UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In the Matter of	:	Case No. 91-1021-W
	:	
EDIO D. MICOZZI and HUGUETTE P. MICOZZI, d/b/a TETRA NAV INDUSTRIES,	:	Chapter 11
	:	
Debtors.	:	

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ORDER--GRANTING MOTION FOR RELIEF FROM STAY AND GRANTING MOTION TO CONVERT

A hearing was held on September 13, 1991, on Universal Cooperative's Motion for Relief from Stay. Anthony A. Longnecker appeared on behalf of the Creditor, Universal Cooperatives, Inc. [hereinafter Universal], and Michael C. Washburn appeared on behalf of the Debtors. At the conclusion of the hearing, the Court took the matter under advisement under a briefing deadline. Universal and the Debtors have timely submitted briefs. Universal filed a supplemental brief in support of its motion on October 18, 1991.

A hearing was held on October 16, 1991, on the U.S. Trustee's motion to convert to Chapter 7. Michael C. Washburn appeared on behalf of the Debtors and John Waters on behalf of the U.S. Trustee. The U.S. Trustee's motion to convert this case to Chapter 7 is under advisement pending a decision on Universal's motion for relief.

Consideration of the Motion for Relief from Stay is a core proceeding pursuant to 28 U.S.C. §157(b)(2)(G).

Consideration of the motion to convert is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A) and this Court has jurisdiction pursuant to 28 U.S.C. § 1334. The Court, upon review of the motion, objection to motion, exhibits received, and arguments of counsel, now enters its findings and conclusions pursuant to Fed.R.Bankr.P. 7052.

FINDINGS OF FACT

1. The Debtors filed for protection under Chapter 11 of the Bankruptcy Code on April 9, 1991.

2. On July 8, 1991, the Court issued an order consolidating the Debtors' case with Case Number 91-1022-W titled Tetra Nav Industries, Inc. Debtors are in the business of manufacturing or assembling electronic and other avionics equipment.

3. One of the properties at issue in the Motion for Relief from Stay is the Debtors' interest in the two-thirds portion of a warehouse and the real estate on which it stands, which the Debtors purchased from Universal and for which Debtors granted Universal a mortgage. This property is referred to as the Fee property. Also at issue is a lease Universal assigned to the Debtors concerning the other one-third of the building and the land on which it stands. This property is referred to as the Lease property.

4. On February 18, 1991, the Iowa District Court granted Universal a judgment terminating all right, title and

interest of the Debtors under the assignment of lease from Universal and foreclosing the mortgage on the fee property. The judgment was in the sum of $789,873.50, plus interest on $534,742.62 at 10.5% per annum from and after November 1, 1990, plus interest on $115,880.88 at 10% per annum after November 1, 1990, plus attorney fees of $24,490.87, abstract costs of $228.50, and court costs of $512.50.

5. Universal introduced a letter from Dale Lindner, Montgomery County Treasurer, indicating that taxes due on the subject property would be $187,894.46 as of September 30, 1991. (Exhibit D).

6. Universal introduced the appraisal (Exhibit C) and testimony of Fred Lock, MAI SRPA and President of Iowa Appraisal and Research Corporation. Mr. Lock testified he would attribute 60% of the outstanding taxes to the real estate and building owned by the Debtors and 40% to the Lease property. Mr. Lock also testified that an additional $21,698 in taxes would be due in March 1991.

7. Mr. Lock further testified the combined market value of the Lease property and the Fee property, free and clear of all encumbrances was $1,150,000. He estimated the value of the Fee property excluding the Lease property to be $639,000.

8. Edio D. Micozzi testified he believed the combined value of the Lease and Fee properties was $1,750.000.

DISCUSSION

Bankruptcy Code Subsection 362(d) provides the court shall grant relief from the automatic stay on request of a party in interest:

> 1) for cause, including 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) of 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.

Universal seeks relief from stay for cause, alleging lack of adequate protection and alleging Debtors have no equity in the property, and that the subject property is not necessary to an effective reorganization. Debtors resist Universal's motion and allege the value of the real estate exceeds any balance due on the Universal judgment plus any accrued real estate taxes and that, therefore, the Debtors' equity cushion provides adequate protection of Universal's interest. At issue then is what relief, if any, Universal may be afforded.

With respect to the issue of equity in § 362(d), Universal bears the burden of proof. 11 U.S.C. § 362(g)(1). On the other hand, the Debtors bear the burden of proof on all other issues, including the "necessary to an effective reorganization" standard under § 362(d)(2)(B). 11 U.S.C. § 362(g)(2).

Resolution of the issues in this case requires both a determination of the fair market value of the debtors' property and an identification of what interests should be protected by the court under the facts and circumstances of a particular case. Belton Inns, 71 B.R. at 816. With respect to the determination of fair market value, the court can only endeavor to make a reasonable estimate of value based upon expert testimony presented to it in court. Id. On the issue of valuation, the Debtors presented only the testimony of Edio Micozzi. Universal presented the testimony of and appraisal by Fred Lock, MIA SRPA, and the Court finds the values offered by Mr. Lock most accurately reflect the fair market value of the properties at issue. Before deciding the issue of valuation, however, the Court must decide whether the property at issue includes the Lease property as well as the Fee property.

LEASE PROPERTY INCLUSION ISSUE

Universal takes the position that only the Fee property should be considered when determining whether the Debtors have equity in the property at issue. (Universal's Supplemental Brief at 3 & 4). Debtors argue the Lease property must be included and considered in the evaluation of equity (Debtors' Brief at 9). This Court holds that the state court judgment terminating the Debtors' rights under the lease assignment is res judicata; and therefore, the Lease property will not be

considered in the Court's determination of Debtors' equity.

Debtors' argument that the entire property (both Fee and Lease portions) must be taken into account when valuing the property is as follows. The land on which the original building was constructed was and still is owned by the City of Red Oak (Debtors' Brief at 1). Upon construction of the original building, the City leased the building and underlying real estate to Bangor Punta under the terms of a certain lease (Debtors' Exhibit 1, the "Red Oak Lease"). Id. That lease provides for the payment of rents in an amount necessary to pay off bonds issued by Red Oak in order to finance the original building. The rents are to pay off the bonds over a twenty-year period ending in October 1992. Id. Upon satisfaction of the bonded indebtedness plus the payment of $1.00, Bangor Punta, or its successor, would then own the building and the underlying real estate--that is, the Lease property. Id; see also Red Oak Lease Section 11.3. Debtors further note that the purchase agreement (Debtors' Exhibit 3) indicates $330,000 of the purchase price of the entire property (Lease and Fee portions) was allocated toward assumption of the lease obligation (Debtors' Brief at 9). Since payment of the $562,000 mortgage, plus the lease or bonded indebtedness, plus $1 would result in Debtors owning the entire facility, Debtors argue, the purchase agreement was really a purchase agreement for the entire facility and not

just the Fee property. Id. Thus, argue the Debtors, the value of the entire facility must be considered in determining equity.

Without explicitly stating so, it appears the Debtors are arguing the lease agreement they assumed should be construed as an equitable mortgage. Iowa courts and this Court have recognized equitable mortgages. See In re Hemphill, 18 B.R. 38, 51 (Bankr. S.D. Iowa 1982) (sale, lease-back and option to repurchase held to be intended as a security transaction); Collins v. Isaacson, 261 Iowa 1236, 158 N.W.2d 14 (1968). Even if the court could find an equitable mortgage in the Red Oak Lease Agreement, this Court determines that the state court default judgment terminating the Debtors' rights in the lease is res judicata.

The law of res judicata, or claim preclusion, is well established; a final judgment on the merits bars further claims by parties on the same cause of action. Kapp v. Naturelle, Inc., 611 F.2d. 703, 707 (8th Cir. 1979) (res judicata precluded bankruptcy court's reconsideration of question of debtor's personal liability for debts when pre-bankruptcy default judgments held debtor personally liable for debts of his wholly-owned corporation). Res judicata prevents litigation of all grounds for, or defenses to, recovery that were previously available to the parties, regardless of whether they were asserted or determined in the prior

proceeding. Id. If entered by a court having jurisdiction of the parties and subject matter, and absent fraud or collusion, even a default judgment operates as res judicata and is conclusive of whatever is essential to support the judgment. Id. As a general rule, bankruptcy courts are required to give res judicata effect to prior judgments of non-bankruptcy courts. Id. at 708. A matter previously adjudicated between the same parties by a court of competent jurisdiction may not be re-litigated in the bankruptcy court. Id.

Debtors do not dispute personal service nor the jurisdiction of the state court. Entered by a court of competent jurisdiction, the Iowa District Court judgment finally and conclusively terminated the Debtors' rights under the assignment of lease, notwithstanding it was obtained by default. Although the Debtors had every opportunity to defend against termination of the lease assignment, including an argument that the lease was intended to be a security transaction, they permitted the judgment to be entered against them. Res judicata precludes this belated argument on the Debtors' interest in the lease after the issue was finally adjudicated in the state court.

A lease agreement that has been validly terminated may not be resurrected by filing a petition in bankruptcy. In re Fitness World West, No. 90-3112-C (Bankr. S.D. Iowa, March 4, 1991) (Judge Hill's Decision Book #166). The state court

judgment terminating the Debtors' rights under the lease assignment is res judicata. The value of the Lease property will not be added to the Fee property in the court's determination of Debtors' equity.

EVALUATION OF DEBTORS' EQUITY IN THE PROPERTY

Universal presented expert testimony and exhibits on value and these may be accepted as a reasonable estimate of value:

Estimate of value of fee simple portion of appraised real property (cost approach) (Exhibit E)	$ 639,000.00

This figure is a reasonable valuation of the property. Even though a "cost approach" to valuing the Fee property might not be the most reliable (see Creditor's exhibit C, Appraisal, at 55), it is the only value offered for the Fee property alone. The Debtors' arguments that the facility should be valued higher because of improvements Debtors made can be disregarded because the appraisal was performed in January 1991, after the improvements were already in place.

Debtors admit to the following money owed to Universal:

Judgement of 2/18/91		$ 789,873.50
Attorney fees	$ 24,490.87	
Abstract costs	$ 512.50	

Additionally, the judgment awards interest. Interest through the date of the hearing is calculated here:

10.5% interest on $534.742 from 11/1/90 to 9/13/91 (317 X 153.83)	$ 48,764.11
10% interest on $115,880.88 from 11/1/90 to 9/13/91 (317 X 31.75)	$ 10,064.75

Total obligation to Universal $ 863,651.04

An equity cushion is defined as the value in the property above the amount owed to the creditor with a secured claim that will protect that creditor's secured interest from decreasing in value during the period that the automatic stay remains in effect. In re Belton Inns, 71 B.R. 811, 816 (Bankr. S.D. Iowa 1987). The existence of liens junior to the movant's lien is not relevant to a determination under 11 U.S.C. § 362(d)(1). Id. at 816-17.

The value of the Debtors' Fee property is $639,000; Universal holds an in rem judgment against the property in an amount over $800,000; therefore, the Debtors have no equity in the property.

WHETHER UNIVERSAL IS ENTITLED TO RELIEF UNDER § 362(d)(1)

Universal argues that where the debt exceeds the value of the property, leaving no equity cushion, a secured creditor is generally entitled to relief from a stay based on lack of adequate protection of its interest. Universal's Brief at 6 (citing In re Belton Inns, 71 B.R. at 817). Universal's reading of Belton Inns is incorrect. United Sav. Ass'n v. Timbers of Inwood Forest Assocs. indicates that the "equity

cushion" theory of adequate protection cannot be justified because under that theory the undersecured creditor always has cause to lift the stay, whereas under § 362(d)(2), lack of equity is not enough--the property must also be unnecessary for an effective reorganization. In re Lane, 108 B.R. 6, 8-9 (Bankr. D. Mass. 1989) (citing United Sav. Ass'n v. Timbers of Inwood Forest Assocs., 484 U.S. 365, 108 S.Ct. 626 (1988)).

The classic "adequate protection" for a secured debt, justifying continuation of the stay, is the existence of an equity cushion. Belton Inns, 71 B.R. at 816. Because that is all the Debtors offer here, their offer of adequate protection is insufficient. Moveover, the Debtors' failure to pay accrued and accruing real estate taxes may erode Universal's interest and contribute to a showing of lack of adequate protection. See In re Offerman Farms, 67 B.R. 279, 282 (Bankr. N.D. Iowa 1986); In re Vacation Village, 49 B.R. 644, 646 (Bankr. N.D. Iowa 1983). Because, however, this Court will grant relief under § 362(d)(2), it need not fashion relief for Universal under § 362(d)(1). See, e.g., Offerman Farms, supra; Vacation Village, supra.

WHETHER UNIVERSAL MAY BE GRANTED RELIEF UNDER § 362(d)(2)

Since Universal has shown the Debtors have no equity in the property, the Debtors have the burden to establish that the collateral at issue is "necessary to an effective reorganization." Timbers, 484 U.S. at 375, 108 S.Ct. at 632

(citing § 362(g)). This requires a showing that if there is conceivably to be an effective reorganization, this property will be needed for it; and that the reorganization is in prospect. Id.

Debtors have failed to meet their burden. Mr. Micozzi's testimony on the necessity of this property to an effective reorganization has varied. At the hearing Mr. Micozzi testified the property was essential to a successful reorganization. Universal alleges the Debtors have not substantially used the building since 1990. Furthermore, Micozzi testified that the government contracts he was negotiating could be performed elsewhere if he could sell the property at issue.

Moreover, an effective reorganization is not in prospect. The U.S. Trustee has filed a motion to convert this case to Chapter 7 for cause, and this Court finds cause for conversion to Chapter 7.

U.S. TRUSTEE'S MOTION TO CONVERT

On request of the United States Trustee, this Court hereby converts this case to a case under Chapter 7 for cause, namely the Debtors' nonpayment of quarterly fees due pursuant to 28 U.S.C. § 1930(6). 11 U.S.C. § 1112(b)(10).

ORDER

IT IS ACCORDINGLY ORDERED that Universal's Motion for Relief from Stay is granted in order for Universal to proceed

under its Iowa District Court judgment.

IT IS FURTHERMORE ORDERED that the United States Trustee's motion to convert is granted and the Debtors shall pay to the U.S. Trustee the appropriate sum(s) required pursuant to 28 U.S.C. § 1930(a)(6) within ten (10) days of the entry of this Order and simultaneously provide to the U.S. Trustee an appropriate affidavit indicating the cash disbursements for the relevant period; the U.S. Trustee shall have judgment against the Debtors for the sums due pursuant to 28 U.S.C. § 1930(a)(6) upon this conversion.

Dated this __18th_____ day of November 1991.

RUSSELL J. HILL
U.S. Bankruptcy Judge