

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF IOWA**

In the Matter of:

Diwan, L.L.C.

Case No. 12-00424-als11

Debtor

Chapter 11

**MEMORANDUM OF DECISION
(date entered on docket: July 16, 2013)**

Before the Court is the Debtor's request that the claim filed by Maha-Vishnu Corporation ("Maha-Vishnu" or "Claimant") in this chapter 11 proceeding be equitably subordinated pursuant to 11 U.S.C. section 510(c). Dale G. Haake represents Diwan, L.L.C. ("Debtor" or "Diwan"). Jeffrey C. McDaniel appears for Claimant.

Jurisdiction of this core proceeding is pursuant to 28 U.S.C. sections 157(b)(1) and 1334. Upon reviewing the evidence and the arguments of the parties the Court applies 11 U.S.C. section 510(c) and partially subordinates Maha-Vishnu's claim.

PROCEDURAL BACKGROUND

Diwan filed a small business chapter 11 case on February 22, 2012. On June 5, 2012, Maha-Vishnu filed a proof of claim stating it was owed \$677,130.41 which was secured by a mortgage. Debtor filed an objection to this claim on June 6, 2012 asserting that the amount of the claim could not be correctly calculated until a sheriff's sale was conducted. This objection is now moot because the sale has taken place during the interim time period. A plan and disclosure statement were filed by the Debtor on September 6, 2012 which treated Maha-Vishnu's claim as fully subordinated to all other creditors, and transferred the lien held by the

Claimant to the Debtor. Claimant objected to this treatment. A confirmation hearing was scheduled at which time the Court, with the parties' consent, bifurcated the issue of equitable subordination from the confirmation process; directed that Maha-Vishnu file an amended proof of claim and allowed the Debtor to file any additional objections to the amended claim.¹

Maha-Vishnu's amended claim states that it is owed a total of \$688,231.45, of which \$612,879.00 is secured and \$75,352.45 is unsecured. Diwan's objection to the amended proof of claim asserted that the proposed plan treated the claim as being subject to equitable subordination and that Maha-Vishnu impaired the value of the motel by its conduct at the sale and related to the tax delinquency.

At the conclusion of the evidentiary hearing related to 11 U.S.C. section 510(c), the Court requested written argument, and asked the parties to brief the issue of the validity and meaning of the Notice of Forfeiture of real estate contract that was admitted as Claimant's Exhibit T. The Court reserved ruling on Debtor's objection to admission of Claimant's Exhibit PP.

FACTS

The dispute between these parties involves a substantial difference of opinion as to the actions, or inactions, arising under a contract for sale of a motel ("Contract") near Williamsburg, Iowa that involved Maha-Vishnu as the Seller and one of its owners, Magan Patel ("Patel") and Thakur, L.L.C. as the Buyer and Rabin Thakur, as guarantor of the Contract and sole owner of Thakur, L.L.C.

¹ Federal Rule of Bankruptcy Procedure 7001(8) states that a proceeding to subordinate any allowed claim is an adversary proceeding, except when a chapter 11 plan provides for the relief. Diwan's plan provides for the subordination of Maha-Vishnu's claim, which alleviated the necessity of a separate adversary proceeding.

Patel was born and raised in India. In the mid 1970's he obtained an engineering degree in the United States. He became involved in the hotel business in 1984. Currently he owns and operates approximately seven hotel properties. He is a part owner in Maha-Vishnu, which in 1992 purchased a motel near Williamsburg, Iowa for \$1.2 million. The motel contained one hundred twenty units and operated as a Days Inn. This property was sold on contract to Shalom Hospitality, Inc. ("Shalom") in 1999. In 2001, a fire damaged the rear wing of the property. Although one hundred eight rooms remained, only thirty-four rooms could be used by guests. Shalom defaulted on its contract and filed bankruptcy. Claimant filed a foreclosure action, and on December 6, 2002, judgment was entered in its favor in the amount of \$1,551,092.39 in rem against the property, and in personam against Shalom and Sebastian Joseph. On February 25, 2003, the Claimant obtained a Sheriff's Deed resulting from its bid of \$400,431.54 at the foreclosure sale. Insurance proceeds of \$500,000 were received by the Claimant, but rather than rebuild the motel, these funds were applied to an outstanding mortgage balance owed by Maha-Vishnu.

Ranbir Thakur was born in India in 1962. His father died when he was a young child. He was educated in India for ten years which equates to a high school education in the United States. In 1984 Thakur moved to New York where he worked as a taxi driver for eleven years. After he had saved \$72,000, Diwan was established with Thakur as its sole owner, and it purchased a gas station on Spring Street in Davenport, Iowa. Later, a second location was acquired on Brady Street. Diwan still owns and operates these businesses. In 2003, Ritesh Patel, Patel's nephew, was hired to work at the gas stations, and he became a trusted employee.

In January 2004 Ritesh told Thakur that his Uncle was a very successful businessman and owned several hotels. He further explained that due to the hotel business, Patel had been able to

afford to bring his whole family to America, had a very grand house and had put two sons through medical school. After these conversations, Patel visited Diwan's business location. Ritesh introduced Thakur, referring to Patel as his Mama Ji². Because of Patel's age, and in a showing of respect, Thakur also began referring to Patel as Mama Ji. Thakur states that Patel told him he had a good business going at the gas station and he would give him a good price to buy his hotel. Thakur testified that he told Patel he did not know anything about hotels, but Patel responded by saying he would help him. Contrary to this version of the events, Patel contends that it was Thakur who asked to buy the motel. He testified that he advised Thakur against the purchase, but Thakur was insistent and persistent in his desire to obtain the property. In spite of these substantially different recollections, both men agree that they discussed the motel purchase three or four times.

Thakur, L.L.C. was formed to purchase the motel. Upon a request from Claimant's attorney, Thakur provided the name of Marc Engelmann as his lawyer. Various exhibits were admitted that demonstrate Claimant's counsel communicated in writing with Mr. Engelmann. Prior to the closing on the sale, Patel requested the legal description for the Spring Street Property owned by Diwan. In response, and apparently without asking why it was needed, Thakur faxed this information to him. This real estate was used by the Claimant as collateral under the Contract.

Thakur claims he made three payments to Patel related to the contract prior to or at the time of the closing: 1) \$25,000 which Patel instructed Thakur not to disclose; 2) \$1,000 for a piece of lawn equipment located at the motel and 3) \$100,000 down payment. The sale documents were prepared by Maha-Vishnu's attorney, who was also present at the time the

² Literally translated to mean "mother's brother."

documents were signed. The closing took place on February 27, 2004. Thakur states he was not provided an advance copy of the documents and that Patel told him he did not need an attorney. Thakur admits that he did not read any of the documents he signed on behalf of Thakur, L.L.C., his personal guarantee, or the mortgage granted by the Debtor on the Spring Street property.

The Contract provided that possession was effective on February 25, 2004. Whether Thakur visited the motel prior to the closing is disputed by the parties. Patel states he does not know whether Thakur went to the motel, but he certainly was not prevented or forbidden from seeing the property. Thakur testified that he asked to see the motel on the way to the closing on February 27, but Patel resisted his requests. He further claims he had no idea the property was damaged or that no franchise with Days Inn existed until *after* he purchased the motel. Pritesh Patel, another of Patel's nephews, testified that he accompanied Thakur to see the motel prior to the time it was purchased. According to his account, this visit occurred in January and lasted about an hour. Pritesh testified that because of the condition of the motel, he and Thakur discussed buying the property as cheaply as possible.

Pritesh Patel was employed to operate the business on behalf of Thakur, L.L.C. Timely contract payments were made to the Claimant for three years. Due to franchise disputes, the condition of the motel, debt service and regular business expenses, Thakur states that he spent approximately \$200,000 in his attempts to operate the motel. In spite of his belief that Patel, as his Mama Ji, had promised to help him with the motel, Thakur's requests for assistance or for the motel to be returned or sold, never came to fruition. Eventually, Thakur ran out of funds and he stopped making the contract payments.

Prior to the time Diwan filed bankruptcy, it commenced a state court action to rescind the Contract. Maha-Vishnu also initiated suit in state court to foreclose its interest in the Contract. These two proceedings were consolidated by the state court and a trial was conducted. In its January 3, 2012 ruling, the state court dismissed Diwan's suit and entered a decree of foreclosure in favor of Maha-Vishnu. The matter was appealed by Diwan. The Iowa Court of Appeals affirmed the trial court in its opinion issued on November 29, 2012.

The property taxes were delinquent on at least two occasions during the time period that the Contract was in place with Thakur, L.L.C. The first delinquency related to tax years 2007 through April 2009. The real estate was redeemed prior to the issuance of a tax deed. A second tax sale occurred on June 20, 2010 due to tax delinquencies for 2009 through 2010. The motel was purchased by the Claimant at Sheriff's Sale for the amount of \$1.00 on June 6, 2012. The property was not timely redeemed from the second tax sale and on August 1, 2012, a Tax Sale Deed was issued that transferred the motel to Alice Prince. At the time of Diwan's bankruptcy filing, neither Maha-Vishnu nor Thakur, LLC owned any interest in the motel.

DISCUSSION

I. Preliminary Issues

Prior to reaching the merits of the issues argued by the parties related to equitable subordination, two preliminary matters must be addressed.

A. Objection to admission of Defendant's Exhibit PP.

As previously discussed, the parties were involved in a state court dispute which consolidated two pending cases: Diwan's request that the contract be rescinded and Maha-Vishnu's action to foreclose on the contract. Exhibit PP is the transcript of the bench trial

conducted in these cases. Debtor's counsel objected to the admission of Exhibit PP on two grounds: 1) because the state court considered a petition for rescission, which has very strict elements, not present in the claims dispute or under 11 U.S.C. section 510(c); and 2) relevance. A petition for foreclosure was consolidated with the petition for rescission, which is of importance related to the Court's questions related to Defendant's Exhibit T. Further, Exhibit PP stems from Debtor's exhibits 37 and 38 and Claimant's exhibits X and Y, which are the petitions of each of these parties' state court actions. The Debtor posed no objection to Claimant's admission of Exhibits FF and KK, which contain the Iowa District Court's written ruling and the opinion issued by the Iowa Court of Appeals. The transcript is relevant for the following reasons: 1) to determine whether factual issues or legal theories were raised and addressed by the state court that are duplicative of those raised in this case; 2) to evaluate the analysis used by the state courts in reaching their decisions; and 3) to determine the status of the Notice of Forfeiture (Exhibit T). For these reasons, the Debtor's objection to admission of Exhibit PP is overruled and the exhibit is received.

B. Whether the contract between Maha-Vishnu and Thakur L.L.C. was forfeited based upon Defendant's Exhibit T.

Under Iowa law if a contract is forfeited the sole remedy available to the contract vendor is possession of the property. Alternatively, if a contract interest is foreclosed a deficiency judgment may result if the collateral is sold for less than the balance owed. Whether the Contract was forfeited or foreclosed is critical to the claim of Maha-Vishnu in this bankruptcy case.

At the close of evidence, the Court questioned the meaning and applicability of the Notice of Forfeiture of Real Estate Contract prepared by Paul J. Bieber. (Exhibit T). The

document indicates that the contract vendee is in default under the contract in the amount of \$182,963, and at paragraph 2 states:

The contract shall stand forfeited unless the parties in default, within 30 days after the *completed service of this notice*, shall perform the terms and conditions in default, and in addition pay the reasonable costs of serving this notice.

(Emphasis added). A contract may only be forfeited if action is taken in strict compliance with Iowa Code Chapter 656. As to service, the statute provides:

[N]otice may be served personally or by publication, on the same conditions, and in the same manner as is provided for the service of original notices, except that when the notice is served by publication no affidavit therefor shall be required before publication. Service by publication shall be deemed complete on the day of the last publication.

Iowa Code § 656.3 (2013).

No testimony or argument related to Exhibit T was offered by either party. No certificate of service was contained as part of the record, and no one argued whether Thakur, L.L.C. or its registered agent³ were actually served with the Notice, or that publication occurred. The state court trial transcript contains no testimony that indicates that Thakur, L.L.C., its registered agent or Thakur disputed the foreclosure action due to a previous forfeiture of the contract.

Exhibit T reflects a stamp that the document was “received” by the Iowa County Sheriff at Marengo, Iowa on January 26, 2010. This receipt stamp is crossed out. Case law is inconclusive as to whether a crossed out file stamp results in the “unfiling” of a document. Moore v. Nelson, 611 F.2d 434 (2d Cir. 1979); Moffett v. Kimberly-Clark Corp., No. 3:97CV1390 (WWE), 1998 WL 698760 (Dist. Conn. Aug. 6, 1998). Here, there is merely a

³ The Defendant’s brief discusses the fact that the Iowa County Sheriff would have no jurisdiction to serve Thakur L.L.C.’s registered agent of record, an attorney located in Scott County, Iowa.

notation that the item was received which does not constitute a docket filing with the Clerk. The fact that this receipt was crossed out may indicate that the item was recalled or canceled, and that no further action was taken related to the Notice.

Based upon the state court litigation it is clear that Maha-Vishnu pursued foreclosure as permitted under paragraph 15 of the Contract, in lieu of forfeiture. Based upon the record, the Contract was properly foreclosed under state law.

II. Subordination of Claim pursuant to 11 U.S.C. § 510(c)

The bankruptcy code provides, in relevant part, that after notice and a hearing, the court may:

- (1) Under principles of equitable subordination, subordinate for purposes of distribution all or part of an allowed claim to all or part of another allowed claim or all or part of an allowed interest to all or part of another allowed interest; or
- (2) Order that any lien securing such a subordinated claim be transferred to the estate.

11 U.S.C. § 510(c) (2013). Under this provision, Diwan argues that Maha-Vishnu's claim is subject to equitable subordination based upon: (1) The Claimant's conduct prior to the sale in a manner designed to mislead the principal of Diwan; (2) The Claimant's conduct, or Patel's family members' conduct, during the performance of the Contract; and (3) The conduct of the Claimant after the state trial regarding the sale of the motel property.

Equitable subordination is an extraordinary remedy and is rarely granted. See Official Comm. of Unsecured Creditors v. Cajun Elec. Power Coop., 119 F.3d 349, 356 (5th Cir. 1997). Most courts have held that to apply equitable subordination three conditions must be met: (1) the claimant must have engaged in some type of inequitable conduct; (2) the misconduct must have resulted in injury to the creditors or conferred an unfair advantage on the claimant; and (3) equitable subordination must not be inconsistent with the Code. See United States v. Noland,

517 U.S. 535, 538-39 (1996). Whether Maha-Vishnu's claim is subject to the remedy provided for at 11 U.S.C. section 510(c) depends upon Diwan's ability to prove that the actions of the Claimant constitute inequitable conduct under the identified factors.

A. Relationship of the Parties

Typically inequitable conduct involves a fiduciary or insider of a debtor or involves a third party actually defrauding other creditors. Official Comm. of Unsecured Creditors v. Cajun Elec. Power Coop., Inc., 119 F.3d at 357; See In re Graycarr, Inc., 330 B.R. 741, 749 (Bankr. W.D. Ark. 2005); Id. Diwan asserts that because Patel and his corporation, Maha-Vishnu, took advantage of Thakur based upon the special meaning and relationship of trust ascribed to the term "Mama Ji" their various actions constitute inequitable conduct.

India recognizes a joint family system. Under this concept, extended family members, especially a Mama Ji, is accorded great respect, involves trust, and can be seen as creating special obligations of protection. These values may apply equally to non-blood relatives. It is described as comparable, but with a stronger connotation, than a godfather under American custom. Neither Thakur nor Patel dispute this characterization of their relationship. However, it is the exact nature and extent of the obligations engendered by their relationship, and the perception of Patel as a Mama Ji, that have the parties at odds.

Thakur contends that he accepted the invitation to purchase the hotel and completely trusted his Mama Ji in the promises made to assist him in operating the business. Although he contends that his efforts to visit the motel prior to the closing were resisted by Patel, he did not question these motives and his trust carried him through the closing. Patel acknowledges that Thakur viewed him as a Mama Ji and that in that role he had no intent to harm Thakur, or his businesses. But, he states that he never made any specific promises to Thakur about his

continued involvement in the motel or that he would solve any or all obstacles faced in its operation. At the end of the day, he admits that he is a businessman and Thakur is responsible for his own decisions. Both men are adamant in their positions.

The definition of fiduciary, and whether a fiduciary relationship exists, has recently been addressed in this Circuit in the context of dischargeability of debt under 11 U.S.C. section 523(a)(6). That code provision provides that upon proof of a defalcation by a fiduciary a debt may be excepted from discharge. The requirements to prove a fiduciary relationship in this context are instructive here. A fiduciary relationship is reflected in an express or technical trust and may be imposed by contract or by statute. See Arvest Mortg. Co. v. Nail (In re Nail), 680 F.3d 1036, 1040 (8th Cir. 2012); Barclays Am./Bus. Credit, Inc. v. Long, (In re Long), 774 F.2d 875, 878 (8th Cir. 1985).

A review of the Contract demonstrates that the parties did not agree to any trust relationship related to the sale of the motel. The Debtor did not advance a statutory basis for the trust relationship it claims, but even if such a statute exists, that does not end the inquiry. “It is not enough that a statute purports to create a trust: A state cannot magically transform ordinary agents, contractors, or sellers into fiduciaries by the simple incantation of the terms ‘trust’ or ‘fiduciary.’” Arvest Mortg. Co. v. Nail, 680 F.3d at 1040.

The cultural definition and application of the term “Mama Ji” appears to be the basis for Diwan’s argument that a fiduciary relationship existed. This issue was specifically addressed in the decision rendered by the Iowa Court of Appeals. Relying on the Restatement (Second) of Contracts the court of Appeals held that:

This was not a fiduciary relationship, this was not a familial relationship,² nor was it a patient-physician relationship; it was also not one of the special contract types listed above. We therefore

conclude that there was no relationship of trust or confidence between Thakur and Patel in this case . . .

f.n. 2 Thakur urges that the parties' common East Indian origins created something akin to a familial relationship. However, we do not agree that a one or two week relationship centered in a real estate transaction can rise to the level of a familial relationship as contemplated by the Restatement.

Thakur v. Maha-Vishnu Corp., No. 12-0441, 826 N.W.2d 515, 2012 WL 5954589 (Iowa Ct. App. Nov. 29, 2012). This conclusion is well reasoned and will not be revisited here. Although the amount of testimony was longer at the bankruptcy court hearing, the facts surrounding the issue of whether there was a fiduciary relationship are identical to those presented in the state court action, and do not support a different outcome.

When a creditor is not a fiduciary or an insider, as that term is legally defined, proof of actions that warrant equitable subordination is very substantial, rising to the level of egregious or gross misconduct. See In re Bellanca Aircraft Corp., 56 B.R. 339, 401 (Bankr. D. Minn. 1985), aff'd, 850 F.2d 1275 (8th Cir. 1988). To meet its burden of proof, the Debtor must establish such conduct by a preponderance of the evidence. See In re Chira, 353 B.R. 693 (Bankr. S.D. FL 2006), aff'd, 378 B.R. 698 (S.D. FL 2007); In re Kreisler, 331 B.R. 364 (Bankr. N.D. Ill. 2005). It is under these standards that the remaining arguments advanced by Diwan will be evaluated.

B. Fraud or Misrepresentation

To prevail on a fraud claim, Diwan must prove: (1) Maha-Vishnu made a representation to Diwan; (2) the representation was false; (3) the representation was material; (4) Maha-Vishnu knew the representation was false; (5) Maha-Vishnu intended to deceive Diwan; (6) Diwan acted in justifiable reliance on the truth of the representation; (7) the representation was a proximate

cause of Diwan's damages; and (8) the amount of damages. Dier v. Peters, 815 N.W.2d 1, 7 (Iowa 2012). "The first three elements are usually treated as one element and referred to as fraudulent misrepresentation." Arthur v. Brick, 565 N.W.2d 623, 625 (Iowa Ct. App. 1997). In addition, "[t]he failure to disclose a material fact known to the person who has a legal duty to inform the other contracting person of the matter can constitute fraud." Id.

Diwan contends that Thakur was not aware and was not informed of the extent of the fire damage and condition of the motel prior to the closing. In the state court proceeding, Thakur and Thakur, L.L.C. also relied upon fraud as the basis for rescission of the contract. The trial court held:

From a review of the record as a whole that Buyer's claim fails because it has not been proven . . . by a preponderance of the evidence that the Seller made a material misrepresentation as to the condition of the motel or the lack of a Days Inn franchise. There was no affirmative misstatement nor was there a fraudulent misrepresentation by failure to disclose any material facts by Seller of Magan Patel as its agent. The Court concludes that Mr. Thakur did inspect the premises before closing and was or should have been aware of its condition.

Thakur v. Maha-Vishnu Corp., No. EQCV022970, No. EQCV013058 (Iowa Dist. Ct. Iowa County Jan. 3, 2012). Although Diwan was not a party to the state court action the facts and cast of characters underlying the fraud argument are identical in both cases.

Under Iowa law, the doctrine of collateral estoppel prevents relitigation if:

- (1) the issue determined in the prior action is identical to the present issue;
- (2) the issue was raised and litigated in the prior action;
- (3) the issue was material and relevant to the disposition in the prior action; and
- (4) the determination made of the issue in the prior action was necessary and essential to that resulting judgment.

Winnebago Indus. v. Haverly, 727 N.W.2d 567, 572 (Iowa 2006). The principle of collateral estoppel applies in bankruptcy proceedings. Federal courts apply the law of the forum under which the prior judgment was entered when determining whether collateral estoppel arises from a prior state court judgment. Osborne v. Stage (In re Stage), 321 B.R. 486, 492 (B.A.P. 8th Cir. 2005). A bankruptcy court can “properly give collateral estoppel effect to those elements of the claim that are identical to the elements required . . . which were actually litigated and determined in the prior action.” Grogan v. Garner, 498 U.S. 279, 284 (1991) (citing Restatement (Second) of Judgments § 27 (1982)). For this reason, the determination made by the trial and appellate court related to the Debtor’s claim of fraud, is adopted for purposes of this ruling under the principles of collateral estoppel.

In this case, the Debtor also appears to argue that Patel made representations as to his potential involvement in helping Thakur make the motel business successful. The basis of this contention is based solely upon Thakur’s interpretation of statements made by Patel. There is nothing in the record that suggests that Maha-Vishnu was bound by these statements, or that its other owner was party to these statements. Further, the conditions or form of any assistance was never discussed, nor defined, by any of the parties involved in the transaction at issue. In its efforts to substantiate fraud, Diwan relies upon statements and conversations involving Thakur, Patel and other third parties as the basis for inequitable conduct. To consider these representations raises an exception to the parole evidence rule, which allows statements to be considered when fraud in the inducement of a contract is alleged. Pinken v. Frank, 704 F.2d 1019, 1022 (8th Cir. 1983).

Claimant’s attorney testified that he attempted to communicate with Marc Engelman, an attorney that was listed as registered agent for Thakur, L.L.C. in the filings with the Iowa

Secretary of State. Thakur insists that he did not have an attorney related to the sale transaction and only employed counsel to establish his business entities. He stated that he trusted Patel due to their special relationship as his Mama Ji, and Patel told him he did not need an attorney.

The language of the Contract is unequivocal in disclosing that the property is being sold “as-is,” identifies only 34 rooms as operational, states that there is electrical damage and that no franchise is in place. As to the mortgage instrument using the Debtor’s property as collateral, it clearly states it is granted for the purpose of guaranteeing the Contract, and the obligations of Thakur, L.L.C. and Thakur. The fact that Thakur, on behalf of either Thakur, L.L.C. or Diwan, did not undertake examination of the written document or obtain legal counsel does not support a finding of fraud in the inducement or inequitable conduct by the Claimant.

C. Control by Claimant

Debtor asserts that the Claimant gained an undue advantage by exercising undue influence and control in the sale and operation of the motel. First, there is no evidence that an undue advantage was present in the sale transaction, or at the closing, that could not have been remedied by actions Thakur could have taken on his own behalf.

Second, there is a similar lack of proof related to control exercised by key employees that were relatives of Patel. Diwan employed Ritesh prior to Thakur having any contact with Patel related to the motel. There is no evidence that Ritesh sought this job in an effort to advance the interests of the Claimant or Patel. Thakur was not involved in the day to day operations of the motel, most of his energies were spent operating Diwan’s gas stations. The decision to hire Patel’s family members appears to have been based upon Thakur’s acquaintance with the family, their offers to assist, and his lack of experience in the motel business.

D. Other Inequitable Conduct

Both the Debtor and the Claimant recognize that Diwan's Spring Street location has a value of between \$550,000 and \$612,000. Valley Bank holds two consensual mortgages against the Spring Street property that total approximately \$250,000. Diwan argues that the Claimant impaired the collateral which resulted in a substantial deficiency that it now seeks to enforce and exceeds all of the Debtor's available equity in Spring Street. The Court views this argument as raising the issue of whether Maha-Vishnu's conduct was inequitable based upon actions it took that can be characterized as "tantamount to fraud, misrepresentation, overreaching or spoliation." 80 Nassau Assocs. v. Crossland Fed. Sav. Bank, 169 B.R. 832, 838 (Bankr. S.D.N.Y. 1994).

There is consistent testimony that the motel was originally offered for sale at \$800,000, a price at which no potential buyers were located. It is clear that the motel was offered to Thakur at a lower price. When asked if he obtained a premium in the purchase price with Thakur, L.L.C. Patel states that as Thakur's Mama Ji, he would not take advantage of him and that is why the price was lowered. Patel told Thakur he would give him a good price and identified the figure at \$625,000. No basis for this reduction based upon the actual value of the property was provided by the Claimant.

The Contract states that the purchase price was \$600,000. After applying a \$100,000 down payment the balance owing was \$500,000 as noted on the face of the Contract. There is no mention of the \$25,000 Thakur paid to Patel which supports his testimony that Patel wanted to keep this information secret. The Contract does not provide for a purchase price of \$625,000. To the extent Thakur is bound by disclosures contained in the Contract, the written terms of that agreement must be equally binding on the Claimant.

Also of note is the valuation evidence received at trial. According to the County Assessor the value of the motel was established at \$433,120. This value is consistent with Maha-Vishnu's bid in the amount of \$400,451.34 at the Sheriff's sale following its foreclosure of Shalom's contract interest, approximately one year prior to the time Thakur purchased the property. There is no evidence as to how the purchase price of \$625,000 was justified when all evidence points to a much lower value. Although Patel denies requesting a premium in the purchase price from Thakur, L.L.C., the evidence supports a contrary conclusion. There is also no evidence as to why, after substantial funds were expended during the time period Thakur, L.L.C. owned the motel, the value decreased to only \$1.00 as evidenced by Claimant's bid at the Sheriff's sale in June 2012.

The bid made by Maha-Vishnu bears no correlation to the value of the property. Under Iowa law

when it is alleged that the guarantee did some affirmative act which diminished other security which might have been available for payment of the debt, or otherwise injured the guarantor in his rights and remedies. Such acts will discharge the latter pro tanto; that is, to the extent, but only to the extent, of the loss incurred.

Fidelity Sav. Bank. V. Wormhoudt Lumber Co., 251 Iowa 1121, 1127, 104 N.W.2d 462 (Iowa 1960) (citations omitted). Although Maha-Vishnu elected to foreclose, the basis for that action stems from a breach of the terms of the Contract between the parties. A person claiming a breach of contract has a duty to mitigate damages. See Kuehl v. Freeman Bros. Agency, Inc., 521 N.W.2d 714, 719 (Iowa 1994). "This duty imposes on the complaining party the obligation to exercise all reasonable diligence to lessen the damages caused by the other party's breach." Id. The evidence clearly establishes the value of the property in the amount of \$400,000 to \$434,000. When questioned about the amount of its bid, the Claimant simply responded, without elaboration, that Thakur was present at the time of sale and could have made a bid of \$1.01 to purchase the

property. Mahu-Vishnu's conduct at the sale ignores any reasonable recognition of value for the motel, and fails to demonstrate any effort to mitigate its loss due to the breach of payment under the Contract.

The joint family system that is recognized in Indian culture promotes the concept of duties and responsibilities even if no blood relationship exists. An individual that is viewed as a Mama Ji takes on the role of a surrogate father who is revered, respected and trusted. Such a kinship does not foreclose business negotiations, but a traditional view is that there is a limited opportunity to question motives or raise concerns with a Mama Ji. In reviewing the record as a whole, it appears that Patel was more than willing to encourage Thakur's perception of him as his Mama Ji during the time period prior to the sale. However, Patel's demeanor and testimony support a different conclusion. For example, he acknowledged that Thakur had no experience to run a hotel, but once he sold it he had no responsibility regarding that issue, and that it was Thakur's problem if he could not properly manage the hotel from Davenport, Iowa. He further stated that he never considered how the motel was going to be operated, provided no advice to Thakur, nor did he ever inquire as to the status of the business operation.

Thakur approached Patel on several occasions to discuss releasing the guarantees and assistance in his attempts to sell the motel. These efforts were rebuked or ignored by Patel. Although Thakur located a buyer that would pay \$288,000 plus the property taxes, Patel rejected the offer based upon his opinion that the buyer was untrustworthy. During his testimony, Patel's intention to enforce the contract balance is evidenced by his statements that he just wanted to get his contract paid, and he had no intention of releasing Thakur or the Spring Street Property from the debt. His testimony was clear that he now expected to "get *his* property on Spring Street."

All actions taken by the Claimant appear to be calculated and directed toward this goal by increasing the maximum amount of liability under the Diwan mortgage.

Diwan has established that its liability was directly impacted under the circumstances of the inflated purchase price and the amount Claimant bid in at the Sheriff's sale. This amounts to overreaching and spoliation by the Claimant, or through the acts of its principals. Absent this conduct, the amount that Diwan would be required to pay under its guarantee would have been substantially smaller. Although Maha-Vishnu and its principal, Patel, engaged in legal conduct, its actions:

shocks one's good conscience. It means, *inter alia*, a secret or open fraud, lack of faith or guardianship by a fiduciary; an unjust enrichment, not enrichment by bon chance, astuteness or business acumen, but enrichment through another's loss brought about by one's own unconscionable, unjust, unfair, close or double dealing or foul conduct.

80 Nassau Assocs. v. Crossland Fed. Sav. Bank, 169 B.R. at 837.

Although a bankruptcy court is a court of equity, "it is not free to adjust the legally valid claim of an *innocent party who asserts the claim in good faith* merely because the court perceives that the result is inequitable." United States v. Noland, 517 U.S. 535, 539 (1996) (emphasis added). That is not the case here. Unlike the other arguments made by Diwan, it has established that the Claimant and Patel's conduct was unjust which effectively harmed it and resulted in an unfair advantage to Maha-Vishnu. The preponderance of evidence supports the conclusion that Claimant engaged in inequitable conduct sufficient to appropriately apply 11 U.S.C. section 510(c) to part of its claim. However, the Court declines to find that it is necessary to transfer the lien held by the Claimant to the estate to effectively and fairly reorder the priorities of creditors. Diwan's proposed plan cannot be confirmed based upon its current treatment of Maha-Vishnu's claim.

III. Alternative Claim Objections

Diwan raises seven distinct legal theories as objections to the claim, including: UCC 2-302 Requirement of Good Faith and Fair Dealing; Inadequacy of Sale Price; Fraudulent Representations; Doctrine of Unconscionability; Bait and Switch; Constructive Trust and Promissory Estoppel. These issues are raised in addition to the request that equitable subordination be imposed. Due to the decision related to equitable subordination, a determination will not be specifically addressed in this ruling. Any further action on these remaining objections are deferred pending confirmation of the Debtor's plan.

IV. Conclusion

The Code permits that all, or part of a claim may be subordinated for inequitable conduct. The evidence reflects that the conduct of the Plaintiff directly impacted Diwan's liability under the mortgage. For the reasons stated herein, Maha-Vishnu's secured claim will be partially subordinated as follows: Value of the property after sale bid (\$433,119.00) and Undocumented Cash Payment (\$ 25,000.00) for a total of \$458,119.00.

The amended claim reflects an unsecured portion in the amount of \$75,352.45. This portion of the claim consists of the under-secured portion of Maha-Vishnu's claim that may include interest or other costs associated with the Contract. All obligations that arose pursuant to the state court judgment were enforceable and are properly included in the proof of claim. There has been no proof to establish that the unsecured portion of the amended claim is subject to equitable subordination and it is not subject to this ruling.

IT IS THEREFORE ORDERED THAT:

1. The secured claim of Maha-Vishnu Corporation is subordinated to all claims and interests in the amount of \$458,119;
2. The secured claim of Maha-Vishnu is allowed in the amount of 154,760;
3. The parties shall bear their own costs.
4. The Debtor shall have 30 days from the date of this order to submit an amended disclosure statement and plan that conforms to this ruling.

/s/ Anita L. Shodeen
Anita L. Shodeen
U.S. Bankruptcy Judge

Parties receiving this Memorandum of Decision from the Clerk of Court:
Electronic Filers in this chapter case.