IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEBRASKA

IN RE:)
)
LEONARD V. KRAUS and)
FLORENCE M. KRAUS,)
)
Debtors.)

BK 86-158
CV 86-0-230

ORDER

This matter is before the Court upon the appeal of Leonard and Florence Kraus (debtors) of the decision of the Untied States Bankruptcy Court for the District of Nebraska granting the Crete State Bank (bank) relief from the automatic stay (filing 1) and for a temporary stay (filing 2). In 1981, the debtors executed a promissory note in favor of the bank in the amount of $254,000.00 (note). The note was secured by a mortgage on the debtors' property (property). A decree of foreclosure was entered in April, 1985, and the debtors exercised their right to a nine-month stay. At the end of the nine-month period in January, 1981, the debtors filed a voluntary petition under Chapter 11 of the bankruptcy laws, which triggered the automatic stay provision of 11 U.S.C. § 362. The bank sought relief from the stay and on March 19, 1986, Judge Mahoney granted the bank's motion. The debtors filed a motion for a stay pending appeal with the Bankruptcy Court which was denied on April 2, 1986. The debtors filed a notice of appeal (filing 1) from the Bankruptcy Court's order granting relief from the stay and moved this Court for a temporary stay (filing 2). The motion for a stay was temporarily granted (filing 4) until this Court had an opportunity to review the record and materials.

The issue for appeal is whether the bankruptcy court erred in sustaining the motion for relief from the automatic stay under 11 U.S.C. § 362(d)(1) and (2). After a review of the briefs and the record submitted on appeal, the Court finds that the decision of the Bankruptcy Court should be affirmed.

On March 19, 1986, when the Bankruptcy Court granted the bank relief from the stay, it made the following findings: (1) the debtors have no equity in the property; (2) the debt as of April 12, 1985, was $224,249.58 plus accrued interest of $105,419.77 (as of March 19, 1986); (3) the value of the property as of January 17, 1986, was $103,000.00; (4) the property continues to decline at approximately $700.00 per month;[1] (5) the property is poor crop land; (6) Mr. Kraus has worked off the property for many years and the farm business has never been a means of support; (7) the farm income is not sufficient to cover principal and interest payments on the note; (8) no effective reorganization is possible; (9) no supplemental insurance policy on the property, naming the bank under a loss payable clause had been obtained as of the hearing; and, (10) adequate protection requires an immediate payment of $2,100.00 and $700.00 per month thereafter, which the debtors are not capable of making.

The Bankruptcy Court stated:

> In most cases this Court would not consider a motion for relief two months into a Chapter 11 case. However, the evidence is clear that these debtors were unable to generate sufficient income from their business

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[1]The Court adopted the debtors' evidence of land value and declination of value, rather than appraisals less favorable to the debtors.

> operation to make the necessary interest and principal payments prepetition. They were unable to redeem the property from a State Court foreclosure proceeding. They had nine months after the State Court foreclosure decree to create some plan concerning their reorganization possibility. They have now had two months since they filed their bankruptcy petition to present some evidence of the possibility or probability of an effective reorganization.
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> The evidence is clear to this Court that the farm business has not in the past and does not now provide sufficient income to the debtors to enable them to satisfy this debt obligation. Further, the evidence is clear that the allowed secured claim of the Bank is approximately $100,000 and the allowed unsecured claim is well over $200,000. Based on all of the evidence, this Court must consider the feasibility of an effective reorganization by these debtors.
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> The conclusion of the Court is this property is not necessary to an effective reorganization because no effective reorganization is possible.

The debtors attack the Bankruptcy Court's decision on three grounds: (1) non-liability on the underlying note; (2) inadequate representation in the bankruptcy proceeding; and (3) underevalaution of the property and the failure to recognize that the property was necessary for an effective reorganization.

The District Court is bound the Bankruptcy Court's findings of fact unless they are clearly erroneous, however, the District Court is not so restricted in reviewing the Bankruptcy Court's interpretation o the law. Bankr. Rule 8013; In re Cricker, 46 B.R. 229 (Bankr. N.D. Ind. 1985).

At issue is 11 U.S.C. §§ 362(d)(1) and (3) which provide that a creditor may obtain relief from an automatic stay by either showing that he is not adequately protected, or that the debtor has no equity in the property and that the collateral was not required for an effective reorganization. 11 U.S.C. §§ 362(d)(1) and (2).[2]

"Adequate protection" is a concept that contemplates the need to avoid impairment of a creditor's interest. Where the Bankruptcy Court believes that the debtor is unable to protect the creditor's interest, the Bankruptcy Court may balance the harm likely to be caused to the creditor by continuation of the stay against the harm likely to accrue to the debtor if the stay is lifted. The Bankruptcy Court may then grant relief from the automatic stay where the balance weighs in favor of the creditor.

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[2]On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section such as by terminating, annulling, modifying, or conditioning such stay--

(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) 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.

11 U.S.C. § 362(d).

In re Southerton Corp., 46 B.R. 391 (M.D. Pa. 1982) (stay lifted for bank to pursue foreclosure); In re Rhoades, 38 B.R. 63 (Bankr. Vt. 1984) (payment of $700.00 per year towards a mortgage debt when interest was $1,862.00 per year is not adequate protection).

For purposes of determining what is adequate protection a court may look at a variety of factors, including: (1) erosion of the equity cushion; (2) the increase in property's value; (3) offer by the debtor of protection that would supply the "indubitable equivalent" of the creditor's interest; (4) economic conditions that do not suggest a realistic prospect for rehabilitation or reorganization under Chapter 11. In re Southerton Corp., 46 B.R. at 399-400.

The Bankruptcy Court properly concluded based upon its findings outlined above that the bank is not adequately protected.

With respect to the second test for relief from the stay, (Section 362(d)(2)) it is impossible to see, based upon the evidence, that the debtors rebutted the bank's evidence which shows that the debtors have no equity in the property and that the property is not necessary for a reorganization. The order granting relief from the automatic stay was appropriately granted.

On appeal to this Court the debtors also claim that they are not liable to the bank on the promissory note which they signed. This issue, including available defenses on the note, is one which should have been litigated at the time of the mortgage foreclosure hearing and appealed in the state court system. A state court judgment (foreclosure) is generally given preclusive effect and

may not be collaterally attacked in the federal courts. Allen v. McCurry, 449 U.S. 90 (1980); Kremer v. Chemical Construction Corp., 102 S. Ct. 1883 ___ U.S. ___ (1982). This Court is, therefore, without jurisdiction to hear the debtors' arguments with respect to liability on the note. Likewise, this Court is without jurisdiction with respect to the debtors' claim that relief from the stay was improperly granted because of the inadequate representation provided by their attorney, Alan Kirshen.[3]

Based upon the foregoing,

IT IS ORDERED that the debtors' appeal (filing 1) of the Bankruptcy Court's order dated March 18, 1986, granting relief from the automatic stay should be and hereby is denied.

IT IS FURTHER ORDERED that the debtors' motion (filing 2) for a temporary stay should be and hereby is denied as moot.

DATED this 30th day of May, 1986.

BY THE COURT:

C. ARLEN BEAM, CHIEF JUDGE
UNITED STATES DISTRICT COURT

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[3]If the debtors wish to pursue the matter of alleged malpractice, it should more properly be done in the state courts.