UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In the Matter of	:	
KCC-FUND IX, A Limited Partnership	:	Case No. 88-808-C H Chapter 11
	:	
Debtor.		
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ORDER--MOTION TO DISMISS AND MOTION TO LIFT AUTOMATIC STAY

On October 11, 1988, a hearing was held on the motion to dismiss and motion to lift stay. The following attorneys appeared on behalf of their respective clients: Gary A. Norton and Gerald P. Urbach for Debtor; T. J. McDonough and Dennis W. Johnson for creditor Froms; Bruce L. Anderson for Hawkeye Federal Savings and Loan; and Terry L. Gibson, Assistant United States Trustee. At the conclusion of said hearing, the Court took the matter under advisement upon a briefing deadline of November 1, 1988. Briefs were timely filed and the Court considers the matter fully submitted.

This is a core proceeding pursuant to 28 U.S.C. §157(b)(2). The Court, upon review of the pleadings, arguments of counsel, and briefs, now enters its findings and conclusions pursuant to F.R.Bankr.P. §7052.

FINDINGS OF FACT

1. On February 29, 1988, Debtor filed its voluntary Chapter 11 petition in the U.S. Bankruptcy Court, Western District, Missouri. On March 31, 1988, venue

was changed to this Court.

2. Debtor's primary business activity is the ownership and operation of a 114 unit apartment complex located at 4300 Westbrook, Ames, Iowa, known as "Westbrook Terrace Apartments" (hereinafter "Westbrook").

3. Debtor is a limited partnership, formed February 6, 1988, pursuant to the laws of the State of Missouri. Debtor was formed for the purpose of purchasing and operating residential, industrial and commercial real estate. As relevant herein, the function of Debtor is to manage Westrook. As such, there are no employees except the principals.

4. Paul and Charlotte From (hereinafter "Froms") are the primary claimants against Debtor. They hold a real estate mortgage against Debtor's primary asset, Westbrook. The Froms, husband and wife, are in their middle to late sixties and are seriously considering retirement. Mrs. From has experienced health problems.

5. On June 11, 1988, Froms filed a motion to modify the automatic stay under both grounds of 11 U.S.C. §362(d). As grounds for cause under §362(d)(1), Froms allege there is no adequate protection and Debtor has been in the process of collecting rents and transferring those funds out of state while at the same time committing waste upon the property. Under §362(d)(2), Froms allege Debtor has no equity in the property and it is not necessary to an

effective reorganization because no reorganization is possible.

6. On August 11, 1988, Froms filed a motion to dismiss. In said motion Froms set out three grounds for dismissal: 1) lack of good faith in filing the petition; 2) §1112(b)(2)--inability to effectuate a plan; and 3) §11 U.S.C. §1112(b)(3)--unreasonable delay by the debtor that is prejudicial to creditors.

7. On August 29, 1988, Debtor filed a disclosure statement and plan of reorganization. An essential component of the plan is that the limited partners make a capital contribution in the amount of $475,000.00.

8. On September 8, 1988, Debtor filed a first amended plan of reorganization and a first amended disclosure statement.

9. Froms entered into an agreement to sell Westbrook to Summit Financial Corp. As part of the payment, Froms received a non-recourse note. Summit Financial sold Westbrook to Debtor.

10. Upon the default of Debtor, Froms were served with notice to cure the default on the underlying mortgages. Froms purchased the rights of Summit and received assignments of Summit's rights in and to Westbrook. In order to maintain their interest in Westbrook, Froms were required to cure the deficiency with a payment of approximately $64,000.00 and make monthly payments of

approximately $17,000.00 on the principal and interest. The monthly payments will be reduced to approximately $10,000.00. In addition, Froms had to pay real estate taxes on the real estate.

11. Froms commenced foreclosure proceedings in state court. As part of these proceedings, T. J. McDonough was appointed receiver.

12. Froms moved for summary judgment in the foreclosure proceedings. On the day set for hearing on said motion, Debtor filed bankruptcy. Westbrook has a fair market value of $2,010,000.00. Debtor owes the Froms approximately $2,400,000.00 on terms of the note and the From claim is in that approximate amount. As a result, Debtor has no equity in Westbrook.

13. Froms are the largest secured creditors of the estate. They are also the largest unsecured creditors.

14. Froms purchased the claims of other unsecured creditors. Upon commencement of foreclosure proceedings credit was required to keep Westbrook operational. The credit rating of Westbrook was bad and Froms paid off other unsecured creditors to avoid the payment of cash on all transactions.

15. Ames is a college town and it is projected that enrollment at Iowa State University will drop by substantial numbers over the next few years.

16. The rental market in Ames is very competitive which has resulted in a very soft market. Substantial rent increases are not projected and appear to be highly unlikely.

17. There is 100% occupancy at Westbrook. The present rental income is insufficient to service existing debt.

18. Froms will vote against the First Amended Plan because they do not have confidence in the management of Westbrook. Further, the health and age of the Froms dictate against a ten year payment period as they were relying upon this investment for retirement income.

19. The underlying mortgage holders will probably vote against the First Amended Plan or any other plan which impairs their financial interest. They have recourse against Froms and therefore have no reason to adjust or modify their position. Accordingly, compromise is highly unlikely.

20. The First Amended Plan of Reorganization calls for an infusion of capital by the limited partners over a short period of time, one year, in the approximate amount of a half million dollars. There is no evidence that such an injection of capital is realistic as there is no evidence that there will be 70% participation by the limited partners as required by the Plan.

21. The pro forma financial statements supporting the First Amended Plan of Reorganization are subject to grave

doubt. The set of pro forma statements was composed by people who were unfamiliar with the Ames housing market; assumptions were made which were not supportable in fact; and errors were made in mathmetical computations which were not explainable.

DISCUSSION

Three issues are presented in this case. The first is whether Debtor's case should be dismissed. The second is whether Froms are entitled to have the automatic stay lifted. The third is whether Debtor's filing of plans of reorganization and disclosure statements affects the Court's ability to grant relief under §1112 (dismissal) or §362 (lift stay). The Court will address each issue separately.

A. Effect of Filed Plans and Disclosure Statements on Court's Ability to Grant Relief

At the conclusion of the October 11, 1988, hearing, the Court requested Debtor and Froms to brief said issue. Both parties cited numerous cases. In its brief, Debtor admitted it had not discovered any case indicating the filing of a plan and disclosure statement is sufficient without more to defeat a motion to lift stay. Concerning dismissal, Debtor cited In re Gulph Woods Corp., 84 B.R. 961, 971 (Bankr. E.D. Pa. 1988) for the proposition that a case cannot be dismissed for lack of good

faith if the debtor proposes "at least a plausibly-confirmable plan."

In the case at bar, as will be more fully developed later in this Order, the Court finds Debtor's proposed plan is not plausibly confirmable, thus distinguishing Gulph Woods. Further, the Court agrees with Froms that the mere filing of a plan is insufficient to defeat a motion to dismiss; rather, the feasibility and confirmability of the plan are the relevant factors. See Moody v. Security Pacific Business Credit, Inc., 85 B.R. 319, 345-48 (W.D. Pa. 1988); In re Asbridge, 61 B.R. 97, 102 (Bankr. D.N.D. 1986). As a result, the Court concludes Debtor's filing of plans of reorganization and disclosure statements does not preclude it from addressing the merits of Froms' motion to dismiss and motion to lift stay.

B. Dismissal

Bankruptcy Code §1112(b) sets out ten non-exclusive "for cause" grounds on which the Court, upon request of a party in interest, may dismiss a case if in the best interests of creditors and the estate, including:

> (2) inability to effectuate a plan;
>
> (3) unreasonable delay by the debtor that is prejudicial to the creditors....

11 U.S.C. §1112(b). A dismissal for cause rests within the Court's sound discretion. In re Economy Cab & Tool Co., Inc., 44 B.R. 721, 724 (Bankr. D. Minn. 1984). The moving party has

the burden of proof of showing "cause" exists. Id.

While a lack of "good faith" in filing a petition is not included in the §1112(b) non-exclusive "for cause" list,

the Code imposes on debtors a duty of good faith in filing and maintaining bankruptcy actions. Matter of Little Creek Development Co., 779 F.2d 1068, 1072 (5th Cir. 1986); In re Kinney, 51 B.R. 840, 845 (Bankr. C.D. Cal. 1985). As a result, many courts, including this one, have found a lack of good faith to constitute "cause" for dismissing the case. See Little Creek, 779 F.2d at 1072; Matter of Republic Realty Corp., No. 88-32-C H, unpub. op. (Bankr. S.D. Iowa July 21, 1988); In re Brandywine Associates, Ltd., 85 B.R. 626 (Bankr. M.D. Fla. 1988); In re Morris Plan Co. of Iowa, 62 B.R. 348 (Bankr. N.D. Iowa 1986).

No one single factor is determinative of a debtor's lack of good faith in filing a Chapter 11 petition. Brandywine, 85 B.R. at 628. The factors to be considered in determining a debtor's good faith are discussed in Little Creek where the court stated:

> Determining whether the debtor's filing for relief is in good faith depends largely upon the bankruptcy court's on-the-spot evaluation of the debtor's financial condition, motives, and the local financial realities. Findings of lack of good faith in proceedings based on...1112(b) have been predicated on certain recurring but non-exclusive patterns, and they are based on a conglomerate of factors rather than on any

> single datum. Several, but not all, of the following conditions usually exist. The debtor has one asset, such as a tract of undeveloped or developed real property. The secured creditors' liens encumber this tract. There are generally no employees except for the principals, little or no cash flow, and no available sources of income to
>
> sustain a plan of reorganization.... Typically, there are only a few, if any, unsecured creditors whose claims are relatively small. The property has usually been posted for foreclosure because of arrearages on the debt and the debtor has been unsuccessful in defending actions against the fore-closure in state court....Bankruptcy offers the only possibility of forestalling loss of the property. There are sometimes allegations of wrongdoing by the debtor or its principles....

Little Creek, 779 F.2d at 1072-73 (emphasis added).

Applying the Little Creek factors to the facts in the case at bar, the Court concludes Debtor's lack of good faith in filing its petition is manifest. Debtor's only asset is Westbrook. Froms' lien, as well as others, encumber Westbrook. Debtor generally has no employees, except for principals, because its sole function is to manage Westbrook. Debtor has little or no cash flow--even though there is 100% occupancy in Westbrook. Debtor's cash flow is not sufficient to service the existing debt. Debtor has few unsecured creditors with relatively small claims, and these small claims were, for the most part, paid by Paul From who received an assignment of their rights. Accordingly, this is essentially a two-party dispute.

Westbrook was subjected to foreclosure proceedings because of arrearages. Finally, Debtor was unsuccessful in defending actions against the foreclosure in state court, and chose to file its petition on the very day a foreclosure summary judgment hearing was scheduled in the foreclosure proceeding. As a result, the Court concludes Debtor's case should be dismissed for lack of good faith in filing the petition.

Assuming arguendo Debtor's case was filed in good faith, Froms' argued two other grounds for dismissal. The first is §1112(b)(2)--inability to effectuate a plan. Under said section, the movant must show debtor lacks all ability to formulate or carry out a plan. Economy Cab, 44 B.R. at 725. If a debtor cannot submit a feasible plan, it does not have the ability to effectuate a plan. Moody, 85 B.R. at 346 (citing Clarkson v. Cooke Sales and Service Co., 767 F.2d 417 (8th Cir. 1985)). The Court can dismiss under said section if it determines it is unreasonable to expect that a plan can be confirmed. In re Zahniser, 58 B.R. 530, 537 (Bankr. D. Colo. 1986). The Court need not wait until a confirmation hearing in order to determine whether a debtor is unable to effectuate a plan. In re Chesmid Park Corp., 45 B.R. 153, 159 (Bankr. E.D. Va. 1984).

Debtor will be unable to obtain the requisite approval of impaired classes of creditors. 11 U.S.C. §1129(a)(10) provides:

> If a class of claims is impaired under the plan, at least one class of claims that is impaired under the plan has accepted the plan, determined without

including any acceptance of the plan by any insider.

The Froms are the largest secured creditors and Paul From testified that they will vote against the plan because

they do not have faith in Debtor's managing general partner and because of their personal circumstances.

The evidence is that the underlying mortgageholders will also vote against a plan that impairs their financial interests in any way. They have no reason to compromise since the Froms assumed the underlying mortgages and are directly liable for them. There is no conceivable way that the underlying mortgagees will vote for any plan impairing their financial rights. Their affirmative vote for a plan is conceivable only if a plan did not impair their financial rights, and then their vote would not be required under §1129.

The Froms are also the largest unsecured creditors. They are therefore capable of determining the vote of the unsecured creditors. As stated, their vote would be against any plan which delayed or impaired their rights.

Westbrook is unable to generate sufficient income to service existing debt, and there is no showing that the infusion

of additional capital will change this fact. The economic condition in the Ames area is not sufficient to justify a substantial increase in rents at Westbrook and there is no showing that this condition will change in the immediate future or over the life of the proposed plan.

There has been no showing that the change in general partners will produce more efficient management. The amended plan contemplates a substitution of the managing general partner which will not assume any existing debt of Debtor. The plan also contemplates a substitution of management by a corporation which has common ownership with the existing general partner. The plan is but the substitution of one general partner for another with infusion of capital by the limited partners.

Therefore, Debtor will be unable to effectuate a plan which would gain the acceptance of the requisite holders of claims.

Froms' second ground for dismissal is §1112(b)(3)--unreasonable delay by the debtor that is prejudicial to creditors. In determining whether delay has been unreasonable, the Court must look to the totality of the circumstances. In re Galvin, 49 B.R. 665, 669 (Bankr. D.N.D. 1985). In addition, "[c]ourts will often combine §1112(b)(2) and (3) and hold that the Debtor made an unreasonable delay that is prejudicial to the creditors because the Debtor did not or cannot effectuate a plan within a certain time period." Moody, 85 B.R. at 351 (citations

omitted).

Debtor filed its first plan on August 29, 1988, six months after the petition was filed. The First Amended Plan was filed on September 8, 1988. Debtor is a single asset entity and any delay may be considered unreasonable more often where the debtor is a single asset entity. Matter of Denrose Diamond, 49 B.R. 754, 757 (Bankr. S.D.N.Y. 1985).

The amount of secured debt substantially exceeds the amount of unsecured debt. The monthly interest payments by the Froms continually decrease the value of their interest in Westbrook. As previously discussed, there is an insufficient showing to indicate that a plan can be confirmed.

Accordingly, there is unreasonable delay which is prejudicial to the Froms.

C. Lift Stay

Assuming arguendo Froms were not successful in their motion to dismiss, their second ground for relief is a motion to lift stay. Under §362(d), on request of a party in interest and after notice and a hearing, the Court may lift stay under either of two grounds:

> (1) for cause, including the lack of adequate protection of an interest in property of such party in interest; or
>
> (2) with respect to a stay of an act against

> property under subsection (a) in this section, if--
>
> (A) the debtor does not have an equity in such property; and
>
> (B) such property is not necessary to an effective reorganization.

11 U.S.C. §362(d). Pursuant to §362(g), Froms have the burden of proof on the issue of Debtor's equity in Westbrook, and Debtor has the burden of proof on all other issues.

Under §362(d)(1), Froms are entitled to relief if: 1) the value of Westbrook is decreasing; and 2) Debtor is not providing adequate protection. Froms allege there is no adequate protection of their interest in Westbrook because of substantial deterioration of the premises in the fall of 1987. Debtor, on the other hand, argues Froms' own witness testified he does not believe Westbrook has declined in value during the entire period of the bankruptcy. Further, Froms' own appraisal demonstrates the project has increased in value. Upon review, the Court finds Debtor has met its burden under §362(g) of proving Westbrook's value has not decreased, thus negating the need to provide adequate protection to Froms. As a result, the Court concludes Froms are not entitled to relief under §362(d)(1).

Under §362(d)(2), Froms are entitled to relief if: 1) Debtor has no equity in Westbrook; and 2) Westbrook is not necessary to an effective reorganization. The parties

stipulated Debtor has no equity because the Westbrook is valued at $2,010,000.00, and Froms' claim is in excess of $2.4 million. Therefore, the only remaining issue is whether Westbrook is necessary to an effective reorganization.

The meaning of the phrase "necessary to an effective reorganization" in §362(d)(2)(B) is subject to two different interpretations. One line of cases places the emphasis on "necessary" and holds that a debtor can meet its burden of proof by showing that without the property creditor seeks to recapture, the debtor could not reorganize. In re Rassier, 85 B.R. 524, 528 (Bankr. D. Minn. 1988); In re Koopmans, 22 B.R. 395, 407 (Bankr. D. Utah 1982). Under the "necessity" test, a debtor is not required to show a reasonable likelihood of a successful reorganization in order to defeat a creditor's §362(d)(2) motion to lift stay. Id.

The second line of cases places the emphasis on "effective reorganization." Matter of Belton Inns, Inc., 71 B.R. 811, 817 (Bankr. S.D. Iowa 1987). In Belton Inns, Chief Judge Jackwig stated:

> The Eighth Circuit recently adopted other court interpretations of the "necessary for an effective reorganization" standard as requiring a debtor not only to show the property is essential to reorganization but to demonstrate that an effective reorganization is realistically possible. In re Ahlers, 794 F.2d 388, 398-99 (8th Cir. 1986). A bare assertion by the debtor that the property is necessary for survival and reorganization does not satisfy the standard. (citation omitted) (emphasis added).

Id. The Court then cited with approval In re Clark Technical Associates, Ltd., 9 B.R. 738, 748 (Bankr. D. Conn. 1981) as follows:

> It is not enough for a debtor to argue that the automatic stay should continue because it needs the secured property in order to propose a reorganization. If this were the test all property held by debtors could be regarded as necessary for the debtor's reorganization. The key word under 11 U.S.C. §362(d)(2)(B) is "effective";...
>
> If all the debtor can offer at this time is high hopes without any financial prospects on the horizon to warrant a conclusion that reorganization in the near future is likely, it cannot be said that the property is necessary to an "effective" reorganization. (citations omitted).

The "effective reorganization" test is the majority view. Rassier, 85 B.R. at 527; In re Playa Dev. Corp., 68 B.R. 549, 554 (Bankr. W.D. Texas 1986). In addition, this view has been adopted, as dictum, in several other circuit courts. United Savings Ass'n v. Timbers of Inwood Forest Associates, Ltd., 808 F.2d 363, 370 (5th Cir. 1987), aff'd ____ U.S. ____ 108 S.Ct. 626, 98 L.Ed.2d 740 (1988); Grundy Nat'l Bank v. Tandem Mining Corp., 754 F.2d 1436, 1440 (4th Cir. 1985). As a result, this Court adopts the "effective reorganization" test under §362(d)(2)(B).

As previously discussed, Debtor suffers from an inability to effectuate a plan and reorganization is simply not possible

as the First Amended Plan is patently unconfirmable. Further, Froms have shown Debtor does not have any equity in Westbrook, and Debtor has failed to show it is capable of submitting a feasible plan for an effective reorganization. As a result, the Court concludes Froms are entitled to relief from the automatic stay under §362(d)(2). However, given the fact Debtor's case will be dismissed, the motion to lift stay is moot.

CONCLUSION AND ORDER

WHEREFORE, based on the foregoing analysis, the Court concludes Debtor's filing of plans of reorganization does not affect the Court's ability to grant relief under 11 U.S.C. §§362, 1112.

FURTHER, the Court concludes Debtor's case should be dismissed on the following grounds: 1) lack of good faith in filing the petition; 2) §1112(b)(2)--inability to effectuate a plan; and 3) §1112(b)(3)--unreasonable delay by the debtor that is prejudicial to creditors.

IT IS ACCORDINGLY ORDERED that Debtor's case is dismissed.

IT IS FURTHER ORDERED that Froms' motion to lift stay is overruled as being moot.

IT IS FURTHER ORDERED that Debtor pay to the United States Trustee the appropriate sum required pursuant to 28 U.S.C. §1930(a)(6) within ten days of the entry of this Order and simultaneously provide to the United States Trustee an appropriate affidavit indicating the cash disbursements for the relevant period.

IT IS FURTHER ORDERED that the Court retain limited jurisdiction to consider any professional fee applications.

Dated this 30th day of January, 1989.

RUSSELL J. HILL
U.S. BANKRUPTCY JUDGE