

UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In the Matter of
LOREN E. MONDT,
ANNABELLE M. MONDT,
fdba Mondt Coffee Shop,

Case No. 87-17-C
Adv. Pro. No. 87-0028

Debtors.

LOREN E. MONDT,
ANNABELLE M. MONDT,
fdba Mondt Coffee Shop,

Plaintiff,

v.

ROBERT RUNYAN, Acting as
Receiver and HAWKEYE FEDERAL
SAVINGS BANK, an Iowa
Corporation,

Defendants.

MEMORANDUM OF DECISION AND ORDER

On May 1, 1987 a trial on complaint for turnover in the above-entitled case was submitted on the stipulation of facts and briefs filed on behalf of the parties. Gary R. Hassel appeared on behalf of the debtor-plaintiffs. Kirke C. Quinn and Bruce L. Anderson appeared on behalf of the defendants. This is a core proceeding pursuant to 28 U.S.C. section 157(b)(2)(E). The parties have stipulated to the following facts for use by the court in lieu of the evidentiary hearing.

FINDINGS OF FACT

1. The debtors filed a Chapter 11 petition on January 5, 1987 and a disclosure statement on January 16, 1987.
2. The principal asset and the asset that is necessary

to fund the proposed plan of reorganization is a 9,000 square foot commercial building on 605 Story Street, Boone, Iowa.

3. The value of the building is disputed by the parties. The debtors have assessed a value of not to exceed \$500,000.00; Hawkeye Federal Savings Bank (Bank) has assessed a value of \$80,000.00; the building is appraised for tax purposes at \$139,537.00; and the building is insured for \$302,000.00 or the insurer's estimate of cost of replacement.

4. On December 9, 1985 the Bank commenced mortgage foreclosure proceedings against the debtors in the Iowa District Court for Boone County. On August 22, 1986 the state court ordered the appointment of Robert Runyan as the receiver in the foreclosure action.

5. Subsequent to the appointment of the receiver, no rental of any portion of the premises has occurred. The property is in a state of disrepair and the debtors have refused to remove their personal property from the premises.

6. On November 5, 1986 a decree of foreclosure was entered in the foreclosure action. The decree entered judgment in rem against the property in the amount of \$49,548.51, plus interest at the rate of 13 percent from November 5, 1986, plus \$2,700.00 in attorney fees and \$125.00 in court costs.

7. In addition, there are real estate taxes now due and owing upon the property in the amount of \$14,797.50, and an Internal Revenue Service lien in the amount of \$1,212.09 for a

total encumbrance against the property in the amount of \$71,376.61.

8. The Bank maintains that in order to place the property in a position to be leased it must be remodeled at substantial expense. This is disputed by the debtor.

9. The Bank further maintains that the debtors' projections regarding renting this property-for several thousand dollars a month are unrealistic due both to the condition of the building and to the economic climate of downtown Boone, Iowa, where there are many commercial buildings that have been left vacant. This is also disputed by the debtor.

10. On February 20, 1987 the debtors filed this complaint against the state court receiver and the bank seeking a turnover of the property foreclosed upon and subject to the receivership.

Applicable Law and Analysis

The debtors' complaint, although referring to 11 U.S.C. section 542(a), is based on 11 U.S.C. section 543(b), which provides:

(b) A custodian shall--

(1) deliver to the trustee any property of the debtor transferred to such custodian, or proceeds of such property, that is in such custodian's possession, custody, or control on the date that such custodian acquires knowledge of the commencement of the case; and

(2) file an accounting of any property of the debtor, or proceeds of

such property, that, at any time, came into the possession, custody, or control of such custodian.

Section 543(b) absolutely requires a custodian to deliver to the bankruptcy trustee, or debtor in possession, any property of the debtor that is in the possession, custody or control of the non-bankruptcy custodian. In re Powers Aero Marine, Services, Inc., 42 B.R. 540, 543 (Bankr. S.D. Tex. 1984).

There is no question that a receiver appointed by a state court is a "custodian" within the meaning of 11 U.S.C. section 101(10). In re CCN Realty Corp., 19 B.R. 526, 528 (Bankr. S.D. N.Y. 1982). To mollify the seemingly harsh and apparently inflexible requirement of section 543(b), Congress provided for the dispensation of the mandatory requirement of turnover in certain circumstances under section 543(d), which states:

- (d) The bankruptcy court may, after notice and hearing, excuse compliance with subsection (a), (b) or (c) of this section, if the interests of creditors, and if the debtor is not insolvent, of equity security holders, would be better served by permitting a custodian to continue in possession, custody or control of such property.

This section is merely a recognition of a long-recognized doctrine of abstention now expressly codified in 11 U.S.C. section 305. A bankruptcy court may decline to entertain any controversy otherwise within its judicial competence if doing so would be in the interest of all parties concerned, although

not necessarily in the interest of the debtor. Matter of WPAS, Inc., 6 B.R. 40, 43 (Bankr. M.D. Fla. 1980).

The debtors seek an order directing the state court receiver to turn over the commercial property in question and any rents and profits derived therefrom. The debtors operated a coffee shop on the property from May 1965 until June 30, 1985, at which point they made plans to convert the building into office and rental space. On August 22, 1986 a receiver was appointed in the pending foreclosure action and the debtors were relieved of possession of the property. The debtors acknowledge that they are not currently engaged in any business but intend to rent the commercial building in question to fund a plan of reorganization.

The defendants, the receiver and the Bank, resist the debtors' complaint on two grounds. The defendants first assert that the debtors have no right to possession of the subject property under state law and thus cannot compel a turnover under bankruptcy law. Secondly, the defendants assert that the interests of creditors would be better served by permitting the receiver to continue in possession of the subject premises. The court shall address each argument in turn.

In support of their contention that the debtors have no right to possession of the property, the defendants cite the

well accepted principle that whatever rights a debtor has in property when his petition is filed continue in bankruptcy -no more, no less. See H.R. Rep. No. 595, 95th Cong., 1st Sess., reprinted in 1978 U.S. CODE CONG. & ADMIN. NEWS 5787. The defendants' reliance upon the decision of In re Lally, 51 B.R. 204 (N.D. Iowa 1985), however, is misplaced. The Lally court considered what interest a debtor had in mortgaged property following a foreclosure sale. 51 B.R. at 205. The court found that after a foreclosure sale only the right of redemption, rather than the property itself passes into the bankruptcy estate if the redemption period has not expired at the time the petition is filed. Id. at 206. The court further concluded that the automatic stay provisions of the Bankruptcy Code did not prevent the running of the redemption period. Id.

The factual situation presented in Lally is distinguishable from this case. Here a foreclosure judgment was entered on November 5, 1986. A sheriff's sale was apparently scheduled for January 7, 1987 but was stayed by the filing of the debtors' petition on January 5, 1987. Although a receiver had been and remains in possession of the property, the debtors still hold legal title. The concept of property of the estate is defined very broadly under 11 U.S.C. section 541(a)(1) and includes "all legal or equitable interests of the debtor in property as of the commencement of the estate." In re CCN Realty Corp., 19 B.R. at 528. The commercial property in question is "property of the debtor" within the

meaning of 11 U.S.C. section 543(b) and is subject to turnover. Accordingly the defendants' first argument must fail.

The defendants' second argument that the interests of creditors would be better served by permitting the receiver to continue in possession is somewhat more persuasive. Pursuant to section 543(d) the court has discretion to authorize the custodian to continue in possession or control of the property if the interests of creditors would be better served. The term "interests of creditors" is not defined in the Code, and application of this test has been developed on a case-by-case basis. In re Powers Aero Marine Service, Inc., 42 B.R. at 543 (Bankr. S.D. Tex. 1984).

At the very least, it can be said that requiring turnover cannot be calculated, or reasonably be foreseen, to be injurious to the creditors or oblivious to them. At the same time, this court must strike a balance between a debtor and its creditors, consistent with the Bankruptcy Code.

Id. After a review of the relevant authority, the Texas bankruptcy court found that cases appear to enunciate three principles in applying section 543(d): "(1) whether reorganization is likely; (2) that funds are necessary for such reorganization and funds exist which will be applied towards it; and (3) mismanagement." Id. at 544.

The defendants contend that the stipulated facts provide evidence sufficient to meet the "interests of creditors" test

under section 543(d). They claim that the prospects for reorganization are poor due to the building's state of disrepair and the overabundance of vacant commercial real estate in the downtown area of Boone, Iowa. This assertion of fact, however, was specifically disputed by the debtors who claim in their complaint to have potential lessees that are ready, willing and able to perform. The defendants also contend that the debtors have no funds to finance the reorganization. Given the limitations of the stipulated facts, the court has no way of determining the correctness of this assertion. No evidence has been submitted to document the actual value or potential rental income value of the property at issue. Finally, the defendants contend that mismanagement is demonstrated by the debtors' prior failure to rent the premises and to meet operating expenses. Again, however, the court has no information from which to determine that the debtors' financial predicament is the result of mismanagement as opposed to some other factor. The receiver himself has failed to rent any portion of the premises since his appointment in August of 1986. The court is not willing to make the conclusions sought by the defendants without more persuasive evidence. Accordingly the debtors' complaint for turnover and the defendants' resistance thereto must be continued for an evidentiary hearing.

The court notes that on August 14, 1987 the United States Trustee filed a motion to convert debtors' Chapter 11 proceeding to a Chapter 7 proceeding. The motion raises an issue that has concerned the court in this case -- whether the case should proceed under Chapter 11. See Matter of Property Management and Inv., Inc., 19 B.R. 202, 206 (Bankr. M.D. Fla. 1982). The United States Trustee's motion states and the debtors have admitted that there is currently no ongoing business in operation. The Eighth Circuit Court of Appeals has recently held that persons who are not engaged in business cannot seek relief under Chapter 11. Wamsganz v. Boatmen's Bank of DeSoto, 804 F.2d 503 (8th Cir. 1986). Accordingly, in order to give adequate consideration to the ultimate disposition of this case a hearing on the United States Trustee's motion to convert will be scheduled at the same time as the continued trial on debtors' complaint for turnover.

ORDER

WHEREFORE based on the foregoing analysis the court finds that a determination of the debtors' complaint for turnover and the defendants' resistance thereto cannot be made on the basis of the record presented.

THEREFORE IT IS HEREBY ORDERED that the debtors' complaint for turnover shall be continued for an evidentiary hearing to be scheduled at the same time as the hearing on the United States Trustee's motion to convert.

Signed and filed this 25th day of September, 1987.

LEE M. JACKWIG

U.S. BANKRUPTCY JUDGE