

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION



In re:) Case No. 12-16778
)
JACK WORKS LLC,) Chapter 11
)
Debtor.) Chief Judge Pat E. Morgenstern-Clarren
)
) **MEMORANDUM OF OPINION AND**
) **ORDER**¹

Secured creditor First-Citizens Bank & Trust Company moves for relief from stay to prosecute a state court lawsuit it filed prepetition against the debtor, Jack Works LLC.² The suit is based on notes given by Jack Works LLC, which notes are secured by mortgages on two pieces of commercial real estate and some related personal property. The debtor opposes the motion.³ For the reasons stated below, the motion is granted.

I. JURISDICTION

Jurisdiction over this proceeding exists under 28 U.S.C. § 1334 and General Order No. 2012-7 entered by the United States District Court for the Northern District of Ohio on April 4, 2012. This is a core proceeding under 28 U.S.C. § 157(b)(2)(G), and it is within the court's constitutional authority as analyzed by the United States Supreme Court in *Stern v. Marshall*, 131 S.Ct. 2594 (2011).

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

² Docket 24.

³ Docket 34.

II. FACTS

A. The Evidentiary Hearing

The court held an evidentiary hearing on November 15, 2012. First-Citizens and the debtor both presented their cases through the testimony of Mitchell Kelly (the debtor's sole member), stipulations,⁴ and exhibits. The relevant facts are not disputed, although the conclusions to be drawn from them are contested.

B. The Debtor's Pre-Bankruptcy Operations

The debtor began its automatic car wash business with one location at 20150 Lorain Road, Fairview Park, Ohio (the Fairview Property), followed by a second location at 1580, 1584, and 1586 West 117th Street, Lakewood, Ohio (the Lakewood Property). The debtor obtained loans to open and operate the businesses; those loans are memorialized in notes secured by mortgages on both properties, as well as by a mortgage on the debtor's personal property at those locations. First-Citizens currently owns and holds those notes and mortgages. Mitchell Kelly is the debtor's only employee and the business is his only source of income.

The debtor's financial troubles stem from its decision to open the Lakewood Property location; the problems were compounded last year when business dropped off at both locations due to the unusually warm winter weather.

When the debtor defaulted on the notes, the debtor and First-Citizens worked together for quite some time to see if the debtor could regain its financial footing. Eventually, First-Citizens filed a state court action to obtain judgment on the notes and foreclose on the mortgages, as well

⁴ Docket 39.

as to ask that a receiver be appointed to run the business. The debtor filed this bankruptcy case on September 17, 2012 to prevent that action from going forward.

C. The Secured Debt

As of October 12, 2012, the debtor owed these amounts to First-Citizens:

On the Fairview Property note	\$989,041.29, plus interest at 4.55% per year, together with additional fees and charges [an additional payment of \$2,050.00 has been applied towards this debt]
On the Lakewood Property note	\$1,460,689.63, plus interest at 4.75% per year, together with additional fees and charges [an additional payment of \$2,950.00 made after that has been applied towards interest on the debt]

The debtor also owes delinquent real estate taxes on the Lakewood Property (\$84,919.35) and the Fairview Property (\$18,774.17). Interest accrues on those amounts at the rate of 1% per month, or \$1,036.90. Additionally, real estate taxes continue to accrue on the two properties in the total monthly amount of \$3,486.14.

The parties stipulated that the debtor does not have any equity in any of the property that secures the debt.

D. The Debtor's Historical Performance

The debtor's operations are seasonal, with the winter and spring months generating 50% to 100% more income than in other months. The debtor's 2011 Profit/Loss Statement shows these combined monthly profits and losses for operations at the two properties:

January	\$12,693.00
February	\$34,671.00
March	\$ 9,092.00
April	(\$ 1,874.00)
May	(\$ 927.00)

June	\$11,414.00
July	\$ 7,649.00
August	(\$ 1,525.00)
September	(\$ 8,118.00)
October	\$ 2,275.00
November	\$ 3,915.00
December	(\$ 3,254.00)

These numbers do not include payments to Mr. Kelly for his services (about \$5,000.00 a month) and do not take into account the roughly \$3,500.00 in real estate taxes that are accruing monthly.

The debtor's 2012 Profit/Loss Statement for January through August of 2012 shows these combined monthly profits and losses for operations at the two properties:

January	\$21,444.00
February	\$21,717.00
March	\$17,691.00
April	\$13,223.00
May	\$11,962.00
June	\$12,454.00
July	\$11,671.00
August	\$10,840.00

These numbers do not take into account the monthly First-Citizens loan payments of approximately \$15,000.00, the monthly real estate taxes of approximately \$3,500.00, or any amount paid to Mr. Kelly for his services.

In the two months since filing Chapter 11, the debtor has had less than \$20,000.00 in gross sales. Mr. Kelly attributes this to bad weather and power outages. He anticipates that business this winter will be similar to or better than last winter's business.

E. The Debtor's Anticipated Plan of Reorganization

To pay the amounts owed to First-Citizens, the taxing authorities, and a salary to Mr. Kelly, the debtor will have to generate at least an additional \$20,000.00 a month. The debtor

believes that it will be able to propose a feasible plan through a combination of increasing revenue by raising rates, increasing business as the winter months approach, and contributing the proceeds of the sale of Mr. Kelly's house, which he plans to put on the market very soon.

F. The Cash Collateral Order

The September 20, 2012 agreed interim cash collateral order provided that the debtor could use First-Citizens' cash collateral through October 31, 2012, but only as provided for in the budget. That order required the debtor to make \$2,500.00 payments to First-Citizens on September 28, 2012, October 12, 2012, and October 26, 2012 and to provide weekly reports starting on September 24, 2012 and each following Tuesday. The reports were to detail the prior week by providing this itemized information for each property: (1) cash received; (2) credit card/debt card income received, net of fees paid; (3) expenses as set forth in the budget incurred but not paid; and (4) expenses paid as set forth in the budget paid. Also, the reports were to state the amount of cash on hand and were to be accompanied by copies of electronic bank statements.

The debtor did not comply with the cash collateral order in a number of ways. It did not provide any financial reports to First-Citizens until October 17, 2012 and then it provided a report that did not include information about cash on hand. It did not make the first payment as required. Instead, it paid \$900.00 on September 28, 2012 and \$1,600.00 on November 2, 2012. However, the second and third payments were made as required. Finally, Mr. Kelly withdrew \$1,400.00 from the debtor's account on September 19, 2012 to cover a personal check that had been refused by his bank for insufficient funds.

III. THE POSITIONS OF THE PARTIES

First-Citizens argues that the stay should be lifted because:

1. The debtor does not have equity in the properties and cannot realistically obtain the revenue stream it needs to propose a confirmable plan, as seen by the fact that the debtor did not introduce any financial projections into evidence;

2. First-Citizens' secured position is not adequately protected because it has no equity cushion in the two properties, and the current real estate taxes and the interest on delinquent real estate taxes continue to accrue to its detriment; and

3. The debtor has not met its responsibilities because it used funds before the court entered the cash collateral order, used \$1,400.00 for a prohibited transaction, made cash collateral payments late, and failed to provide the detailed financial information called for by the cash collateral order.

The debtor contends that, as is true of many small business owners, Mr. Kelly had to learn as he went along in the chapter 11 process. The debtor is relying on historical performance because it is difficult to do accurate projections for a weather-based business and the business cannot afford to hire an accountant. And it argues further that Mr. Kelly has acted in good faith and should be given more time to develop a plan.

IV. DISCUSSION

A. Relief From Stay

Filing a bankruptcy petition "operates as a 'stay' of actions that could have been filed against the entity to recover claims . . . Similarly, once a petition is filed, judgments cannot be enforced against the debtor, the debtor's property cannot be repossessed or foreclosed on, and

liens cannot be perfected or enforced against the debtor's property.” *Onkyo Europe Elecs.*

GMBH v. Global Technovations, Inc. (In re Global Technovations, Inc.), 694 F.3d 705, 711 (6th Cir. 2012) (citing 11 U.S.C. § 362(a)). First-Citizens asks that the stay be lifted as provided under § 362(d):

(d) 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;

(2) with respect to a stay of an act against property under subsection (a) of this of 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)(1) and (2). First-Citizens has the burden of proof on the issue of the debtor's equity in the properties. 11 U.S.C. § 362(g). The debtor has the burden of proof on all other issues. *Id.*

B. 11 U.S.C. § 362(d)(1)

Under § 362(d)(1), relief from stay may be granted for cause, which includes, but is not limited to, the lack of adequate protection of an interest in property. Because the Bankruptcy Code does not define cause, the determination whether to grant relief for cause must be made 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 concept of adequate protection focuses on whether a secured creditor is protected “against any decrease in the value of its collateral which may result from depreciation, destruction, or the debtor’s use of the collateral.” *Volvo Comm. Fin. LLC the Americas v. Gasel Transp. Lines, Inc. (In re Gasel Transp. Lines, Inc.)*, 326 B.R. 683, 691-92 (B.A.P. 6th Cir. 2005). A debtor’s failure to pay real estate taxes or to make other payments can result in deterioration of an undersecured creditor’s 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).

Additionally, a debtor’s use of cash collateral without consent or authority, or its use of cash collateral in violation of a consent order, are relevant considerations in determining whether cause exists to lift the stay. *See for example, Kelvin v. Avon Printing Co. (In re Kelvin Publ’g, Inc.)*, 72 F.3d 129 at *2 (6th Cir. 1995) (unpublished opinion) (noting that a court can lift the stay in cases where a debtor has violated the bankruptcy code’s cash collateral provisions); *In re SBPM Holdings, Inc.*, 2010 WL 4976952 at *4 (Bankr. S.D. Tex. 2010) (noting that the debtor had used cash collateral without consent or authority in finding cause for relief from stay); *Nationsbanc, N.A. v. LDN Corp. (In re LDN Corp.)*, 191 B.R. 320, 323 (Bankr. E.D. Va. 1996)

(same); *In re Henrico Hotel Assocs., L.P.*, 1994 WL 16191612 at *3 (“An additional basis for cause is found in the debtor’s breach of the cash collateral agreement.”).

In this case, cause exists to lift the stay because First-Citizens’ interest in the properties is not adequately protected. First-Citizens is undersecured and the value of its interest in the properties is declining every month. The decline is attributable to the interest accruing on the delinquent real estate tax obligations and the fact that current taxes are accruing without the debtor setting aside funds to make the payments. The combined monthly amount for the accruing interest and current taxes is approximately \$4,500.00. These obligations are secured by liens on the two properties, which liens have priority over First-Citizens’ secured position. Thus, as the amounts attributable to the taxes go up, the value of First Citizens’ position goes down.

The debtor’s failure to comply with the agreed interim cash collateral order provides further cause for lifting the stay. The debtor failed right out of the box to make the initial payment required under the order, and compounded the problem by failing to provide First-Citizens with timely and complete reports. At that point, the order precluded the debtor from using cash collateral, but it continued to use it nevertheless. Equally troubling is the debtor’s payment of Mr. Kelly’s personal debt on September 19, 2012, when its request for authority to use cash collateral had not yet been ruled upon.

C. 11 U.S.C. § 362(d)(2)

Under § 362(d)(2), where a debtor lacks equity in the property, relief from the stay is appropriate if the property “is not necessary to an effective reorganization[.]” 11 U.S.C. § 362(d)(2). “What this requires is not merely a showing that if there is conceivably to be an effective reorganization, this property will be needed for it; but that the property is essential for

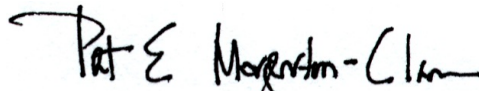
an effective reorganization *that is in prospect*. This means . . . that there must be a reasonable possibility of a successful reorganization within a reasonable time.” *United Sav. Ass’n of Texas v. Timbers of Inwood Forest Assoc. Ltd.*, 484 U.S. 365, 376 (1988) (internal quotation marks and citation omitted) (emphasis in original). “[A]t a minimum, the Debtor must provide the Court with a broad outline of how it intends to employ the rehabilitative mechanisms of the Code to effectuate a reorganization plan within a reasonable time period.” *In re Planned Sys., Inc.*, 78 B.R. 852, 866 (Bankr. S.D. Ohio 1987).

Because the parties stipulated that the debtor does not have equity in the properties, the only issue is whether the properties are necessary for an effective reorganization. The debtor did not meet its burden of proof on this issue. The debtor’s hopes for a successful reorganization depend on its ability to generate sufficient funds to pay First-Citizens and the real estate taxes; however, those hopes are speculative at best. The debtor has not stayed current on those obligations in the past and Mr. Kelly did not provide any concrete numbers regarding the debtor’s ability to do so going forward. Although Mr. Kelly has an honest belief that a price increase and more favorable (i.e. worse) weather will generate sufficient funds, he did not provide any specifics regarding the price increase or projections regarding future sales. Mr. Kelly’s plan to sell his home to generate funds to keep the business going during lean months actually belies his contention that the business can generate the funds needed going forward. Consequently, the debtor did not prove that there is any possibility of a successful reorganization within a reasonable time frame.

V. CONCLUSION

For the reasons stated, the motion for relief is granted and the stay is lifted to permit First-Citizens to proceed with its state court remedies.

IT IS SO ORDERED.

A handwritten signature in black ink, reading "Pat E. Morgenstern-Clayren". The signature is written in a cursive, flowing style. The "P" is large and loops around the "at". The "M" is also large and loops around the "orgenstern". The "Clayren" part is written in a more straightforward cursive.

Pat E. Morgenstern-Clayren
Chief Bankruptcy Judge