R. 707, 713 (Bankr. D.P.R. 1995). See also, *In re Compton Impressions, Ltd.*, 217 F.3d at 1261 (cost of foreclosure and disposal of the collateral is a factor when considering reasonableness).

¹⁷ *Textile Banking Co. v. Widener*, 265 F.2d 446, 454 (4th Cir. 1959); *In re Iberica*, 180 B.R. at 713; *In re Richards Pontiac*, 24 B.R. 758, 760 (Bankr. E.D.N.Y. 1982).

¹⁸ *In re Trengre*, 127 B.R. 552, 556–7 (Bankr. E.D. Pa. 1991).

¹⁹ See *In re North Country Place, Ltd.*, 92 B.R. 439, 449 (Bank. C.D. Cal. 1988).

²⁰ *In re Trim-X, Inc.*, 695 F.2d 296, 300–1 (7th Cir. 1982).

²¹ *Id.* at 296.

²² 11 U.S.C. § 554(a) provides:

“[A]fter notice and a hearing, [a] trustee may abandon any property of the estate that is burdensome to the estate or that is of inconsequential value to the estate.”

²³ *In re Trim-X*, 695 F.2d at 300.

²⁴ *In re Iberica*, 180 B.R. 707, at 713 (Bankr. D.P.R. 1995).

²⁵ The Court of Appeals for the Ninth Circuit decided that necessity bars an applicant from obtaining 506(c) sales expenses if the secured lender could have fully satisfied its debt at the beginning of the chapter 11 proceedings. In a matter regarding a debtor’s surcharge motion against a fully secured lender, the Ninth Circuit held that the debtor could not establish necessity where a secured lender could have foreclosed at the outset of a chapter 11 proceeding and have fully satisfied its debt. See *In re Compton Impressions, Ltd.*, 217 F.3d at 1261 (9th Cir. 2000). See also *In re Comband Technologies, Inc.*, 69 F.3d 532 (unpublished disposition), 1995 WL 64285 (4th Cir.) at *3,4; *In re North Country Place, Ltd.*, 92 B.R. 437, 448 (Bankr. C.D. Cal. 1988).

3. *Expenses that Benefit the Secured Party.* The express terms of § 506(c) only allow the recovery from a secured creditor's collateral "to the extent of any benefit to the holder of such claim."²⁶ Such benefit to the secured creditor must be direct and quantifiable.²⁷ Some courts inquire as to whether an expenditure was made with the intent primarily to "protect or preserve the collateral of the secured creditor."²⁸ "Merely providing some benefit to the debtor . . . does not satisfy § 506(c)'s requirements."²⁹ Thus, some cases hold a surcharge under § 506(c) is denied where the costs and expenses associated with it are incidental to a reorganization or are the separate maintenance obligation of a debtor or its trustee with regard to the property.³⁰ Still other cases hold that if the secured creditor benefited from ongoing business operations, certain costs, such as withholding taxes, can be surcharged against the collateral.³¹

¶ 28.03 SECURED CREDITOR'S CONSENT TO SALE

Under the plain language of § 506(c), the consent of a secured creditor to the sale by the trustee of collateral or to the taking of any action by the secured creditor that forces expenses to be incurred are not the primary criteria in the statute for imposing a § 506(c) surcharge. In the face of the lack of express statutory direction, courts have found a secured creditor's consent relevant to support the imposition of a surcharge under § 506(c).³²

Some courts view consent as a substitute for the three-prong test (reasonableness, necessity, and benefit to the secured party);³³ other courts, however, view consent as satisfying one or more of the prongs.³⁴ The presence of consent by a secured claimant to the preservation or disposition of its collat-

²⁶ 11 U.S.C. § 506(c).

²⁷ See, e.g., *In re Grimland, Inc.*, 243 F.3d 228 (5th Cir. 2001); *In re Parque Forestal, Inc.*, 949 F.2d 504 (1st Cir. 1991); *In re Flagstaff Foodservice Corp.*, 739 F.2d 73 (2d Cir. 1984); *Matter of Delta Towers*, 924 F.2d 74 (5th Cir. 1991).

²⁸ *In re Lockwood Corp.* 223 B.R. 170, 175 (8th Cir. 1998) (citing *Central Bank of Mont. v. Cascade Hydraulics & Util. Serv., Inc.* (In re *Cascade Hydraulics & Util. Serv., Inc.*), 815 F.2d 546, 548 (9th Cir.1987)).

²⁹ *Id.* (quoting *Loudoun Leasing Dev. Co. v. Ford Motor Credit Co.* (In re *K & L Lakeland, Inc.*), 128 F.3d 203, 211 (4th Cir.1997) (quoting *In re Visual Indus., Inc.*, 57 F.3d 321, 327 (3d Cir. 1995)); see also *In re C&S Assocs.*, 29 F.3d 903, 906-7 (3d Cir. 1994); *In re Cascade Hydraulics and Util. Serv., Inc.*, 815 F.2d 546, 548 (9th Cir. 1987).

³⁰ *In re C&S Assocs.*, 29 F.3d at 906-7; *In re Flagstaff Foodservice Corp.*, 739 F.2d 73, 76 (2d Cir. 1984).

³¹ *I.R.S. v. Boatmen's First Nat'l Bank*, 5 F.3d 1157, 1160 (8th Cir. 1993), overruled on other grounds by *In re Hen House Interstate, Inc.*, 177 F.3d 719 (8th Cir 1999), aff'd *Hartford Underwriters v. Union Planters Bank*, 530 U.S. 1 (2000).

³² See *In re Hen House Interstate, Inc.*, 150 F.3d 868, 871 (8th Cir. 1998) vacated for reh'g en banc (this case was decided at 177 F.3d 719, aff'd *Hartford Underwriters v. Union Planters Bank*, 530 U.S. 1 (2000) without reference to this issue); *In re Blackwood Associates L.P.* 153 F.3d 61, 68 (2d Cir. 1998); *In re Glickman, Berkovitz, Levinson & Weiner*, 186 B.R. 883, 887 (E.D. Pa. 1995).

³³ See e.g., *In re Hen House*, 150 F.3d at 871; *In re Glickman, et al.* 186 B.R. at 887.

³⁴ See *In re Parque Forestal, Inc.*, 949 F.2d 504, 512 (1st Cir. 1991).

eral by the debtor, debtor-in-possession, or trustee, may lead a court to view such consent as advance acknowledgment that some of the incurred costs and expenses would benefit the secured claim holder.³⁵ Additionally, in the face of consent by a secured party some courts have proven more liberal in their surcharging of particular costs and expenses under § 506(c).³⁶ The secured creditor's consent to the continued operation of a business that preserves going-concern value and enhances the secured creditor's position may be viewed as a consent to a surcharge for certain expenses of the operation, such as payroll taxes and travel expenses.³⁷

Consent must come from the secured creditor against whom a § 506(c) claim is being made. The consent of a senior secured creditor who will be little affected because it has an equity cushion should not bind the junior secured creditor who actually will pay the costs and expenses.

In one pre-Code case in which the court allowed a § 506(c) reimbursement on the theory of consent, the secured creditor wrote a letter authorizing the payment of the trustee's compensation—not ordinarily chargeable to the secured creditor—from the proceeds of collateral.³⁸ This case represents a rare example of straightforward, explicit consent that justified recovery of costs and expenses.

More often, consent is implied from the actions of the secured creditor. A request by a secured creditor that a trustee be appointed in a chapter 11 case resulted in the court finding that such creditor not only consented to the trustee's costs and expenses, but had caused those costs and expenses to be incurred.³⁹ Thus, a secured creditor who seeks the appointment of a trustee should anticipate paying the kind of costs that are normally incurred by the trustee. Particularly “in cases [involving] minimal unencumbered assets [where] the holder of a secured claim has sought the appointment of a chapter 11 trustee to oversee a reorganization or a chapter 7 trustee to liquidate the estate, some courts have been more likely to find that the secured creditor has impliedly consented to recovery by the trustee of a wider range of costs and expenses than would normally be allowable under § 506(c).”⁴⁰

A creditor that expressly or implicitly consents to the sale of encumbered property free and clear of that creditor's lien may be found to have agreed to bear the costs and expenses of the sale, the costs reasonably incurred in the

³⁵ I.R.S. v. Boatmen's First Nat'l Bank, 5 F.3d 1157, 1159–61 (8th Cir. 1993), overruled on other grounds by *In re Hen House Interstate, Inc.*, 177 F.3d 719 (8th Cir. 1999), aff'd *Hartford Underwriters v. Union Planters Bank*, 530 U.S. 1 (2000); *In re Orfa Corp.*, 170 B.R. 272, 273 (8th Cir. 1993); *In re Annett Ford, Inc.*, 64 B.R. 946, 947 (Bankr. D. Neb. 1986).

³⁶ See, e.g., *In re Soucek*, 50 B.R. 753, 755 (Bankr. D.C. 1985).

³⁷ *In re Comband Technologies, Inc.*, 69 F.3d 532 (unpublished disposition), 1995 WL 64285 (4th Cir.) at *3; *Boatmen's*, 5 F.3d at 1159.

³⁸ *In re Orbitronics*, 254 F.Supp. 400, 405 (E.D. Wis. 1966).

³⁹ *In re Hotel Assocs.*, 6 B.R. 108, 111–2 (Bankr. E.D. Pa. 1980); see also 4 *Collier on Bankruptcy* § 506.04[3][a] at 506-55 (15th ed. 1996).

⁴⁰ 4 *Collier on Bankruptcy* § 506.05 [5] [c] (iii) at 506-138; see also *In re Bob Grissett Golf Shoppes, Inc.*, 50 B.R. 598, 601 (Bankr. E.D. Va. 1985).

preservation of the property, and a proportion of the general administrative and overhead expenses.⁴¹ However, consent is not to be lightly inferred and the mere cooperation of a secured party should not constitute consent.⁴² Nor should a secured creditor's consent be extrapolated to cover a greater spectrum of expenses than those to which the secured creditor actually consented.⁴³

On the other hand, courts tend to be more conservative in assessing the scope of § 506(c) expenses that can be incurred in the absence of consent from a secured party. For example, some courts hold that a nonconsenting lien holder will ordinarily be charged only with those costs and expenses that would have been required to foreclose on the lien in an appropriate forum of its own choice.⁴⁴ Under this restrictive view, such foreclosure costs might properly include the filing fee, sheriff's fee, advertising costs, and other costs incidental to the sale, but should not include general administrative expenses.⁴⁵

Courts that are sympathetic to equitable factors in favor of the party seeking recovery of costs and expenses have sometimes inferred consent to recovery of costs from other forms of affirmative conduct by the holder of a secured claim.⁴⁶

¶ 28.04 CATEGORIES OF EXPENSES THAT MAY BE RECOVERED

Expenses that have been considered necessary for the preservation or disposition of the collateral of a secured creditor and thus, in certain circumstances, reimbursable include:

1. Rent;⁴⁷
2. Debtor's attorney fees, but only to the extent that it can be

⁴¹ In re Modem Mix, Inc., 18 B.R. 746, 749 (Bankr. S.D. Ala. 1982).

⁴² A bank's cooperation with a debtor in permitting the debtor to use cash collateral for specific expenses necessary to complete a residential development and sell the units was not a blanket consent to be charged with additional expenses not included in the original written agreement. In re Compton Impressions, Ltd., 217 F.3d 1256, 1261 (9th Cir. 2000). In re Ferncrest Court, 66 F.3d 778, 782 (6th Cir. 1995).

⁴³ In re Cascade Hydraulics and Util. Servs., Inc., 815 F.2d 546, 549 (9th Cir. 1987); In re Sports Info. Data Base, Inc., 64 B.R. 824, 827 (Bankr. S.D.N.Y. 1986).

⁴⁴ E.g., Textile Banking Co. v. Widener, 265 F.2d 446, 453-54 (4th Cir. 1959); In re Max Sung Hi Lim, 12 B.R. 821, 822 (Bankr. D. Haw. 1981).

⁴⁵ See, e.g., In re Central Foundry Co., 45 B.R. 395, 407 (Bankr. N.D. Ala. 1984).

⁴⁶ Id.; see also In re Ferncrest Court, 66 F.3d at 782 (mortgagee, as successor to original mortgagee, acquiesced or consented to surcharge to pay broker's fees because original mortgagee permitted debtor a period of time to market the property and the second mortgagee never objected to the debtor's retention of the real estate broker).

⁴⁷ In re Richards Pontiac, 24 B.R. 758, 759 (Bankr. E.D.N. Y. 1982).

demonstrated that the secured creditor benefited from the general representation of the debtor in the bankruptcy proceeding;⁴⁸

3. Trustee's attorney fees;⁴⁹
4. Security costs incurred to protect assets;⁵⁰
5. Appraisal costs, including marketing consultants and architects;⁵¹
6. Brokers' fees;⁵²
7. Trustee fees, including expenses;⁵³
8. Maintenance and repair costs;⁵⁴
9. Taxes;⁵⁵
10. Payroll taxes;⁵⁶
11. Costs of sale-publication and notice fees;
12. Auctioneer fees;⁵⁷ and
13. Miscellaneous costs such as moving expenses, travel expenses, or utility costs.⁵⁸

The court in *In re Hotel Associates*⁵⁹ listed factors to be considered when a court determines whether the trustee's costs and expenses should be borne by the secured creditor. These include the following:

1. Whether it was likely that the court would have approved a reorganization plan that would have benefited the secured creditor;
2. Whether the services rendered protected the interests of the secured creditor, as well as those of the unsecured creditors and the debtor;
3. Whether the secured creditor received any actual benefit from the reorganization proceedings;
4. Whether the trustee was reasonably diligent and competent in concluding the unsuccessful reorganization proceedings;
5. Whether the secured creditor caused, consented to, or waived any objection to the trustee's activities; and
6. Whether the secured creditor caused any delays or blocked the formation of a successful plan.⁶⁰

⁴⁸ *In re Sonoma V*, 24 B.R. 600, 604 (9th Cir. B.A.P. 1982); *Butler v. BayBank Middlesex*, 169 B.R. 484, 485 (Bankr. D. Mass. 1994).

⁴⁹ *In re River Processing*, 145 F.3d 1340 (unpublished disposition), 1998 WL 279395 (9th Cir.) at **2 (where services resulted in a quantifiable benefit to the secured creditors).

⁵⁰ *In re Parque Forestal, Inc.*, 949 F.2d 504, 512; *In re Trim-X, Inc.*, 695 F.2d 296, 297 (7th Cir. 1982).

⁵¹ *Matter of Briscoe Enters., Ltd. II*, 994 F.2d 1160, 1170 (5th Cir. 1993).

⁵² *In re Ferncrest Court Partners*, 66 F.3d 778, 782 (6th Cir. 1995).

⁵³ See *In re Elmwood Farm, Inc.*, 19 B.R. 338, 341-342 (Bankr. S.D.N.Y. 1982); *In re Truitt*, 15 B.R. 169, 170 (Bankr. N.D. Ga. 1981).

⁵⁴ See *In re Hamilton*, 18 B.R. 868, 873 (Bankr. D. Colo. 1982).

⁵⁵ See *In re Hotel Assocs.*, 6 B.R. 108, 113 (Bankr. E.D. Pa. 1980).

⁵⁶ *I.R.S. v. Boatmen's First Nat'l Bank*, 5 F.3d 1157, 1160 (8th Cir. 1993), overruled on other grounds by *In re Hen House Interstate, Inc.*, 177 F.3d 719 (8th Cir. 1999), *aff'd Hartford Underwriters v. Union Planters Bank*, 530 U.S. 1 (2000).

⁵⁷ *In re Tull & Sons*, 28 B.R. 112, 114 (Bankr. D. Md. 1983).

⁵⁸ *In re Trim-X, Inc.*, 695 F.2d at 302 (7th Cir. 1982).

⁵⁹ 6 B.R. 108 (Bankr. E.D. Pa. 1980).

⁶⁰ *Id.* at 113.

¶ 28.05 STANDING TO RECOVER EXPENSES

Before the Supreme Court's decision in *Hartford Underwriters Insurance Company v. Union Planters Bank*,⁶¹ courts were split as to whether a party other than the trustee or debtor in possession could bring suit directly against a secured creditor to recover costs and expenses under § 506(c). Although the language of § 506(c) gives only the trustee the right to recover such expenses,⁶² it does not by its terms preclude recovery by other parties.⁶³ Recently, however, the Supreme Court of the United States dismissed that notion and settled any dispute among the Circuits regarding standing. In *Hartford Underwriters v. Union Planters Bank* the Court directly dealt with the narrow question of whether § 506(c) "allows an administrative claimant of a bankruptcy estate to seek payment of its claim from property encumbered by a secured creditor's lien."⁶⁴ The Court held that only a trustee or debtor-in-possession⁶⁵ has standing to invoke the use of § 506(c), and that an administrative claimant has no such standing.

Union Planters held that § 506(c) could not be independently invoked by an administrative claimant, and thus affirmed the Eighth Circuit.⁶⁶ To reach that conclusion, the Court relied on the plain language of § 506(c), which states that "the trustee" is the one that may use § 506(c). The Court's reading that § 506(c) was intended to be an exclusive provision of the Code was based on the following points of statutory interpretation. First, one cannot presume nonexclusivity of a statute that "authorizes specific action and designates a particular party empowered to take it. . . ."⁶⁷ Second, because the trustee "has a unique role in bankruptcy proceedings makes it is entirely plausible that Congress would provide a power to him and not others."⁶⁸ Third, other portions of § 506 are broadly phrased and may be used by a "party in interest" or an "entity" although, in contrast, § 506(c) is specifically limited to the "trustee." Fourth, it is contrary to common sense and usage that a provision is exclusive only when the exclusion is explicit and is phrased, for instance, in the form "only the trustee."

While limiting the right of an administrative claimant to invoke the use of § 506(c), The Court did not, however, leave an administrative claimant without any means of protecting itself. The Court suggested the following protections for administrative claimants:

⁶¹ 530 U.S. 1; 120 S.Ct. 1942 (2000).

⁶² Section 1107 of the Bankruptcy Code gives a debtor-in-possession the same rights as a trustee in this context.

⁶³ 11 U.S.C. § 506(c).

⁶⁴ 530 U.S. at 3.

⁶⁵ *Id.* at 6, n.3, see also, *In re Isenbart*, 255 B.R. 62 (Bankr. D. Kan. 2000) ("[] debtors-in-possession may also seek payment under § 506(c). . . .").

⁶⁶ *In re Hen House Interstate, Inc.*, 177 F.3d 719.

⁶⁷ 530 U.S. at 7.

⁶⁸ *Id.*

They may insist on cash payment, or contract directly with the secured creditor, and may be able to obtain superpriority under § 364(c)(1) or a security interest under §§ 364(c)(2), (3) or § 364(d). And of course post petition creditors can avoid unnecessary losses simply by paying attention to the status of their accounts. . . .⁶⁹

Although the Court held that an administrative claimant could not independently invoke the use of § 506(c), it was very clear that it did not address the issue of whether an administrative claimant could exercise a derivative right to invoke 506(c). In a footnote, the Court noted that it did “not address whether a bankruptcy court could allow other interested parties to act in the trustee’s stead in pursuing recovery under 506(c).”⁷⁰ While other courts have granted derivative rights to creditors or creditors’ committees to bring avoidance actions when the trustee refused to do so, the Court, in *Union Planters*, did not answer the question of whether a similar approach could be taken with respect to § 506(c) by an administrative claimant when the trustee or debtor-in-possession refuses to act under that section.

¶28.06 WAIVERS OF RIGHTS TO ASSERT § 506(c) CLAIMS

Quite often at the beginning of a chapter 11 case, a debtor-in-possession enters into a borrowing or a stipulation for the use of cash collateral that allows the debtor to operate, notwithstanding the rights of the secured creditor. In return for the secured creditor’s advancement of postpetition lending or consent to the use of cash collateral, the secured creditor often will seek to extract from the debtor an agreement that, in return for the secured creditor’s cooperation, no claim under § 506(c) may be asserted against the secured creditor’s collateral. When such an agreement is approved by the court, the § 506(c) waiver clause would appear on the surface to have the full force and effect of an order of the court. Many bankruptcy judges today tend to question the entry of such orders because of the significance of the § 506(c) waiver. Notwithstanding these concerns, § 506(c) waivers are still quite common. In a few cases, the validity of such a waiver has been challenged long after the entry of an order approving a stipulation that contains waiver language. In *In re Film Equipment Rental Co.*,⁷¹ such a clause was upheld on appeal. In a case where the debtor had entered into a settlement agreement that contained a § 506(c) waiver, such waiver was upheld.⁷² In some cases, the waiver of § 506(c) rights has been declared void as providing a windfall to the secured

⁶⁹ Id. at 12.

⁷⁰ Id. at 13, n.5.

⁷¹ 1991 WL 274464 (S.D.N.Y.).

⁷² *In re IBI Security Serv., Inc.* 133 F.3d 205, 209–10 (2d Cir. 1997). See also, *In re Molten Metal Technology, Inc.*, 244 B.R. 515, 527 (D. Mass. 2000).

creditor at the expense of administrative claimants⁷³ or because such a waiver is violative of “the congressional mandate that a trustee have the authority to use a portion of secured collateral for its preservation or proper disposal.”⁷⁴

While it may seem fair and reasonable to enforce a court order approving an agreement under which the debtor waives § 506(c) rights, the question remains whether it is fair to hold that creditors that are not parties to the agreement with the debtor and whose postpetition administration claims have not yet been incurred at the time of the waiver should also be bound by the waiver. Policy issues raised regarding § 506(c) waivers can have a significant impact on the administration of future chapter 11 and chapter 7 bankruptcy cases. For example, in *In re Lockwood Corp.*,⁷⁵ the Eighth Circuit Bankruptcy Appellate Panel felt constrained to find a § 506(c) waiver void because of the precedent established in the *In re Hen House Interstate, Inc.* decision.⁷⁶ Nevertheless, in a footnote in its decision, the *Lockwood* court expressed policy reasons behind its concerns with holding the § 506(c) waiver void:

Hen House, in voiding this clause, and as applied to factual situations such as this, may indeed, as [has been] suggested, cause the wellspring of postpetition lending by new lenders, to be greatly diminished, or even to evaporate completely. Moreover, and just as importantly, these immunizing clauses are not only common in postpetition lending agreements, they are also common in cash collateral agreements. Therefore, the holding in *Hen House* not only raises new and significant obstacles for debtors in obtaining postpetition lending, but also makes it difficult for debtors in possession to negotiate cash collateral agreements with their prospective lenders. Further, the *Hen House* decision also will hinder courts from allowing the use of cash collateral, as such rulings must be based upon findings that a postpetition replacement lien will constitute adequate protection. Under the current precedent, as just discussed, this has now become, in many situations, an exceedingly difficult task to accomplish.⁷⁷

The *Hen House* decision was, however, vacated for rehearing *en banc*. The Eighth Circuit redetermined the *Hen House* case and held that only a trustee or a debtor-in-possession has rights to assert a § 506(c) claim. Neither the Eighth Circuit nor the Court addressed the waiver issue on rehearing or appeal. It is, therefore, not clear whether *Lockwood* remains good law or whether it would be decided in the same way in light of the *Hen House* decision.

⁷³ *In re Hen House Interstate, Inc.*, 150 F.3d 868, 872 (8th Cir. 1998), vacated for reh'g en banc (this case was decided at 177 F.3d 719, without reference to this issue and affirmed by *Hartford Underwriters v. Union Planters Bank*, 530 U.S. 1 (2000), which neither addressed the issue); *In re Ridgeline Structures, Inc.*, 154 B.R. 831, 832 (Bankr. D.N.H. 1993).

⁷⁴ *In re Brown Bros.*, 136 B.R. 470, 474 (Bankr. W.D. Mich. 1991).

⁷⁵ 223 B.R. 170 (8th Cir. B.A.P. 1998).

⁷⁶ 150 F.3d 868 (8th Cir. 1998).

⁷⁷ *In re Lockwood Corp.*, 223 B.R. 170, 176, n.7 (8th Cir. B.A.P. 1998).

¶ 28.07 OTHER POTENTIAL AVENUES FOR RECOVERY OF EXPENSES

Because it is difficult to bring the general expenses of bankruptcy administration within the scope of § 506(c), it is necessary to examine other ways a trustee may recover costs and expenses within the Code.

1. *11 U.S.C. § 552(b)*. The rule under § 506(c), which requires a showing of benefit to the holder of a secured claim, has a parallel in 11 U.S.C. § 552(b), which may permit an imposition of charges on proceeds of collateral. According to the legislative history, “[t]he provision allows the court to consider the equities in each case. In the course of such consideration, the court may evaluate any expenditures by the estate relating to proceeds and any related improvement in the position of the secured party.”⁷⁸

2. *Use of rents—11 U.S.C. § 363(c)(2)*. Section 363(c)(2) provides that the trustee or debtor may not use cash collateral without either the consent of the creditor with an interest in the collateral or court authorization.⁷⁹ Rents from income property subject to a properly perfected mortgage typically constitute cash collateral.⁸⁰ Thus, a trustee, upon a showing of adequate protection,⁸¹ will likely be allowed to use rents to maintain and operate the mortgaged property but not to finance new ventures or maintain other collateral.⁸²

3. *Other federal statutes*. In *In re Sterling Steel Treating Inc.*,⁸³ the debtor held a public auction of the debtor’s real and personal property. Included in the property to be sold was a parcel of land that contained hazardous wastes. (All bidders were given an opportunity to inspect the premises.) The property was sold on an “as is” basis to the highest bidder.

Prior to closing, the purchaser discovered the contamination and immediately disposed of the waste with the approval of the Environmental Protection Agency. At the time of closing, the purchaser withheld from the purchase price \$25,000 as reimbursement for the cost of removing the waste. The actual cost of the cleanup was \$8,500.

The trustee filed an adversary proceeding under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA)⁸⁴ to recover the balance of the purchase price, contending that the purchaser was responsible for paying the costs of cleanup. The purchaser answered that the hazardous waste constituted a material defect in the property. The purchaser also sought a judgment that the estate was required to pay the cleanup costs.

The court found that the purchaser had reason to know of the contam-

⁷⁸ 124 Cong. Rec. 32, 400 (1978) (statement of Rep. Edwards).

⁷⁹ 3 Collier on Bankruptcy § 363.04 [3], at 363-29 (15th ed. 1996).

⁸⁰ See *641 Avenue of Amer., L.P. v. 641 Assocs.*, 189 B.R. 583, 590 (Bankr. S.D.N.Y. 1995).

⁸¹ *In re the Mews Assocs.*, 144 B.R. 867, 871 (Bankr. D.S.D. 1992).

⁸² See *In re One Fourth St. N., Ltd.*, 103 B.R. 320, 322 (Bankr. M.D. Fla. 1989).

⁸³ 94 B.R. 924 (Bankr. E.D. Mich. 1989).

⁸⁴ 42 U.S.C. § 9601, et seq.

ination of the property and, as such, should pay at least part of the costs.⁸⁵ The court also found the debtor jointly responsible since it had originally placed the hazardous wastes on the property.⁸⁶ Striking a balance, the court held that the actual cleanup costs should be borne equally by the debtor and the purchaser.⁸⁷

4. *Priority of interim administrative expenses—11 U.S.C. §§ 330 and 331.* Another theory through which secured creditors may be compelled to pay costs and expenses without reference to § 506(c) states that administrative expenses might outrank a secured claim whenever they are awarded as interim compensation to lawyers and accountants under §§ 330 and 331. This suggestion has some support in case law,⁸⁸ but the weight of authority is against it.⁸⁹

5. *Priority—11 U.S.C. § 724(b).* Finally, § 724(b)⁹⁰ governs the distribution of that property of the estate against which tax liens are asserted. Under this provision, a trustee may be able to recover administrative expenses from the proceeds of the sale that are otherwise distributable to tax lien claimants.⁹¹ Accordingly, when property is burdened by tax liens, that portion of the sale proceeds attributable to tax liens becomes a fund into which the trustee may be able to dip in order to pay administrative expenses under § 507(a)(1)–(6), without affecting other secured claims.⁹²

⁸⁵ In re Sterling Steel Treating, Inc., 94 B.R. 924, 930–31 (Bankr. E.D. Mich. 1989).

⁸⁶ Id. at 930.

⁸⁷ Id. at 931.

⁸⁸ See In re Callister, 15 B.R. 521, 535 (Bankr. D. Utah 1981).

⁸⁹ See, e.g., In re Ridgemont Apartment Assocs., 95 B.R. 247, 249–50 (Bankr. N.D. Ga. 1989).

⁹⁰ 11 U.S.C. § 724(b) provides in pertinent part:

Property in which the estate has an interest and that is subject to a lien . . . that secures an allowed claim for a tax, or proceeds of such property, shall be distributed as follows:

* * *

(2) second, to any holder of a claim of a kind specified in section 507(a)(1), 507(a)(2), 507(a)(3), 507(a)(4), 507(a)(5), 507(a)(6), or 507(a)(7) of this title, to the extent of the amount of such allowed tax claim that is secured by such tax lien;

(3) third, to the holder of such tax lien, to any extent that such holder's allowed tax claim that is secured by such tax lien exceeds any amount distributed under paragraph (2) of this subsection;

fourth, to any holder of an allowed claim secured by alien on such property that . . . is junior to such tax lien;

(5) fifth, to the holder of such tax lien, to the extent that such holders allowed claim secured by such tax lien is not paid under paragraph (3) of this subsection.

⁹¹ In re Sherrill, 78 B.R. 804, 807–9 (Bankr. W.D. Tex. 1987).

⁹² Id. at 807.