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U.S. BKCY. APP. PANEL
OF THE NINTH CIRCUIT

NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY APPELLATE PANEL

OF THE NINTH CIRCUIT

In re	)	BAP No. CC-04-1261-MoPMa
	)	
SHAHRIAR DARGAHI and, NAZILA ADELI-NADJAFI,	)	Bk. No. SV 03-15884-AG
	)	
Debtors.	)	
	)	
_____	)	
	)	
SHAHRIAR DARGAHI and, NAZILA ADELI-NADJAFI,	)	
	)	
Appellants,	)	
	)	
v.	)	**M E M O R A N D U M**[1]
	)	
KENT INVESTMENT COMPANY,	)	
	)	
Appellee.	)	
_____	)	

Argued on March 23, 2005
at Pasadena, California

Submitted on December 15, 2005[2]

Filed - February 24, 2006

Appeal from the United States Bankruptcy Court
for the Central District of California

Honorable Arthur M. Greenwald, Bankruptcy Judge, Presiding.

Before: MONTALI, PERRIS and MARLAR, Bankruptcy Judges.

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[1] This disposition is not appropriate for publication and may not be cited to or by the courts of this circuit except when relevant under the doctrines of law of the case, claim preclusion, or issue preclusion. See 9th Cir. BAP Rule 8013-1.

[2] Submission of this appeal was deferred a number of times, at the panel's suggestion and the parties' request, for what ultimately proved to be unsuccessful attempts at mediation.

The bankruptcy court granted relief from the automatic stay under Section 362 to foreclose on a gas station.[3] We hold that the bankruptcy court erred as a matter of law by equating a lack of equity cushion with a lack of adequate protection, so its order cannot be sustained under Section 362(d)(1). The bankruptcy court also clearly erred by not taking into account a $300,000 mistake by the appraiser whose valuation it accepted, and we cannot say that this error was immaterial to its finding that there was no equity in the property under Section 362(d)(2)(A). Accordingly, neither of the alternative grounds for granting relief from the automatic stay can be sustained. We REVERSE and REMAND.

I. FACTS

Debtor Shahriar Dargahi ("Debtor") and his co-debtor wife, Nazila Adeli-Nadjafi (collectively, "Debtors"), own an Arco gas and service station and convenience store known as Kia's Service Station in Long Beach, California (the "Subject Property"). Debtors purchased the Subject Property in 1997 from Kest Investment Co. ("Kest"), which took back a first deed of trust. Debtors remodeled the Subject Property in December 1998 and February 1999, replacing leaking underground storage tanks and putting in new pumps, new concrete, a walk-in cooler, a new bathroom, flooring, new paint, and new stucco.

Debtors allege that Kest misled them into relying on Kest's pending application with an agency of the State of California

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[3] Unless otherwise indicated, all chapter, section and rule references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1330, and to the Federal Rules of Bankruptcy Procedure, Rules 1001-9036, as enacted and promulgated prior to the effective date of The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. 109-8, Apr. 20, 2005, 119 Stat. 23.

("Cal/EPA") for compensation to cover the costs of cleaning up contamination from the leaking underground storage tanks, but in fact Kest's application had already been denied for failure to follow up on the requirements for compensation. Debtors assert claims against Kest based on these allegations (the "Reimbursement Claims").

Debtors and Kest could not resolve their disputes, Kest commenced foreclosure proceedings, and Debtors filed their voluntary Chapter 11 petition on July 14, 2003 (the "Petition Date"). On October 30, 2003, Kest filed a motion for relief from the automatic stay (the "Motion") alleging that (a) Kest's interest in the Subject Property is not adequately protected and alternatively (b) Debtors have no equity in the Subject Property and it is not necessary for an effective reorganization. The Motion alleges that the fair market value of the Subject Property is $439,000.00 as of October 10, 2003, based on an appraisal prepared by Donald L. Mellman ("Mellman"). This was later reduced to $409,000.00 based on the parties' stipulation that remaining environmental remediation would cost $30,000.00. Transcript Mar. 29, 2004, p. 107:11-13.

Debtors allege that the Subject Property is worth $700,000.00 as of January 17, 2004, based on an appraisal prepared by Lawrence R. Pynes ("Pynes"), again subject to a $30,000.00 reduction for remaining environmental remediation. Id. Debtors also argue that the business is profitable, that the Subject Property is appreciating and necessary for a reorganization, and that Kest's claim must be reduced because of the offsetting Reimbursement Claims.

The matter was tried over four days in February and March, 2004. The trial was a classic battle of appraisers with additional disputes regarding the accuracy of Debtors' financial records and projections.

Both appraisers would have preferred to use an income valuation approach but apparently Debtor had not maintained adequate records of income and expenses. Transcript Feb. 13, 2004, pp. 33:20-22 and 86:4-21. Both appraisers therefore focused on a sales comparison approach.[4]

The appraisers used very different methods of comparing sales. Mellman used three local comparables, starting with the sales prices as reported by a service called Co-Star Realty Information, Inc. ("Co-Star"). He adjusted up or down based on looking at each gas station for an hour or so to determine the volume of business and other factors such as whether the neighborhood is a high crime area. He criticized Pynes for using non-local, non-recent sales of gas stations that are all significantly more valuable than the Subject Property.

Pynes used comparables for which he had comprehensive information generally based on his company's involvement in the transaction. Pynes criticized Mellman for relying on Co-Star's reported sales price without having similarly comprehensive information. Transcript Feb. 13, 2004, pp. 92:14-20, 93:22-94:8. Pynes also defended his use of comparables from around the nation. He testified that location was not very significant except insofar

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[4] Pynes also included a cost approach and a capitalization of income approach based partly on gross income, but he apparently used these two alternative approaches more as a check on the sales comparison approach than as independently reliable valuation methods.

as being next to a highway, for example, might increase traffic and thereby affect volume. Transcript Feb. 13, 2004, pp. 94:19-95:25. He adjusted up or down by multipliers to account for a high or low volume at the particular location as compared with Debtors' volume, location, and other factors.

On May 10, 2004, the bankruptcy court entered its written Findings of Fact and Conclusions of Law (the "Decision") and a separate order granting the Motion. The Decision finds that as of the Petition Date Kest's lien was $446,643.63, total liens were $619,589.53, and "[b]ased upon the appraisal evidence presented by the Movant Kest, the Subject Property had a fair market value on the Petition Date of $409,000.00." The Decision states that Debtor's testimony and evidence of income lacked credibility.

The decision concludes that Kest lacks adequate protection, under Section 362(d)(1), based only on the facts that Debtors lack any equity in the Subject Property and Kest lacks an equity cushion.

CONCLUSIONS OF LAW

* * *

> 5. Considering only Movant Kest's lien, the Debtors[] have no equity in the property ($446,643.67 less $409,000.00),[5] nor does there exist an equity cushion. Accordingly, Movant Kest lacks adequate protection.

As an alternative basis for granting relief from the automatic stay the Decision states that "Debtors do not have any equity in the Subject Property" and "the Subject Property is not

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[5] The bankruptcy court presumably meant to reverse these two numbers: starting with the value of the Subject Property (found to be $409,000.00), one would deduct Kest's lien (found to be $446,589.53) leaving a negative balance (i.e. no equity).

necessary to an effective reorganization" so Kest is entitled to relief under Section 362(d)(2).

Debtors filed a timely notice of appeal. On Debtors' motion we granted a stay pending appeal, conditioned on Debtors either posting a $50,000.00 bond or making monthly payments of $5,000.00. Debtors have previously reported, without contradiction by Kest, that they have been making the monthly payments.

II. ISSUES

A. Did the bankruptcy court apply the wrong legal standard to determine a lack of adequate protection under Section 362(d)(1)?

B. In view of Mellman's alleged mistakes, did the bankruptcy court err by accepting Mellman's valuation of the Subject Property?[6]

III. STANDARDS OF REVIEW

We review the decision whether or not to grant relief from the automatic stay for abuse of discretion. In re Kissinger, 72

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[6] Debtors also argue that the debt to Kest is disputed and should be discounted, that Debtor's testimony should have been believed, and that there is a reasonable possibility of a successful reorganization within a reasonable time. We reject these arguments.

Kest is correct that its proof of claim is prima facie evidence of the amount of the debt. 11 U.S.C. § 502(a). Debtors have alleged some Reimbursement Claims that might be setoffs to this debt but they introduced no evidence to support those claims at trial, and Debtors have not filed any objection to Kest's proof of claim (it is irrelevant that, according to Debtors, the reason they have not objected is a lack of cash flow sufficient to litigate an objection at this time).

As for Debtor's credibility and the prospects for a successful reorganization, there was evidence that Debtor did not keep adequate records, he admitted several mistakes in the financial summaries he did submit, and a positive cash flow (even post-petition) would depend on numerous factors as to which there was conflicting evidence. The bankruptcy court's findings of fact cannot be disturbed except for clear error, and on these issues Debtors have shown no such error.

F.3d 107, 108 (9th Cir. 1995). A bankruptcy court necessarily abuses its discretion if it bases its ruling upon an erroneous view of the law or a clearly erroneous assessment of the evidence. The panel also finds an abuse of discretion if it has a definite and firm conviction that the bankruptcy court committed a clear error of judgment in the conclusion it reached. In re Beatty, 162 B.R. 853, 855 (9th Cir. BAP 1994). We review legal issues de novo and the bankruptcy court's factual findings for clear error. In re Baldwin Builders, 232 B.R. 406, 410 (9th Cir. BAP 1999). The trial court's determination whether a proffered expert's opinion testimony is sufficiently reliable to be admitted in evidence is subject to review for abuse of discretion. White v. Ford Motor Co., 312 F.3d 998, 1007 & n. 22 (9th Cir. 2002), amended on denial of mot. for reh., 335 F.3d 833 (2003).

IV. DISCUSSION

It is now approaching two and a half years since Kest filed its Motion. The facts may have changed considerably in the meantime, but the issues are not moot and we must address the order before us.

Section 362(d) provides, in relevant part:

> (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; [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)(1) and (2).

The test is disjunctive: relief from the automatic stay is warranted if either paragraph of Section 362(d) is satisfied -- i.e., if Kest lacks adequate protection (Section 362(d)(1)) or alternatively if Debtors lack equity in the Subject Property and such property is not necessary for an effective reorganization (Section 362(d)(2)).

The burdens of proof are set forth in Section 362(g):

> (g) In any hearing under subsection (d) or (e) of this section concerning relief from the stay of any act under subsection (a) of this section --
>
> (1) the party requesting such relief has the burden of proof on the issue of the debtor's equity in property; and
>
> (2) the party opposing such relief has the burden of proof on all other issues.

11 U.S.C. § 362(g).

A. The bankruptcy court erred as a matter of law by equating lack of equity with a lack of adequate protection

The bankruptcy court ruled that "Debtors[] have no equity in the property," Kest has no equity cushion, and "[a]ccordingly, Movant Kest lacks adequate protection." (Emphasis added.) This is incorrect as a matter of law. If, as the bankruptcy court found, Kest had no equity cushion then it was not entitled to interest on its secured claim. United Sav. Ass'n v. Timbers of Inwood Forest Assoc. Ltd., 484 U.S. 365, 382 (1988) ("the undersecured petitioner is not entitled to interest on its collateral during the stay to assure adequate protection under 11

U.S.C. § 362(d)(1)"). Nor did the bankruptcy court find any other basis for concluding that Kest lacked adequate protection, such as declining value of the Subject Property or a lack of insurance. Compare id. at 370 ("if the apartment project in this case had been declining in value petitioner would have been entitled, under § 362(d)(1), to cash payments or additional security in the amount of the decline"). Therefore, the bankruptcy court's conclusion that Kest lacks adequate protection is not supported.

Nor can we say that the bankruptcy court's error was immaterial. Debtor offered uncontradicted evidence, in the form of his declaration, that there was no waste of the Subject Property and it was not deteriorating. Kest's Motion alleges that "[t]he fair market value of the [Subject] Property is declining" but it never offered any evidence to support that allegation.

Kest's only argument on this appeal is that "[e]ach day that passed the present value of Kest's claim was progressively less" and that this is the same as a lack of adequate protection. That view has been rejected by the Supreme Court in Timbers, 484 U.S. 365. Therefore, the bankruptcy court applied an incorrect legal standard and relief from the automatic stay cannot be sustained under Section 362(d)(1).

B. The bankruptcy court clearly erred by not accounting for Mellman's $300,000 mistake

Mellman's miscalculation was basic: he deducted $150,000 from the value of his comparable #3 (the "Tear-Down Site") when he should have added $150,000. The difference is $300,000.

1. Mellman's mistake

Mellman testified that the purchaser of the Tear-Down Site

would have to incur a net expense of $150,000 more than he would ever recover on a future resale (the "Unrecoverable Costs") in order to make that gas station operable. Mellman compared this expense to his own unrecoverable costs in improving his kitchen, for which he spent $22,000 but which "probably added only $5,000 to the value of my house." Transcript Feb. 10, 2004, pp. 176:24-177:3. In other words, the Unrecoverable Cost to the purchaser to make the Tear-Down Site operable was $150,000 more than the Tear-Down Site's sales price, not $150,000 less.

Mellman's $150,000.00 deduction is inconsistent with his own methodology, as Pynes explained. Transcript Feb. 13, 2004, p. 130:11-18. Mellman's methodology was to increase the relative value of the Subject Property to account for ways in which the Tear-Down Site is inferior -- like its lack of diesel pumps and worse location -- and to decrease the relative value of the Subject Property to adjust for advantages of the Tear-Down Site -- like its larger land size and its irregular shape that "offers excellent sight clearance and access." The one exception is the Unrecoverable Costs, an inferior aspect of the Tear-Down Site for which Mellman's appraisal erroneously decreases the relative value of the Subject Property:

SALE #3:	SALES PRICE:		$532,000.00
	ADJUSTMENTS:		
Land size, 9,420 SF @ $10 SF, irregular:		-$94,200	
Gas pumps & islands:		-0-	
Diesel pumps, 7%		+$37,200	
Location, **inferior** traffic count:(20%)		**+**$106,400	
Improvements, replace cost per ALSAL: [the **Unrecoverable Costs, also inferior**]		-$150,000	
	TOTAL:		-$100,600.00
	ADJUSTED VALUE SUBJECT:		$431,400.00
	SAY:		$431,500.00

[Emphasis added.]

Mellman denied that there was any mistake on cross examination:

> [DEBTOR'S ATTORNEY:] [W]hen you did the analysis of comparing that sale [of the Tear-Down Site] to my client's sale [sic], didn't you, in fact, subtract $150,000 . . . ?
>
> [MELLMAN:] Yes.
>
> [DEBTOR'S ATTORNEY:] Why would you decrease the value of my client's property from one that is inoperable and vacant at the time of its sale?
>
> [MELLMAN:] . . . I went ahead with good reason and I took 150,000 off the price based on the fact that they had to come in and do work, and they did, they changed brands. As I explained to you, when I did my kitchen on my house, though, it only -- the recoverable on that was 20 to 30 percent of what I spent. So based on my experience over 50 years, I deducted $150,000 from this purchase price, and that gave me equivalent of the subject.
>
> [DEBTOR'S ATTORNEY:] I'm totally lost.
>
> [MELLMAN:] Well, I can understand, because you're not experienced in this.
>
> [DEBTOR'S ATTORNEY:] . . . [N]o. I'm fully lost at your explanation. The property sold for $532,000, correct?
>
> [MELLMAN:] Right.
>
> [DEBTOR'S ATTORNEY:] At that time it was vacant. It

was inoperable.

[MELLMAN:] Right.

[DEBTOR'S ATTORNEY:] They went in after that time and they did improvements.

[MELLMAN:] Right.

[DEBTOR'S ATTORNEY:] But then when you compare the value of my client's property to this property, you subtracted $150,000 from the sale price.

[MELLMAN:] Of the comparable.

[DEBTOR'S ATTORNEY:] Right.

[MELLMAN:] Yeah, because it had to have that work done, and it was upgraded to the point where it was comparable to the subject.

* * *

[DEBTOR'S ATTORNEY:] It doesn't make sense, your Honor.

[THE COURT:] Well, that's your opinion, but --

[DEBTOR'S ATTORNEY:] It's not my opinion.

[THE COURT:] Well, I don't want to argue with you about it. You'll have time to make your argument.

Transcript Feb. 13, 2004, pp. 25:7-16, 26:8-27:12, 30:3-7 (emphasis added).

In rebuttal testimony Mellman changed his explanation. Instead of repeating that the Tear-Down Site had to be "upgraded to the point where it was comparable to the subject" he testified that he "deducted [$]150,000 from this tear-down site" because the Tear-Down Site had more value "in relation to a vacant site." Compare Transcript Feb. 13, 2004, p. 27:8-9 (emphasis added) with Transcript Mar. 29, 2004, p. 58:13-15 (emphasis added). This is the wrong comparison. As Debtors point out, the Tear-Down Site is not being compared with a vacant site. It is being compared with

the Subject Property, which is occupied, has all of its permits, and is fully operable. Adding instead of subtracting Mellman's $150,000 estimate of the Unrecoverable Costs, the adjusted value of the Subject Property based on the Tear-Down Site should be $731,500, not $431,500.

On this appeal Kest's attorney argues that Debtors' attorney has confused "bare land" with the vacant gas station on the Tear-Down Site, and the latter is more valuable because it already had a conditional use permit for a gas station. Transcript Feb. 13, 2004, p. 24:18-23. We assume without deciding that this distinction is accurate, but this issue has nothing to do with Mellman's $300,000 mistake.

The bankruptcy court mischaracterized Mellman's mistake as only the "opinion" of Debtor's attorney (Transcript Feb. 13, 2004, p. 30:3-7) and it accepted Mellman's valuation without comment or change. We conclude that the bankruptcy court clearly erred by not accounting for Mellman's $300,000 mistake. We now consider whether that error was material.

2. The error is material

Kest relies entirely on its argument that Mellman made no mistake. It has advanced no alternative argument that any mistake is immaterial. Nevertheless, we must consider whether it is.

Mellman calculated the value of the Subject Property by taking the mathematical average of his three comparables -- $443,000, $441,500, and $431,500 -- and rounding the result to $439,000. Mellman noted that "this estimate of value must be adjusted for the cost of clearing the contamination," which the parties later stipulated to be $30,000. Based explicitly on

Mellman's appraisal the bankruptcy court found that "the Subject Property had a fair market value on the Petition Date of $409,000." If Mellman had valued the Tear-Down Site at $731,500, consistent with the proper application of his own methodology, then the mathematical valuation of the Subject Property would be approximately $509,000 ($443,000 + $441,500 + 731,500 = $1,616,000, divided by 3 = $538,667, minus $30,000 = $508,667). This is $100,000 more than the valuation that the bankruptcy court accepted.

That mathematical difference alone might be immaterial in different circumstances. A $509,000 valuation is still well below the $619,589.53 in liens found by the bankruptcy court, so if the bankruptcy court had been persuaded that Mellman's $300,000 error did not taint his appraisal then perhaps it would still have found that Debtors lacked any equity in the Subject Property.

That is not what happened. As noted above, Mellman either could not recognize his mistake or simply refused to acknowledge it, the bankruptcy court mischaracterized it as only the "opinion" of Debtor's attorney, and the Decision adopts Mellman's valuation without comment or change. Given the bankruptcy court's obligation to scrutinize proffered expert testimony with particular care, and given the critical importance of the competing appraisers' opinions, we cannot say that the bankruptcy court would have reached the same result if it had recognized and considered Mellman's $300,000 mistake. See Claar v. Burlington Northern Ry. Co., 29 F.3d 499, 501 (9th Cir. 1994) (for experts, requirement of personal knowledge is relaxed but not the necessity for court to scrutinize methodology or reasoning) (citing, inter

alia, Daubert v. Merrell Dow Pharmaceuticals, Inc., 509 U.S. 579 (1993)). See also Kumho Tire Co., Ltd. v. Carmichael, 526 U.S. 137 (1999) (applying Daubert to non-scientific experts).

Our conclusion is reinforced by the fact that the two appraisers disagreed completely on a number of other issues, so any factors bearing on either appraiser's reliability could have a far-reaching effect. For example, besides the Tear-Down Site Mellman used two other comparables and the appraisers disagreed whether it was relevant that both of those comparables were sold in private sales to existing tenants. Mellman dismissed that fact as irrelevant. Transcript Feb. 13, 2004, pp. 18:5-19:11. Pynes disagreed sharply:

> [PYNES:] . . . as you'll find as we analyze Mr. Mellman's report that sometimes if you just use sales without having documented information, without having income information, without even knowing what interest is being purchased, that you can come to an incorrect conclusion. . . . For example, you've seen situations . . . where a tenant would be in with an option to purchase, where the purchase price was established maybe five years ahead of time, or a situation where there's a tenant in place and they have a very low lease rate, so in essence they have a leasehold interest. They have an interest in the property, and what they're buying and what's being reported is a sale that may be of the seller's leased fee position which may be heavily discounted because of a low lease that's already in place.

Transcript Feb. 13, 2004, pp. 87:7-12, 88:8-89:2.

Pynes then testified that in fact both of Mellman's comparables other than the Tear-Down Site were transactions in which a tenant under an existing lease purchased from the landlord, although like Mellman he could not find out the confidential financial details. Transcript Feb. 13, 2004, pp. 97:17-98:7.

We express no opinion whether Pynes or Mellman is correct. We simply hold that the bankruptcy court might have weighed the relative strengths of Mellman's and Pynes' opinions differently, and possibly reached a different result, had it recognized and considered Mellman's $300,000 mistake. Therefore, we cannot say that the bankruptcy court's error is immaterial.

V. CONCLUSION

Simply being an undersecured creditor is not enough by itself to establish a lack of adequate protection under Section 362(d)(1). The bankruptcy court made no finding that the Subject Property was declining in value or other factors such as a lack of hazard insurance that would establish a lack of adequate protection.

Nor do the excerpts of record adequately support the bankruptcy court's finding that Debtors lacked any equity in the Subject Property for purposes of Section 362(d)(1) or (2). The bankruptcy court made a clear error by not taking into account Mellman's $300,000 mistake and his refusal or inability to acknowledge that mistake. We cannot say that this error was immaterial to the bankruptcy court's valuation of the Subject Property. The relative weights of the two appraisers' opinions were critical to the bankruptcy court's valuation of the Subject Property, and if the bankruptcy court had recognized Mellman's $300,000 mistake it might have been persuaded to accept Pynes' $700,000 valuation or something closer to it.

Accordingly, the bankruptcy court's order granting Kest relief from the automatic stay is REVERSED and REMANDED.