

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION



In re:) Case No. 10-10252
) (jointly administered with
DETROIT AVENUE REALTY CO., *et al.*,) Case No. 10-10251)
)
Debtors.) Chapter 11
)
) Judge Pat E. Morgenstern-Clarren
)
) **MEMORANDUM OF OPINION**¹
) **AND ORDER**

The court held a combined evidentiary hearing on debtor Detroit Avenue Realty Co.'s motion to use cash collateral and creditor Urban Partnership Bank's amended motion for relief from stay, both of which were opposed.² For the reasons stated below, the motion to use cash collateral is denied and the motion for relief from stay is granted.

JURISDICTION

Jurisdiction exists under 28 U.S.C. § 1334 and General Order No. 84 entered by the United States District Court for the Northern District of Ohio. This is a core proceeding under 28 U.S.C. §§ 157(b)(2)(G) and (M).

BACKGROUND

These motions arise in two administratively consolidated chapter 11 cases: *In re Tyson*, filed by Kenneth Tyson individually, and *In re Detroit Avenue Realty*, filed by a corporation owned and operated by Mr. Tyson. After the cases were filed, secured creditor ShoreBank Cleveland was closed by the Illinois Department of Financial and Professional Regulation and

¹ This opinion is not intended for commercial publication, either print or electronic.

² Docket 21, 25, 38, 40.

the FDIC was appointed receiver. The debtors do not dispute that Urban Partnership Bank is now the owner and holder of the notes secured by mortgages on the real estate at issue.³ For ease of reading, however, this opinion will refer to the secured creditor as ShoreBank.

The lender has a security interest in the real estate and also has an assignment of the rents generated by the property.⁴ When Detroit Avenue Realty (Detroit Realty) defaulted prepetition, ShoreBank began to collect rent directly from the only tenant on the property and continued to do so postpetition. Shortly after the filing, ShoreBank agreed to place those funds into an escrow account pending further court order. Detroit Realty owes more than \$700,000.00 to ShoreBank which, the parties agree, leaves ShoreBank as an undersecured creditor.

FACTS

I.

Kenneth Tyson is the president and sole shareholder of Detroit Realty. Detroit Realty owns three contiguous parcels of real estate on Detroit Avenue in Lakewood: the first has a commercial building on it that is leased to Donato's Pizza; the second has a driveway and drive-through window for Donato's; and the third—now vacant—had an ATM that was removed in 2009.

When Detroit Realty purchased the first parcel in 1997, all parties knew that it had been occupied by a Sohio gas station and that it was contaminated. BP agreed to indemnify Detroit Realty for certain contamination issues. Detroit Realty itself agreed to remediate asbestos in the roof of the commercial building and to remove lead in the soil left behind by an auto body shop.

³ A motion to use cash collateral would normally be heard on an expedited basis. The parties agreed, however, to hold both motions in abeyance while the FDIC reviewed the situation and determined how to dispose of ShoreBank's assets.

⁴ ShoreBank exhs. 4, 5, 10, 11, 15, 16, and 17.

Detroit Realty agreed with its lenders, including ShoreBank, that it would obtain an NFA (declaration that no further action was needed to clean up) within five years. Detroit Realty bought the second and third parcels in 2006. At the time, Mr. Tyson did not know that the plume under the first parcel (radius of contaminated soil) extended into the adjacent parcels.

BP currently runs a remediation system on the site 24 hours a day, seven days a week. No one knows exactly when the cleanup will be finished, but Mr. Tyson estimated it will take two to six more years. Mr. Tyson has completed the remediation that he was personally required to do. The NFA will not be issued until BP is finished.

II.

In 2007, Donato's entered into a five-year lease to operate in the commercial space, with three options to renew for five years each. The monthly lease payment is \$5,250.00. The lease is double net, meaning that Detroit Realty rather than Donato's pays the real estate taxes. According to the debtors' joint plan projections, the monthly real estate tax is \$1,750.00.

ShoreBank alleges that the joint monthly debt service for the notes secured by the mortgages is \$6,320.03.⁵ The parties agree that Detroit Realty fell behind in the note payments, as a result of which ShoreBank began to collect the rents directly from Donato's. Because Detroit Realty does not have any other source of income, it has not made any note payments or tax payments. More than \$100,000.00 is due in taxes as of June 2010. ShoreBank is holding \$68,000.00 in escrow.

⁵ Amended Motion at exhs. D and E, docket 38.

III.

The parties dispute the value of the real estate that secures the loan made by ShoreBank, although they agree that ShoreBank is undersecured regardless of which appraisal is used. Both parties provided testimony from an appraiser at the hearing; Thomas Goepfert, vice president of S.G. Gallas & Associates for ShoreBank, and L.T. Davis for the debtors. Both men are experts in the field and each did a careful evaluation based on the information given to him. Mr. Goepfert opined that the combined market value of the three parcels is \$525,000.00 while Mr. Davis opined that the value is \$144,500.00.

The court credits the testimony given by Mr. Davis because he included in his appraisal two critical pieces of information that were not given to Mr. Goepfert: the exact terms of the Donato's lease and the existence of the environmental problems. Without a copy of the lease, Mr. Goepfert assumed that it was triple net rather than double net, which undermined his income approach to value. Without the information about the environmental situation, Mr. Goepfert did not make the downward adjustment to the sales comparison approach to value that he acknowledges is needed. Additionally, the court notes that he compared the subject property to restaurant properties in suburbs that have not been affected by the recession to the extent that Lakewood has.

The Davis appraisal was done in 2009, almost two years ago. The testimony showed, however, that the commercial real estate market in Lakewood has not improved since then, and the court is satisfied that the appraisal is still accurate. Accordingly, the court finds that the fair market value of the three parcels is \$144,500.00. Further, the court finds credible Mr. Tyson's testimony that the property value is currently stable and not likely to decline.

IV.

The debtors filed a joint plan of reorganization that does not differentiate between their obligations and responsibilities, although the cases have not been substantively consolidated. As Mr. Tyson described the plan in his testimony, the real estate at issue will be valued at \$144,500.00 and ShoreBank will be paid that amount at 3.75% interest over 30 years through a monthly payment of \$669.00. The real estate taxes and taxes owed to the Internal Revenue Service will be paid. The debtors anticipate that rent paid by Donato's will continue to be the only source of income for Detroit Realty.

THE POSITIONS OF THE PARTIES

In ShoreBank's hearing brief, it argues that it should be granted relief from stay for cause under 11 U.S.C. § 362(d)(1), including a lack of adequate protection of its interests. ShoreBank further argues that Detroit Realty's failure to pay the real estate taxes is cause in itself to grant relief and that there is a clear potential for the property to decline in value. Detroit Realty responds that it could not pay the taxes because ShoreBank diverted the Donato's rent and Detroit Realty does not have any other source of income. ShoreBank replies that the Donato's rent is not substantial enough to make monthly payments on both the taxes and the notes.⁶

In the related motion to use cash collateral under 11 U.S.C. § 363, Detroit Realty argues that it needs the Donato's rent to operate the business, including paying the real estate taxes and maintaining the property. ShoreBank, it contends, is adequately protected because (1) the money will go to maintain the property, thus ensuring it will keep its value, and (2) there is an income

⁶ Detroit Realty also makes an argument under § 362(d)(2). The court does not need to address that, or any other parts of § 362, because ShoreBank limited its argument to subsection § 362(d)(1).

stream from the rents that will provide ShoreBank with replacement liens of equal value.

ShoreBank counters that the property has the potential to decline and, again, that permitting Detroit Realty to use the funds will not result in sufficient money to pay the taxes and payments on the notes.

DISCUSSION

I.

The Motion for Authority to Use Cash Collateral

A debtor may use rents which are cash collateral⁷ without the secured creditor's consent only if the court authorizes such use. 11 U.S.C. § 363(c)(2). Bankruptcy Code § 363(e) requires an order authorizing the debtor's use of cash collateral to be conditioned on the debtor providing adequate protection for the creditor's interest in the collateral. 11 U.S.C. § 363(e). "Adequate protection is generally defined as a method by which a secured creditor may apply to the Bankruptcy Court to protect 'its interests against the diminution in value of [its] security during a bankruptcy proceeding.'" *In re WestPoint Stevens, Inc.*, 600 F.3d 231, 257 (2d Cir. 2010) (quoting *Bluebird Partners, L.P. v. First Fidelity Bank N.A.*, 85 F.3d 970, 972 (2d Cir.1996)). The debtor has the burden of proof on this issue. 11 U.S.C. § 363(p)(1).

A secured creditor that holds a security interest in real property *and* a security interest in the rents derived from that property has two separate interests, each of which must be analyzed

⁷ Ohio law determines whether ShoreBank has a security interest in the rents. *Butner v. United States*, 440 U.S. 48, 54 (1979). Detroit Realty does not dispute that ShoreBank holds such a security interest or that the rents are cash collateral as that term is defined under the Bankruptcy Code. See 11 U.S.C. § 363(a) (defining cash collateral as "cash . . . or other cash equivalents . . . in which the estate and an entity other than the estate have an interest and includes . . . rents, or profits of property subject to a security interest as provided in section 552(b) of this title . . ."). Additionally, Detroit Realty does not dispute the postpetition effect of ShoreBank's security interest under 11 U.S.C. § 552(b).

separately on the issue of adequate protection. *Stearns Bldg. v. WHBCF Real Estate (In re Stearns Bldg.)*, No. 98-1257, 165 F.3d 28 at *5 (6th Cir. Sept. 3, 1998). Before Detroit Realty may use the rents, therefore, it must provide ShoreBank with adequate protection in the form of cash payments, an additional or replacement lien, or such other relief “as will result in the realization . . . of the indubitable equivalent of such entity’s interest in such property.” 11 U.S.C. § 361.

Detroit Realty seeks to use the rents: (1) to maintain and preserve its assets; (2) to pay necessary taxes; (3) to purchase necessary goods and services; and (4) to continue its business operations; it offers to protect ShoreBank’s interest in the rents through a replacement lien on postpetition rents. Because the value of the property and the rents combined is less than the amount owed to ShoreBank, and Detroit Realty proposes to use the rents without providing any additional form of security or payment, adequate protection poses a serious issue.

Detroit Realty contends that ShoreBank will be protected because the rents which it generates going forward will also be subject to the lien, thereby providing ShoreBank with a replacement lien in rents. This argument was rejected by the Sixth Circuit in the *Stearns Building* decision, in which the court noted that—

Where . . . there is a specific assignment of rents given as security, a diversion of any portion of the rents to a party other the secured party is clearly a diminution of the secured party's interests in the assignment of rents portion of the security. . . . The secured party has a security interest in the full amount of the future rents. Therefore, this court cannot accept that the use of future rents to replace the expenditure of the prior months rents somehow provides adequate protection for the secured party.

In re Stearns Bldg., 165 F.3d at *5 (quoting *Travelers Ins. Co. v. River Oaks Ltd. Partnership (In re River Oaks Ltd. Partnership)*, 166 B. R. 94, 99 (E.D. Mich. 1994)). Although the *Stearns*

Building decision is unpublished and was issued in a procedurally different posture, it is directly on point and is appropriately applied in the context of this case. *In re Buttermilk Towne Center, LLC*, ___ B.R. ___, 2010 WL 5185870 (B.A.P. 6th Cir. Dec. 23, 2010). ShoreBank already has a security interest in the rents going forward; therefore, giving ShoreBank a “replacement lien” in those rents does not give ShoreBank anything more than it already has. Using the rents under these circumstances will deplete ShoreBank’s interest in the rents, meaning that ShoreBank will not be adequately protected.

Alternatively, Detroit Realty argues that ShoreBank’s interest will be adequately protected because the rents will be used to maintain the real estate and preserve its value. As that property is also ShoreBank’s collateral, the argument goes, ShoreBank will be adequately protected. This argument fails for two reasons.

First, Detroit Realty wants to use the rents to buy goods and services and continue its business operations; these expenses do not directly relate to maintaining the property.⁸ Second, Detroit Realty did not establish that using the rents to maintain the property would adequately protect ShoreBank’s interest in the rents. In cases such as this, “[w]here . . . there is a specific assignment of rents given as security, a diversion of any portion of the rents to a party other than the secured party is clearly a diminution of the secured party’s interest in the assignment portion of rents portion of the security.” *In re River Oaks Ltd. Partnership*, 166 B. R. at 99.

The debtor relies on *Fed. Nat’l Mortgage Assoc. v. Dacon Bolingbrook Assocs. Ltd. Partnership*, 153 B. R. 204 (N.D. Ill. 1993) to support its position. In that case, the creditor was slightly oversecured based on the value of the property. The court held that the debtor could use

⁸ Detroit Realty did not provide a proposed budget for the use of the rents, so the details of how it proposes to apply the money are not clear.

rents to preserve the property, holding that such use adequately protected the creditor's interest in the rents because "the value of the secured creditor's interest in its collateral will thereby be increased." *Id.* at 214. The facts in this case are very different because ShoreBank is significantly undersecured and Detroit Realty did not prove that using the rents in the manner proposed would increase the property value. Additionally, Detroit Realty's use of the rents to maintain the property clearly does not protect ShoreBank's interest in the rents. As ShoreBank has a secured interest in both the property and the rents, the motion to use cash collateral must be denied.

II.

The Motion for Relief from Stay

The filing of the bankruptcy petition put in place an automatic stay that prevents ShoreBank from realizing the value of its collateral. 11 U.S.C. § 362(a). ShoreBank moves for relief from stay under § 362(d)(1). That section provides for relief "for cause, including the lack of adequate protection of an interest in property of such party in interest[.]" 11 U.S.C. § 362(d)(1). ShoreBank has the burden of proving that Detroit Realty does not have equity in the property and Detroit Realty has the burden of proof on all other issues. 11 U.S.C. § 362(g).

"Because the Code provides no definition of what constitutes 'cause' under . . . Section 362(d) . . . , courts must determine whether discretionary relief is appropriate on a case-by-case basis." *Laguna Assocs. Ltd. Partnership v. Aetna Cas. & Sur. Co. (In re Laguna Assocs. Ltd. Partnership)*, 30 F.3d 734, 737 (6th Cir. 1994). "[T]he term 'cause' is a broad and flexible concept which permits a bankruptcy court, as a court of equity, to respond to inherently fact-sensitive situations." *In re Indian River Estates, Inc.*, 293 B.R. 429, 433 (Bankr. N.D. Ohio 2003). The court may grant relief where there is a "lack of adequate protection of an interest in

property.” The interest in property referred to in this section includes “the right of a secured creditor to have the security applied in payment of the debt upon completion of the reorganization; and . . . that interest is not adequately protected if the security is depreciating during the term of the stay.” *United Savings Ass’n of Texas v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 370 (1988). An undersecured creditor is entitled to be adequately protected against such deterioration. *Id.*


A debtor’s failure to pay real estate taxes or to make other payments can result in this type of deterioration of a creditor’s secured position and can amount to cause for relief. *In re Mosello*, 195 B.R. 277, 293-94 (Bankr. S.D.N.Y. 1996); *Fed. Deposit Ins. Corp. v. Henrico Hotel Assocs., L.P.* (*In re Henrico Hotel Assocs., L.P.*), 1994 WL 16191612 (Bank. E.D. Va. 1994) at *3; *see also In re Anthem Cmtys./RBG, LLC*, 267 B.R. 867, 874 (Bankr. D. Colo. 2001) (noting that the accrual of postpetition property taxes is relevant to demonstrate the erosion of a creditor’s secured claim).

The evidence did not show that the property will decline in value, as ShoreBank contended. The evidence did, show, however, that Detroit Realty’s inability to pay the real estate taxes is eroding ShoreBank’s secured position. Detroit Realty correctly points out that it could not pay the taxes because ShoreBank collected the rent directly from Donato’s. The loan documents gave ShoreBank the right to do this, and Detroit Realty did not identify any provision in those documents that required ShoreBank to use the money to pay the taxes as opposed to holding the money to apply to the debt owed to it. The tax arrearages have been steadily mounting since the cases were filed and they will continue to mount because Detroit Realty has been denied the use of the rents. All of this is to the detriment of ShoreBank’s interest in the property. Under these facts, the court concludes that cause exists to lift the stay.

CONCLUSION

For the reasons stated, the motion to use cash collateral is denied and the motion for relief from stay is granted.

IT IS SO ORDERED.



Pat E. Morgenstern-Clarren
United States Bankruptcy Judge