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CIVIL PROCEDURE—APPELLATE PROCEDURE—DETERMINING POINT OF ENTRY OF JUDGMENT—*STACHLOWSKI V. STACH*, 328 N.C. 276, 401 S.E.2d 638 (1991)

Because the limitations period for filing a notice of appeal is triggered by the entry of judgment,[1] the exact point of entry must be easily identifiable.[2] Unfortunately, neither rule 3 of the North Carolina Rules of Appellate Procedure,[3] which provides that written notice of appeal must be taken within thirty days after entry of judgment, nor rule 58 of the Rules of Civil Procedure,[4] which governs entry of judgment generally, defines clearly the point of entry in all cases. Rule 58 provides that entry of judgment occurs when the clerk makes a notation of the court's judgment in its minutes.[5] The rule is silent on when entry of judgment occurs in the many cases in which the clerk makes no such notation. In *Stachlowski v. Stach*[6] the North Carolina Supreme Court failed to resolve these lingering questions surrounding entry of judgment. Attempting to fill the gaps in rule 58, the court set forth a three-factor test for determining when judgment is entered in cases that rule 58 does not foresee.[7] Although this test resolved the problem presented in *Stach*, the factors that constitute it are so malleable that the test fails to provide the predictability future appellants need to preserve their rights. As a result, the only safe course of action for North Carolina practitioners is to file for appeal within thirty days from when judgment is rendered orally by a trial court.

On January 17, 1989, a Person County trial court, after hearing the evidence regarding plaintiff's suit seeking modification of a child custody order, announced its judgment in open court.[8] The court ruled that it would give full faith and credit to the original order, noting that there had been no material change in the circumstances.[9] It then directed

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1. WILLIAM A. SHUFORD, NORTH CAROLINA CIVIL PRACTICE AND PROCEDURE § 58-3 (3d ed. 1988).
2. N.C. R. CIV. P. 58 cmt.
3. N.C. R. APP. P. 3.
4. N.C. R. CIV. P. 58.
5. *Id.*
6. 328 N.C. 276, 401 S.E.2d 638 (1991).
7. *Id.* at 287, 401 S.E.2d at 645.
8. *Id.* at 277, 401 S.E.2d at 639.
9. *Id.*

counsel for the defendant to draft the order.[10] The court did not direct the clerk to enter judgment, nor did the clerk make a notation of the judgment in the minutes of the court.[11] The judge signed the order April 6, 1989, almost three months later, on which date plaintiff filed a written notice of appeal.[12]

A divided panel of the North Carolina Court of Appeals held that the plaintiff's appeal was untimely under rule 3 of the Rules of Appellate Procedure because he did not file it within ten days[13] of the "entry" of judgment; entry, the majority held, occurred on January 17, when the trial court orally pronounced its decision on the custody issue.[14] The supreme court reversed. In some circumstances, the high court explained, rule 58 of the Rules of Civil Procedure identifies precisely when the trial court's judgment is deemed entered.[15] All three situations that rule 58 contemplates, however, involve some action by the clerk of court.[16] The trial court's decision in *Stach*, by contrast, was not noted by

10. *Id.* The order was also to include visitation privileges still under negotiation. *Id.*

11. *Id.* at 280-81, 401 S.E.2d at 641.

12. *Id.* at 278, 401 S.E.2d at 640.

13. In July 1989, the General Assembly amended rule 3 of the North Carolina Rules of Appellate Procedure, increasing the time period for giving notice of appeal to 30 days after the entry of judgment. N.C. R. APP. P. 3. The *Stach* court, however, analyzed the case according to the law at the time of the trial. *Stach*, 328 N.C. at 277, 401 S.E.2d at 639; *see* N.C. GEN. STAT. § 1-279 (1983), *repealed by* Act of June 21, 1989, ch. 377, § 1, 1989 N.C. Laws 830, 830. At the same time that the General Assembly repealed § 1-279, it added a provision making the rules of appellate procedure operative in deciding the timing of appeal. Act of June 21, 1989, ch. 377, § 2, 1989 N.C. Laws 830, 830-31 (current version at N.C. GEN. STAT. § 1-279.1 (Supp. 1991) ("Any party entitled by law to appeal . . . may take appeal by giving notice of appeal within the time, in the manner, and with the effect provided in the rules of appellate procedure.").

14. *Stach*, 328 N.C. at 287, 401 S.E.2d at 645. The court of appeals stated, in a three-paragraph opinion, that a party must give written notice of appeal within ten days of "entry" of judgment under rule 3 of the North Carolina Rules of Appellate Procedure. Stachlowski v. Stach, 98 N.C. App. 668, 669, 391 S.E.2d 849, 850 (1990), *rev'd*, 328 N.C. 276, 401 S.E.2d 638 (1991). Furthermore, the date of entry is not the formal signing, but the date that oral notice is given in open court. *Id.* Thus, because the trial court announced its judgment on January 17, the notice of appeal of April 6 was well beyond the required period for filing. *Id.* at 669-70, 391 S.E.2d at 850.

15. *Stach*, 328 N.C. at 287, 401 S.E.2d at 645. The court also drew a distinction between "rendering" judgment, which is the stating or announcing of judgment, and "entering" judgment. *Id.* at 278, 401 S.E.2d at 640.

16. N.C. R. CIV. P. 58. First, when there is a jury verdict or decision by a judge in open court that a party may recover "only a sum certain or costs or that all relief shall be denied . . . in the absence of contrary direction by the judge," entry occurs when the clerk makes a notation in his minutes of the decision. *Id.* Second, "[i]n other cases where the judgment is rendered in open court," the clerk should make a notation "as the judge may direct" that will constitute entry. *Id.* Finally, "[i]n cases where judgment is not rendered in open court," entry does not take place until the clerk has received an order for entry of judgment from the judge, filed it, and mailed notice of the filing to the parties. *Id.*

the clerk, and thus did not fit into any of the rule 58 scenarios.[17] According to the supreme court, when the express provisions of rule 58 are inapplicable, three factors should be used to determine the point of entry of judgment: (1) easy identification by the parties, (2) fair notice to the parties, and (3) finality of the trial court's decision.[18] Although these factors are judicially created, the court believed that they satisfy the principle that, despite its lack of direct applicability, "the intent and purpose of [rule 58] should nevertheless guide . . . when entry of judgment occur[s]."[19]

Applying the factors to *Stach*, the court found that because the trial court did not direct the clerk to enter judgment, and because the trial court ordered defense counsel to include in the order visitation privileges that were still being negotiated, January 17—the date the judge announced his decision in court—was not easily identifiable as the date of entry.[20] Furthermore, the court stated that the trial judge's oral pronouncement did not give fair notice to the parties that judgment had been entered.[21] In the typical case covered by the express terms of rule 58,[22] adequate notice is provided by the clerk's notations in the minutes.[23] By contrast, in cases like *Stach*, when the judge makes a "contrary direction" such as ordering counsel to draft the judgment, the other parties at the time of the in-court pronouncement do not have notice of the details of the judgment.[24] The court thus concluded that when rule 58 does not expressly apply, "fair notice concerns indicate that 'entry' occurs only after draft orders or judgments are submitted to and adopted

17. *Stach*, 328 N.C. at 281, 401 S.E.2d at 642. First, there was a "contrary direction" given by the judge when he asked defendant's lawyer to prepare the order; thus, the situation did not fall under the first paragraph of rule 58. *Id.* at 280, 401 S.E.2d at 641. Second, the trial judge did not direct the clerk to make the notation in the minutes as required by the second paragraph, nor was there any evidence of a notation in the minutes. *Id.* Finally, paragraph three did not apply because judgment was rendered in open court. *Id.* at 281, 401 S.E.2d at 641.

18. *Id.* at 282, 401 S.E.2d at 642.

19. *Id.* at 281, 401 S.E.2d at 642. The comment to rule 58 states that it is "highly desirable that the moment of entry of judgment be easily identifiable and it is also desirable that fair notice be given all parties." N.C. R. Civ. P. 58 cmt. The court also said that because rule 58 is expressly subject to rule 54(b), which defines judgments as either final or interlocutory, the finality of the trial court's decision is also a factor in the determination. *Stach*, 328 N.C. at 282, 401 S.E.2d at 642; *see* N.C. R. Civ. P. 54(b).

20. *Stach*, 328 N.C. at 283, 401 S.E.2d at 642-43.

21. *Id.* at 283-84, 401 S.E.2d at 643.

22. The "typical case" covered by rule 58 is a decision that a party should recover a sum certain or costs or that all relief should be denied. *Id.* at 283, 401 S.E.2d at 643.

23. *Id.*

24. *Id.*

by the court."[25]

Analyzing the "finality" prong of the three-part test,[26] the court explained that the principal concern addressed by this factor "is that all matters for determination be resolved" at the time judgment is deemed entered.[27] Because the court left some of the issues to be negotiated after January 17, that date was not appropriate as the date of entry.[28] Furthermore, the court held, the finality factor must be measured by the "extent to which the trial court may take action *after* entry of judgment."[29] While the second paragraph of rule 58, for example, allows a court to "approve the form of the judgment and direct its prompt preparation and filing,"[30] when a trial court is the finder of fact, it must comply with the requirements of rule 52 in the following order: "(1) find the facts on all issues joined in the pleadings; (2) declare the conclusions of law arising from the facts found; and (3) enter judgment accordingly."[31] Thus, the court concluded that there could be no valid entry of judgment here without findings of fact and conclusions of law as required by rule 52.[32] Because the trial court had not formally made such findings and conclusions at its oral pronouncement on January 17, that date also failed the finality prong of the *Stach* test. The court necessarily concluded that entry of judgment occurred on April 6, 1989, when the trial court signed the defendant's proposed order.[33]

The *Stach* court, recognizing that rule 58 does not work in all cases,[34] announced a test for determining the point of entry of judgment when the rule fails. The test is applied easily when all three factors point to the later date as they did in *Stach*. The court, however, gave no indi-

25. *Id.* The court was concerned about a party having to prepare an appeal "without the benefit of the court's written order or judgment." *Id.*

26. *Id.* at 284, 401 S.E.2d at 643-44.

27. *Id.* at 284, 401 S.E.2d at 643.

28. The court first stated that since the parties still were negotiating visitation privileges that were to be included in the order, the trial court's decision was not final on all matters. *Id.*

29. *Id.* at 284, 401 S.E.2d at 644.

30. N.C. R. Civ. P. 58.

31. *Stach*, 328 N.C. at 285, 401 S.E.2d at 644; *see* N.C. R. Civ. P. 52.

32. *Stach*, 328 N.C. at 285, 401 S.E.2d at 644. The court also noted that rule 52(b) provides for amendment to findings after the entry of judgment. *Id.* at 286, 401 S.E.2d at 644. The rule states, "Upon motion of a party made not later than 10 days after entry of judgment the court may amend its findings . . . and may amend the judgment accordingly." N.C. R. Civ. P. 52. The court reasoned that the provision would be unnecessary if findings of fact were not required to precede the entry of judgment. *Stach*, 328 N.C. at 286, 401 S.E.2d at 644.

33. *Stach*, 328 N.C. at 287, 401 S.E.2d at 645.

34. The underlying problem in *Stach* was that rule 58 did not expressly apply. One commentator has said, "If any civil rule needs to be rewritten, it is Rule 58, which envisions three scenarios for the entry of judgment, all of which rarely occur in actual practice." 2 G. Gray Wilson, North Carolina Civil Procedure § 58-1, at 321 (1989).

cation how the three factors should balance against each other if each should happen to point to a different date. Despite acknowledging that "[f]or the purpose of determining the timeliness of appeals, the time of entry of judgment should be established clearly,"[35] the court crafted a balancing test whose factors must be considered on a case-by-case basis by courts in the future. The supreme court's holding fails to provide a bright-line rule that practitioners need in determining when to file a written notice of appeal.

The federal entry of judgment doctrine clearly provides more predictability than the North Carolina scheme embodied in rule 58 of the North Carolina Rules of Civil Procedure and *Stach*. Not only does rule 58 of the Federal Rules of Civil Procedure provide clearer guidelines for entering judgment than its North Carolina counterpart,[36] but also the federal courts require strict compliance with rule 58[37] before the period for filing an appeal begins.[38] Thus, either the moment of entry is a matter of public record available to both parties or the time for filing an appeal is virtually unlimited. Such a system induces the prevailing party to ensure that the court and clerk comply with rule 58 to the letter.[39]

With its three-prong test to determine the point of entry of judgment, the North Carolina Supreme Court has failed to give North Carolina practitioners needed predictability. Admittedly, in most situations like that of *Stach*, the date of signing will be the date of entry. With the *Stach* test, however, how can parties be sure of the exact date? One court's interpretation of the three factors might be quite different from that of another court. Entry of judgment should be a basic, predictable point, requiring no judicial interpretation or application of judicially cre-

35. *Stach*, 328 N.C. at 279, 401 S.E.2d at 641.

36. Federal rule 58 states that a judgment is not effective until entered as provided in rule 79(a), which orders the clerk to keep a "civil docket" containing entries of all appearances, orders, verdicts, and judgments. FED. R. CIV. P. 58, 79(a). The Federal Rules also state that "[e]very judgment shall be set forth on a separate document." *See* FED. R. CIV. P. 58.

37. *See* Herrera v. First N. Sav. & Loan Ass'n, 805 F.2d 896, 898-99 (10th Cir. 1986) (holding that date of entry is the date on which the separate document is entered on the civil docket); Chem-Haulers v. United States, 536 F.2d 610, 615 (5th Cir. 1976) (holding that an order is not final until it is entered in the civil docket).

38. *See, e.g.*, United States v. Indrelunas, 411 U.S. 216, 221-22 (1973) (per curiam) (holding that the separate-document provision of federal rule 58 needs to be applied mechanically "in order to avoid new uncertainties as to the date on which judgment is entered"). Justice Blackmun best summarized the doctrine: "[T]he separate-document requirement must be applied mechanically in order to *protect* a party's right of appeal, although parties may waive this requirement in order to maintain appellate jurisdiction of their case." Amoco Oil Co. v. Jim Heilig Oil & Gas, Inc., 479 U.S. 966, 969 (1986) (Blackmun, J., dissenting from denial of certiorari).

39. *See* Hughes v. Halifax County Sch. Bd., 823 F.2d 832, 834 (4th Cir. 1987) (allowing plaintiff to move for entry of judgment on an order pursuant to federal rule 58).

ated standards. North Carolina's rule 58 does not give such predictability, and the holding in *Stach* fails to remedy the rule's deficiencies.

S. GRAHAM ROBINSON

BANKRUPTCY LAW—VALUATION OF RETAINED COLLATERAL—*BROWN & CO. SECURITIES CORP. V. BALBUS (IN RE BALBUS)*, 933 F.2d 246 (4th Cir. 1991)

Individual debtors, subject to certain eligibility requirements,[1] may initiate a bankruptcy proceeding under Chapter 13[2] of the Bankruptcy Code[3] and formulate a reorganization plan directing a portion of future earnings to creditors but providing for retention of assets. The liability of such debtors to secured creditors in Chapter 13 depends upon section 506(a)[4] of the Bankruptcy Code, which, in part, requires bifurcating an undersecured claim[5] into a secured portion to the extent of the value of the collateral and an unsecured claim for the remainder.[6] Essential to determining the extent of a debtor's liabilities, of course, is properly com-

1. "Only an individual with regular income that owes, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts of less than $100,000 and noncontingent, liquidated, secured debts of less than $350,000 . . . may be a debtor under Chapter 13 of this title." 11 U.S.C. § 109(e) (1988).

2. *Id.* §§ 1301-1330.

3. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (1978) (codified as amended primarily at 11 U.S.C. §§ 101-1330 (1988)).

4. 11 U.S.C. § 506(a).

5. An undersecured claim is one in which the value of the creditor's claim exceeds the value of the collateral. For example, if a creditor holds an outstanding mortgage of $100,000, but the real property providing security for the debt is worth only $80,000, the mortgage is undersecured by $20,000. (This example ignores sales costs.)

6. Section 506(a) provides:

> An allowed claim of a creditor secured by a lien on property in which the estate has an interest . . . is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property . . . and is an unsecured claim to the extent that the value of such creditor's interest . . . is less than the amount of such allowed claim. 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).

The classification of a debt vitally affects repayment: a debtor in a Chapter 13 reorganization must pay secured claims in full, *id.* § 1325(a)(5)(B)(ii), and must pay unsecured claims either in full, or according to the debtor's available disposable income over the next three years, *id.* § 1325(b).

Because Chapter 5 of the Bankruptcy Code applies generally to the operative bankruptcy

puting the value of the collateral. A related issue that has split the courts is whether hypothetical sales costs[7] must be deducted from the section 506(a) valuation of secured assets that a debtor will retain in a Chapter 13 plan.[8] In *Brown & Co. Securities Corp. v. Balbus (In re Balbus)*,[9] the United States Court of Appeals for the Fourth Circuit determined that when a debtor proposes to retain a secured asset the hypothetical cost of selling that asset should not be subtracted from a calculation of value.[10] As a result, Chapter 13 debtors may experience greater difficulty in meeting their obligations.[11] Moreover, the court failed to reconcile the potentially discordant language of section 506(a).[12] A preferable approach, one followed by a majority of courts,[13] requires bankruptcy courts to value the secured creditor's interest in the bankruptcy estate's interest in the property with proper allowances for hypothetical liquidation costs.[14]

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chapters (Chapters 7, 11, 12, and 13), the analysis presented herein remains pertinent in a Chapter 11 context. *Id.* § 103(a).

7. Courts deduct estimated sales costs to reflect what the creditor could recover in a commercially reasonable sale of the collateral. *In re* Boring, 91 B.R. 791, 795 (Bankr. S.D. Ohio 1988). Courts generally estimate prospective sales costs at 10% of collateral value. *See, e.g., In re* Smith, 92 B.R. 287, 291 (Bankr. S.D. Ohio 1988); Parr v. First Ala. Bank (*In re* Parr), 30 B.R. 276, 277-78 (Bankr. N.D. Ala. 1983); *In re* Ward, 13 B.R. 710, 712 (Bankr. S.D. Ohio 1981). With respect to real estate collateral, these sales cost allowances approximate the costs of "a broker's fee, title insurance, and financing costs." Wolk v. Goldome Realty Credit Corp. (*In re* 222 Liberty Assocs.), 105 B.R. 798, 803 (Bankr. E.D. Pa. 1989). For a further discussion of asset valuation, including the proper charging of sales costs and other expenses of bankruptcy administration, see David G. Carlson, *Secured Creditors and Expenses of Bankruptcy Administration*, 70 N.C. L. REV. 417, 452-55 (1992).

8. *See infra* notes 40-46 and accompanying text.

9. 933 F.2d 246 (4th Cir. 1991).

10. *Id.* at 252.

11. *See supra* note 6; *infra* notes 51-52 and accompanying text.

12. The first sentence of § 506(a) creates "a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property," while the second sentence requires that "[s]uch value . . . be determined in light of the purpose of the valuation and of the proposed disposition or use of such property." 11 U.S.C. § 506(a) (1988).

The first sentence of § 506(a) suggests that the ultimate value to the creditor, what could be achieved upon repossession and disposition, should guide the valuation. *See In re* Claeys, 81 B.R. 985, 992 (Bankr. D.N.D. 1987). Study of the first sentence alone would lead to foreclosure value in all instances because the maximum a creditor can realize upon repossession and sale is the foreclosure value. *Id.* at 991.

The language of the second sentence, standing alone, produces two possible results: where a debtor plans to retain collateral, consideration of the "proposed disposition or use" indicates that market value is appropriate; where a debtor plans to allow sale of the asset, the foreclosure value is appropriate. *In re* Bellman Farms, Inc., 86 B.R. 1016, 1019 (Bankr. D.S.D. 1988).

13. *See infra* notes 40-42 and accompanying text.

14. While the majority of courts ultimately rely on the foreclosure value as the valuation method, courts use a variety of other methods to arrive at this value. *See, e.g.*, James F. Queenan, Jr., *Standards for Valuation of Security Interests in Chapter 11*, 92 COM. L.J. 18, 19, 31 (1987).

Further, courts should adjust this value to reflect any decrease in value from the use of the property.[15]

In early 1989, Peter Gordon Balbus filed for bankruptcy under Chapter 13 of the Bankruptcy Code, listing $324,050 in secured debts and $95,019 in unsecured debts in his petition schedules.[16] Brown & Co. Securities Corp. (Brown), a secured creditor, asserted that although Balbus planned to retain his real property, the court should subtract prospective liquidation costs from the valuation of the real estate collateral.[17] Subtracting this fictional liquidation expense would have reduced the value of Balbus's real property security by $16,950, correspondingly increased the unsecured debt to $111,969, and disqualified Balbus from Chapter 13 relief.[18] Brown accordingly moved to dismiss the Chapter 13 case or, in the alternative, to have the case converted to a Chapter 7 liquidation proceeding.[19]

The United States Bankruptcy Court for the Eastern District of Virginia denied Brown's motion and held that hypothetical sales costs should be ignored in calculating the value of secured assets that will remain in the debtor's possession.[20] In an unpublished decision, the United States District Court for the Eastern District of Virginia affirmed the decision of the bankruptcy court and later denied Brown's motion for reconsideration.[21]

A divided panel of the United States Court of Appeals for the Fourth Circuit, affirming the district court ruling, held that potential sales costs should not be factored into a section 506(a) valuation when the Chapter 13 reorganization plan allows the debtor to keep the property providing security for his debt.[22] Noting that the preferred method of valuation depends on the emphasis supplied to the first and second

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15. *See infra* note 57 and accompanying text.

16. *Balbus*, 933 F.2d at 247. The parties concurred that "unsecured debts" should include the undersecured portion of secured claims. Brief of Appellant at 3, *Balbus* (No. 90-2067); *see In re* Jerome, 112 B.R. 563, 566 (Bankr. S.D.N.Y. 1990). Balbus's undersecured debt, totalling $37,050, thus was classified with his unsecured debt of $57,968 to arrive at a total of $95,018 of unsecured debt.

17. *Balbus*, 933 F.2d at 248.

18. *Id.*; *see supra* note 1. To recoup a larger amount, creditors generally urge a higher valuation for secured debt. *See, e.g., In re* Crockett, 3 B.R. 365, 367 (Bankr. N.D. Ill. 1980).

19. *Balbus*, 933 F.2d at 247. The valuation issue arose in the overall context of plan confirmation. *In re* Balbus, 104 B.R. 767, 767 (Bankr. E.D. Va. 1989), *aff'd sub nom.* Brown & Co. Sec. Corp. v. Balbus (*In re* Balbus), 933 F.2d 246 (4th Cir. 1991).

20. *In re* Balbus, 104 B.R. 767, 770 (Bankr. E.D. Va. 1989), *aff'd sub nom.* Brown & Co. Sec. Corp. v. Balbus (*In re* Balbus), 933 F.2d 246 (4th Cir. 1991).

21. *Balbus*, 933 F.2d at 247.

22. *Id.* at 252.

sentences of section 506(a),[23] the court acknowledged that deducting sales costs when a debtor plans to keep the collateral emphasizes the statutory requirement that the "creditor's interest" be valued.[24] According to the court's analysis of the statute, however, deducting hypothetical sales costs in all instances would render superfluous the second sentence of section 506(a) by failing to consider the proposed use of the property.[25] Because Balbus planned to keep his real property, the court concluded that the sales costs were merely projections and should not be considered.[26]

In arriving at its conclusion that hypothetical sales costs should not be deducted, the court also examined the latter half of section 506(a), which requires consideration of the purpose of the valuation. The court concluded that the purpose of the valuation was to determine Balbus' eligibility for Chapter 13 relief.[27] The court feared that deducting "reasonable" sales costs could lead to manipulation of the section 109(e) limits.[28]

Finally, the court of appeals relied on the bankruptcy court's application of dictum in *United Savings Ass'n v. Timbers of Inwood Forest Associates*,[29] which analogizes the language "interest in property" appearing in section 506(a) to the same term used in section 362 of the Bankruptcy Code, the provision in question in *Timbers*.[30] The Supreme Court in *Timbers* concluded that in section 506(a) a "creditor's 'interest in property' obviously means his security interest without taking account of his right to immediate possession of the collateral upon default."[31]

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23. For a discussion of the conflict between the two parts of § 506(a), see *supra* note 12.

24. *Balbus*, 933 F.2d at 248 (quoting *In re* Claeys, 81 B.R. 985, 990-91 (Bankr. D.N.D. 1987)).

25. *Id.* at 251. The court relied on the decisions of a "growing number of courts" that deduct hypothetical liquidation costs only when the debtor proposes to sell the property. *Id.* at 249-50.

26. *Id.* at 252.

27. *Id.* at 251.

28. *Id.* The court reasoned that Congress had established a fixed, rather than variable, limit on Chapter 13 eligibility in § 109(e). *See* 11 U.S.C. § 109(e) (1988). In light of this legislative history, the court concluded that the inclusion of intrinsically unpredictable sales costs as unsecured debt would defeat Congress's intention to establish a specific dollar limit on eligibility. *Balbus*, 933 F.2d at 251.

29. 484 U.S. 365 (1988).

30. *Balbus*, 933 F.2d at 250-51 (citing *Timbers*, 484 U.S. at 371-72).

31. *Timbers*, 484 U.S. at 372. The Supreme Court stated further that "[t]he phrase 'value of such creditor's interest' in § 506(a) means 'the value of the collateral.' " *Id.*

The debtor in *Timbers* filed a petition for relief under Chapter 11. United Savings Association, a secured creditor, sought relief from the automatic stay of foreclosure activity granted in § 362(a) because of the absence of "adequate protection" required by § 362(d)(1). *Id.* at 368; *see* 11 U.S.C. § 362 (automatic stay provision). The Court rejected the assertion that a

The court of appeals in *Balbus* concurred with the bankruptcy court's application of *Timbers* to show that the value of a secured creditor's interest should reflect solely the value of the collateral and should not depend on hypothetical sales costs.[32] Relying on *Timbers*, the bankruptcy court refused to subtract liquidation costs from Balbus's real property.[33]

Judge Murnaghan filed a dissenting opinion, arguing that Chapter 13 debtors should deduct liquidation costs from the valuation of secured claims. Judge Murnaghan opined that the majority incorrectly premised its statutory analysis on the assumption that the second sentence of section 506(a) requires calculating the value of the property to the debtor.[34] Judge Murnaghan stressed that "such value" in the second sentence of section 506(a) clearly refers to "creditor's interest" in the first sentence.[35] The dissent stated that the creditor's interest must be calculated to reflect the net amount that the creditor could receive upon repossession and sale of the property.[36] Judge Murnaghan explained that, regardless of the debtor's retention of the property, subtracting hypothetical sales costs from security value yields the net realizable value of collateral to secured creditors.[37]

Moreover, in rejecting the majority's holding the dissent found the *Timbers* dictum inapposite because *Timbers* did not address the issue of hypothetical sales costs in a security valuation.[38] Judge Murnaghan suggested that a more reasonable interpretation of the *Timbers* dictum is that " 'the value of such creditor's interest' in collateral cannot exceed the 'value of the collateral' and therefore cannot include the creditor's lost opportunity to take possession of the property."[39]

A majority of courts, consistent with Judge Murnaghan's statutory interpretation in *Balbus*, have held that section 506(a) mandates valua-

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creditor's "interest in property" includes the right to immediate possession upon default and consequently deserves reimbursement for deprivation of use during the period of the bankruptcy stay. *Timbers*, 484 U.S. at 370-72.

32. *Balbus*, 933 F.2d at 250-51; *In re* Balbus, 104 B.R. 767, 769-70 (Bankr. E.D. Va. 1989), *aff'd sub nom.* Brown & Co. Sec. Corp. v. Balbus (*In re* Balbus), 933 F.2d 246 (4th Cir. 1991).

33. *Balbus*, 933 F.2d at 250-51.

34. *Id.* at 254 (Murnaghan, J., dissenting).

35. *Id.* (Murnaghan, J., dissenting). To counter the majority's proposition that deducting sales costs in all instances effectively eliminates the second sentence of § 506(a), Judge Murnaghan argued that the first sentence is rendered mere surplusage by the majority's failure to consider the creditor's interest. *Id.* (Murnaghan, J., dissenting).

36. *Id.* (Murnaghan, J., dissenting).

37. *Id.* (Murnaghan, J., dissenting).

38. *Id.* at 255 (Murnaghan, J., dissenting).

39. *Id.* (Murnaghan, J., dissenting).

tion of the creditor's interest in the property.[40] The creditor's interest properly consists of what the creditor would receive upon repossession and sale.[41] To recover any value from the collateral, the secured creditor would have to take possession and sell; the court, therefore, must determine what the creditor could realize upon disposition, accounting for the time and expense incurred in so doing.[42]

Other courts express the alternate view, advanced by the majority in *Balbus*, that section 506(a) commands deduction for liquidation expenses only if the debtor plans to dispose of the collateral.[43] These courts focus on the second sentence of section 506(a) to determine that "the debtor's intention is the cornerstone of the calculation."[44] According to this view, subtracting prospective liquidation costs in all situations would render the second sentence of the statute "mere surplusage" by disregarding the use or disposition of the property.[45] Furthermore, courts endeavor to avoid a debtor's accruing gains by reason of her bankruptcy: "[T]he debtors cannot eat with the hounds and run with the hares. Seeking retention of the property, they cannot insist on liquidation values to be paid to the creditor in installments."[46]

The analysis of the court in *Balbus*, under the guise of protecting consumer debtors in reorganization bankruptcy, fails in several respects. First, the majority's reliance on *Timbers* was unfounded. The bankruptcy court opinion, upon which the court of appeals relied for its *Tim-*

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40. *See In re* Balbus, 104 B.R. 767, 768 (Bankr. E.D. Va. 1989), *aff'd sub nom.* Brown & Corp. Sec. Co. v. Balbus (*In re* Balbus), 933 F.2d 246 (4th Cir. 1991); *In re* Boring, 91 B.R. 791, 795 (Bankr. S.D. Ohio 1988).

41. "The fact that a debtor intends to retain the collateral does not emasculate the fact that it is in the first instance the creditor's interest in the collateral that must be valued." *In re* Claeys, 81 B.R. 985, 991 (Bankr. D.N.D. 1987); *see* Valley Nat'l Bank v. Malody (*In re* Malody), 102 B.R. 745, 749 (9th Cir. 1989); *In re* Smith, 92 B.R. 287, 290 (Bankr. S.D. Ohio 1988); *Boring*, 91 B.R. at 795; *In re* Petry, 76 B.R. 651, 653 (Bankr. C.D. Ill. 1987); *In re* Cook, 38 B.R. 870, 873 (Bankr. D. Utah 1984); Cohen v. Werner (*In re* Cohen), 13 B.R. 350, 353 (Bankr. E.D.N.Y. 1981); *In re* Klein, 10 B.R. 657, 660 (Bankr. E.D.N.Y. 1981); Chrysler Credit Corp. v. Van Nort (*In re* Van Nort), 9 B.R. 218, 220-21 (Bankr. E.D. Mich. 1981).

42. *Claeys*, 81 B.R. at 991.

43. *See* Beacon Hill Apartments, Ltd. v. Columbia Sav. & Loan Ass'n (*In re* Beacon Hill Apartments, Ltd.), 118 B.R. 148, 151 (Bankr. N.D. Ga. 1990); Wolk v. Goldome Realty Credit Corp. (*In re* 222 Liberty Assocs.), 105 B.R. 798, 803 (Bankr. E.D. Pa. 1989); *In re* Penz, 102 B.R. 826, 828 (Bankr. E.D. Okla. 1989); *In re* Bellman Farms, Inc., 86 B.R. 1016, 1019 (Bankr. D.S.D. 1988); Crouch v. Pioneer Fed. Sav. Bank (*In re* Crouch), 80 B.R. 364, 366-67 (Bankr. W.D. Va. 1987); *In re* Robinson Ranch, Inc., 75 B.R. 606, 608 (Bankr. D. Mont. 1987); *In re* Fiberglass Indus., Inc., 74 B.R. 738, 742 (Bankr. N.D.N.Y. 1987) (Chapter 11); *In re* Courtright, 57 B.R. 495, 497 (Bankr. D. Or. 1986); *In re* Crockett, 3 B.R. 365, 367 (Bankr. N.D. Ill. 1980).

44. *Wolk*, 105 B.R. at 803.

45. *Courtright*, 57 B.R. at 497; *see supra* note 25 and accompanying text.

46. *Crockett*, 3 B.R. at 367.

bers discussion,[47] admitted that *Timbers* did not address the problem that the *Balbus* court faced: determining the value of a secured creditor's interest.[48] Nonetheless, the bankruptcy court directly translated the *Timbers* dictum to Balbus's case, ignoring legislative history which indicates that valuation within the adequate protection context will differ from the valuation for plan confirmation.[49] Furthermore, applying the *Timbers* dictum to claim valuation in the *Balbus* situation does not integrate the two sentences of section 506(a) since it always results in market valuation.[50]

Additionally, the court's maneuvering in *Balbus* failed to resolve the impracticality of the section 109(e) debt limits.[51] The majority's conclusion, although purporting to protect unwary debtors from being squeezed out of Chapter 13 by inclusion of excessive amounts of unsecured debt, may place greater strain on debtors attempting to repay secured debt undiminished by sales costs. Advocating the market-value approach actually could harm debtors whose unsecured debts are within the section 109(e) limits by requiring them to repay higher amounts of secured debt.[52] The *Balbus* decision reflects an attempt by the court to manipulate the statutory mandate of section 109(e). Instead, the court should have focused on expressing a workable framework for conducting section 506(a) valuations. The court felt unnecessarily apprehensive that deducting sales costs would eliminate various debtors from filing for reorganization bankruptcy.[53]

Finally, the *Balbus* court's reading of section 506(a) effectively eliminated the instruction in the first sentence to study the "creditor's interest." Similarly, courts that routinely deduct sales costs may ignore the statutory mandate of the second half of section 506(a).[54] A proper anal-

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47. *Balbus*, 933 F.2d at 250-51.

48. *In re* Balbus, 104 B.R. 767, 769 (Bankr. E.D. Va. 1989), *aff'd sub nom.* Brown & Co. Sec. Corp. v. Balbus (*In re* Balbus), 933 F.2d 246 (4th Cir. 1991).

49. S. REP. No. 989, 95th Cong., 2d Sess. 68 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5854; *see supra* notes 19, 31.

50. The dissent offered a more sagacious interpretation of the *Timbers* dictum. *See supra* text accompanying note 39.

51. The § 109(e) limits were established in 1978 and have remained unchanged since that time. 11 U.S.C. § 109(e) (1988).

52. Research has demonstrated that Chapter 13 debtors often experience difficulty adhering to their reorganization plans. *See* TERESA A. SULLIVAN ET AL., AS WE FORGIVE OUR DEBTORS: BANKRUPTCY AND CONSUMER CREDIT IN AMERICA 4 (1989).

53. The Supreme Court, however, recently obviated the necessity of judicial manipulation to permit an individual debtor to file in a reorganization Chapter rather than a liquidation chapter. *See* Toibb v. Radloff, 111 S. Ct. 2197, 2202 (1991) (holding that individuals may file under Chapter 11).

54. Although they reach the proper result, courts that deduct sales costs in determining

ysis of section 506(a) construes both sentences of the statute together. The creditor's interest consists of the amount that he ultimately could recover upon repossession and sale. The second sentence modifies the first by focusing attention on the property's use or disposition in bankruptcy. Clearly, both sentences arrive at the liquidation value when property will be liquidated. A dilemma arises, however, when a debtor plans to retain collateral.

The interpretation enunciated by the court in *In re Claeys*,[55] a construction the *Balbus* dissent embraced,[56] provides a desirable uniform standard for the valuation of retained collateral in a reorganization bankruptcy. Courts first must value the creditor's interest in the collateral. Consonant with a determination of the creditor's interest, sales costs must be deducted. The second prong of the analysis parallels the second sentence of section 506(a) and requires an examination of the use of the property. If the use will reduce the property's value, the measure of value should be adjusted accordingly.[57]

Consistent application of the section 506(a) valuation provision within the context of confirming a Chapter 13 reorganization plan is needed to avoid the current unpredictable results attributable to the divergent judicial approaches. The *Claeys* approach—valuing the creditor's interest in the collateral and considering the use or disposition of the property—offers sound statutory interpretation within feasible confines. If consistent sales costs are applied, the lower value of the secured debt,[58] although not favored by creditors, probably will result in the creditor's recouping what she expected in negotiating the extension of credit. The auspicious result of the *Claeys* analysis will be an increase in the probability of success of debtors' reorganization plans and the creditors' receiving not only what they would receive on foreclosure, but also some percentage of the undersecured portion of the debt.

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the value of a secured claim often fail to acknowledge the necessity of applying the second half of § 506(a) in tandem with the first half.

55. 81 B.R. 985, 991 (Bankr. D.N.D. 1987).

56. *Balbus*, 933 F.2d at 254 (Murnaghan, J., dissenting) (citing *Claeys*, 81 B.R. at 992).

57. For an example of a use that would reduce collateral value, see *Claeys*, 81 B.R. at 992.

58. Legal vernacular frequently describes the confirmation of a bankruptcy reorganization plan over the objections of a creditor as a "cramdown." *See* Queenan, *supra* note 14, at 19-20 (describing the semantics and mechanics of property valuation).