

UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In the Matter of)
)
) Case No. 90-02754-D
JOSEPH MARION NEILL, d/b/a)
NEILL CONSTRUCTION, and)
MICKEY MARY NEILL,) Chapter 11
)
Debtors.)

**ORDER--OBJECTIONS TO CLAIMS AND
MOTION FOR RELIEF FROM STAY**

The hearing on Objections to Claims came before the Court on July 17, 1991. Walter Conlon appeared for the Debtors; Kevin Query for Small Business Administration (SBA) and the Internal Revenue Service (IRS); Albert Hoecker, pro se; David P. Miller for the Unsecured Creditors Committee; and John Waters for the U.S. Trustee.

At the hearing, a stipulation as to the IRS claim was submitted, which resolved the dispute between the IRS and the Debtors. Likewise, the dispute between the Debtors and Johnson was resolved by an agreement presented, approved, and signed. An order regarding the claims of the Iowa Department of Finance and Michael Byrne Manufacturing was also approved and signed by the Court. The objections regarding the Hoecker claim were continued for an evidentiary hearing.

The objection to the SBA claim was taken under advisement upon a briefing deadline. Briefs were timely filed and the Court considers the matter fully submitted.

On August 23, 1991, SBA's Motion for Relief from Stay and debtors' objection thereto came before the Court for hearing.

Walter Conlon appeared on behalf of the Debtor and Kevin R. Query on behalf of SBA. SBA's motion relates to the same claim taken under advisement in the objection to the SBA claim. The motion for relief from stay, and objection thereto, was also taken under advisement along with briefs. Because the claims issues and motion for relief from stay are interrelated and for the sake of efficiency, the Court considers them together.

These are core proceedings pursuant to 28 U.S.C. § 157(b)(2)(B) & (G). The Court now enters its findings of fact and conclusions pursuant to Fed.R.Bankr.P. 7052.

FINDINGS

1. The debtors' homestead was subject to two mortgages, a first lien in favor of the State Central Savings Bank of Keokuk (State Central) and a second lien in favor of the Small Business Administration (SBA).

2. February 4, 1983, State Central filed a foreclosure action in the District Court of the State of Iowa in and for Lee County naming, among others, Debtors and SBA as defendants.

3. March 22, 1983, SBA filed its answer including a cross-petition asking that its junior mortgage be foreclosed.

4. May 24, 1983, the District Court of the State of

Iowa entered its Judgment and Decree of Foreclosure. State Cent. Sav. Bank v. Smiley, et al., No. CE430(5) 0283 (Iowa Dist. Ct. May 24, 1983). The judgment ordered that plaintiff State Central waive deficiency judgment and indicated a redemption period of six months. The judgment and decree did not address the SBA cross-petition though counsel for SBA was present at the district court hearing.

5. July 20, 1983, subject real estate was sold by special execution.

6. On or about October 21, 1983, SBA filed a redeeming lienholder's affidavit with the District Court of Iowa stating that as a creditor it had redeemed. On January 17, 1984, the District Court of Iowa issued a ruling clarifying the debtor's right of redemption with regard to the real estate. The District Court of Iowa acknowledged that Neill was served notice of the sale providing for a one year redemption period.

Thereupon, said District Court ordered the Debtor shall have an exclusive right of redemption until January 20, 1984; and that thereafter, if the Debtor did not redeem, the creditors, including SBA, may redeem for a period of three months from January 20, 1984 by filing a lienholder's affidavit. Moreover, the District Court stated:

Nothing herein shall be construed to limit the rights of the Small Business Administration to pursue its cross petition for foreclosure of their lien in the event of redemption on or before January 20,

1984, by J. Marion Neill.

State Cent. Sav. Bank v. Smiley, et al., No. CE 430 (S) 0283 (Iowa Dist. Ct. Jan. 17, 1984) (Ruling clarifying rights of redemption).

7. On January 20, 1984, the Debtors exercised their right of redemption.

8. On August 26, 1988, SBA filed a foreclosure complaint in the United States District Court for the Southern District of Iowa with regard to the property at issue.

9. July 3, 1989, Debtors moved in the District Court of Iowa for summary judgment with prejudice against the cross-petition of SBA.

10. July 17, 1989, SBA moved to dismiss its cross-petition and responded to debtors' motion for summary judgment.

11. July 18, 1989, the District Court of Iowa issued a Ruling on Motion for Summary Judgment on Cross-Petition and Motion to Dismiss. The ruling acknowledged that the case file did not disclose that any [Iowa Rule of Civil Procedure] 215.1 notice was ever directed at the cross-petition. Furthermore, the District Court stated that it believed the cross-petition had not been dismissed by operation of law. Finally, the Court ordered that the SBA motion to dismiss its cross-petition be sustained.

12. Debtors filed for protection under Chapter 11 of the

Bankruptcy Code on October 25, 1990.

13. SBA filed its Motion for Relief from Stay on July 5, 1991. On July 22, 1991, SBA filed a waiver of its right under 11 U.S.C. §362(e) for a hearing on its Motion for Relief from Stay within thirty days from the date of its request.

DISCUSSION

The Neills object to the SBA claim and SBA Motion for Relief from Stay on the ground that the SBA claim is barred by the doctrine of res judicata. The property at issue was subject to an Iowa District Court decree of foreclosure. SBA was named as a defendant in that proceeding and had raised a cross-petition for foreclosure. The Neills argue that the decree of foreclosure granted to the senior lienholder in that case extinguished any interest SBA held in the property since the decree did not grant, or even address, SBA's cross-petition. Because such a result diverges from Iowa foreclosure law and because this Court finds SBA's claim was not adjudicated in the Iowa District Court decree of foreclosure, this Court holds SBA's claim is not extinguished by the doctrine of res judicata.

The validity of a creditor's claim is determined by rules of state law. Grogan v. Garner, ___ U.S. ___, ___, 111 S.Ct. 654, 657 (1991). A bankruptcy court cannot give collateral estoppel effect to a prior state court adjudication if the

issue before the bankruptcy court differs from the issue that was before the state court. Matter of Supple, 14 B.R. 898, 904 (Bankr. D. Conn. 1981). Res judicata in the sense of claim preclusion exists when the litigant has brought an action, an adjudication has occurred, and the litigant is foreclosed from further litigation on the claim. Israel v. Farmers Mut. Ins. Ass'n, 339 N.W.2d 143, 146 (Iowa 1983); Harrison v. State Bank, 440 N.W.2d 398, 399 (Iowa Ct. App. 1989). Res judicata as issue preclusion has four prerequisites:

- (1) The issue concluded must be identical;
- (2) The issue must have been raised and litigated in the prior action;
- (3) The issue must have been material and relevant to the disposition of the prior action; and
- (4) The determination made of the issue in the prior action must have been necessary and essential to the resulting judgment.

Israel, at 146; Harrison, at 401.

The Neills have failed to produce a record sufficient to find the SBA cross-petition or the issues it raised were adjudicated in the prior state court action. Counsel for the Neills produced only the SBA answer and cross-petition in the state court proceeding and the state court judgment and decree of foreclosure. The Neills did not produce any record of the state court proceeding which might indicate SBA's claim was adjudicated. The judgment entered in state court does not

refer at all to the SBA cross-petition claim.

By contrast, SBA has produced, among other documents, a ruling dated January 17, 1984 by the Iowa District Court, which clarified the Neills' right of redemption and explicitly provided that "[n]othing herein shall be construed to limit the rights of the Small Business Administration to pursue its cross-petition for foreclosure of their [sic] lien in the event of redemption on or before January 20, 1984, by J. Marion Neill." Clearly, the Iowa District Court did not believe that SBA's claim was precluded. The Iowa District Court further indicated in its Ruling on Motion for Summary Judgment on Cross-Petition and Motion to Dismiss that the May 24, 1984 Judgment and Decree of Foreclosure did not address the issues of the cross-petition; that the cross-petition was not dismissed by operation of law; and that the United States of America's motion to dismiss its cross-petition would be sustained.

State Cent. Sav. Bank v. Smiley, et al., Equity No. CE 430 (S) 0283 (Iowa Dist. Ct. May 24, 1984), addressed the foreclosure of State Central Savings Bank's mortgage. SBA's mortgage interest in the same property was not addressed. The Iowa District Court's failure to address SBA's cross-petition did not constitute an adjudication of SBA's cross-petition claim. Therefore, res judicata does not apply to preclude SBA's claim.

Moreover, to determine that SBA's junior lien position was extinguished by these circumstances would be contrary to Iowa foreclosure law. Under the foreclosure system laid out in Farmers Prod. Credit Ass'n v. McFarland, 374 N.W.2d 654 (Iowa 1984), where a junior lienholder is not provided a creditor redemption period, such as when the mortgagor redeems within its exclusive redemption period, the junior lienholder's lien is not extinguished and remains viable against the property. McFarland, 374 N.W.2d at 657-58; but see McFarland, 374 N.W.2d at 659-62 (Justices Carter, Uhlenhopp and Wolle dissenting). Here, State Central foreclosed its mortgage, the Debtor redeemed within its exclusive period for redemption; thus SBA's lien is still valid against the property.

The Court now turns its attention to SBA's Motion for Relief from Stay. SBA argues sufficient cause for relief from stay exists in that the Neills fail to provide for the SBA claim under their plan of reorganization. Debtors' fourth amended plan provides for the SBA claim if the claim is granted by the court. Because the Court does by this order allow the SBA claim, the ground for relief alleged by SBA is rendered moot. Any further objections SBA may have may be made as objections to the plan. Thus, SBA's motion for relief from stay shall be denied.

ORDER

IT IS HEREBY ORDERED that the Small Business Administration claim is not barred by res judicata by virtue of the Iowa District Court decree of foreclosure entered in State Cent. Sav. Bank v. Smiley, et al., Equity No. CE 430 (S) 0283 (Iowa Dist. Ct. May 24, 1983).

IT IS FURTHER ORDERED that the Small Business Administration's Motion for Relief from Stay is denied.

Dated this 22nd day of November, 1991.

RUSSELL J. HILL
U.S. Bankruptcy Judge