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NOT FOR PUBLICATION

HAROLD S. MARENUS, CLERK
U.S. BKCY. APP. PANEL
OF THE NINTH CIRCUIT

UNITED STATES BANKRUPTCY APPELLATE PANEL
OF THE NINTH CIRCUIT

| | | | |
|--------------------------|---|---------------------------------------|------------------|
| In re |) | BAP No. | CC-04-1261-MoPMA |
| |) | | |
| SHAHRIAR DARGAHI and, |) | Bk. No. | SV 03-15884-AG |
| NAZILA ADELI-NADJAFI, |) | | |
| |) | | |
| Debtors. |) | | |
| |) | | |
| _____ |) | | |
| |) | | |
| SHAHRIAR DARGAHI and, |) | | |
| NAZILA ADELI-NADJAFI, |) | | |
| |) | | |
| Appellants, |) | | |
| |) | | |
| v. |) | <u>MEMORANDUM</u> ¹ | |
| |) | | |
| KENT INVESTMENT COMPANY, |) | | |
| |) | | |
| Appellee. |) | | |
| _____ |) | | |

Argued on March 23, 2005
at Pasadena, California

Submitted on December 15, 2005²

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.

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.

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

7 Debtors and Kest could not resolve their disputes, Kest
8 commenced foreclosure proceedings, and Debtors filed their
9 voluntary Chapter 11 petition on July 14, 2003 (the "Petition
10 Date"). On October 30, 2003, Kest filed a motion for relief from
11 the automatic stay (the "Motion") alleging that (a) Kest's
12 interest in the Subject Property is not adequately protected and
13 alternatively (b) Debtors have no equity in the Subject Property
14 and it is not necessary for an effective reorganization. The
15 Motion alleges that the fair market value of the Subject Property
16 is \$439,000.00 as of October 10, 2003, based on an appraisal
17 prepared by Donald L. Mellman ("Mellman"). This was later reduced
18 to \$409,000.00 based on the parties' stipulation that remaining
19 environmental remediation would cost \$30,000.00. Transcript Mar.
20 29, 2004, p. 107:11-13.

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

1 The matter was tried over four days in February and March,
2 2004. The trial was a classic battle of appraisers with
3 additional disputes regarding the accuracy of Debtors' financial
4 records and projections.

5 Both appraisers would have preferred to use an income
6 valuation approach but apparently Debtor had not maintained
7 adequate records of income and expenses. Transcript Feb. 13,
8 2004, pp. 33:20-22 and 86:4-21. Both appraisers therefore focused
9 on a sales comparison approach.⁴

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

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

26
27 ⁴ Pynes also included a cost approach and a capitalization
28 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.

1 as being next to a highway, for example, might increase traffic
2 and thereby affect volume. Transcript Feb. 13, 2004, pp. 94:19-
3 95:25. He adjusted up or down by multipliers to account for a
4 high or low volume at the particular location as compared with
5 Debtors' volume, location, and other factors.

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

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

18 CONCLUSIONS OF LAW

19 * * *

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

23 As an alternative basis for granting relief from the
24 automatic stay the Decision states that "Debtors do not have any
25 equity in the Subject Property" and "the Subject Property is not
26

27 ⁵ The bankruptcy court presumably meant to reverse these
28 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).

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

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

8 II. ISSUES

9 A. Did the bankruptcy court apply the wrong legal standard
10 to determine a lack of adequate protection under Section
11 362(d) (1)?

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

15 III. STANDARDS OF REVIEW

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

18
19 ⁶ Debtors also argue that the debt to Kest is disputed and
20 should be discounted, that Debtor's testimony should have been
21 believed, and that there is a reasonable possibility of a
22 successful reorganization within a reasonable time. We reject
23 these arguments.

24 Kest is correct that its proof of claim is prima facie
25 evidence of the amount of the debt. 11 U.S.C. § 502(a). Debtors
26 have alleged some Reimbursement Claims that might be setoffs to
27 this debt but they introduced no evidence to support those claims
28 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.

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

15 IV. DISCUSSION

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

20 Section 362(d) provides, in relevant part:

21 (d) On request of a party in interest and after
22 notice and a hearing, the court shall grant relief
23 from the stay provided under subsection (a) of this
24 section, such as by terminating, annulling,
25 modifying, or conditioning such stay --

26 (1) for cause, including the lack of adequate
27 protection of an interest in property of such
28 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

1 (B) such property is not necessary to an
2 effective reorganization

3 11 U.S.C. § 362(d)(1) and (2).

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

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

11 (g) In any hearing under subsection (d) or (e) of
12 this section concerning relief from the stay of any
act under subsection (a) of this section --

13 (1) the party requesting such relief has the
14 burden of proof on the issue of the debtor's
equity in property; and

15 (2) the party opposing such relief has the burden
16 of proof on all other issues.

17 11 U.S.C. § 362(g).

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

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

1 U.S.C. § 362(d)(1)"). Nor did the bankruptcy court find any other
2 basis for concluding that Kest lacked adequate protection, such as
3 declining value of the Subject Property or a lack of insurance.
4 Compare id. at 370 ("if the apartment project in this case had
5 been declining in value petitioner would have been entitled, under
6 § 362(d)(1), to cash payments or additional security in the amount
7 of the decline"). Therefore, the bankruptcy court's conclusion
8 that Kest lacks adequate protection is not supported.

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

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

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

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

27 1. Mellman's mistake

28 Mellman testified that the purchaser of the Tear-Down Site

1 would have to incur a net expense of \$150,000 more than he would
2 ever recover on a future resale (the "Unrecoverable Costs") in
3 order to make that gas station operable. Mellman compared this
4 expense to his own unrecoverable costs in improving his kitchen,
5 for which he spent \$22,000 but which "probably added only \$5,000
6 to the value of my house." Transcript Feb. 10, 2004, pp. 176:24-
7 177:3. In other words, the Unrecoverable Cost to the purchaser to
8 make the Tear-Down Site operable was \$150,000 more than the Tear-
9 Down Site's sales price, not \$150,000 less.

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

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1 SALE #3: SALES PRICE: \$532,000.00

2 ADJUSTMENTS:

3 Land size, 9,420 SF @

4 \$10 SF, irregular: -\$94,200

5 Gas pumps & islands: -0-

6 Diesel pumps, 7% +\$37,200

7 Location, **inferior**

8 traffic count:(20%) +\$106,400

9 Improvements, replace

10 cost per ALSAL:

11 [the **Unrecoverable Costs,**

12 **also inferior**] -\$150,000

13 TOTAL: -\$100,600.00

14 ADJUSTED VALUE SUBJECT: \$431,400.00

15 SAY: \$431,500.00

[Emphasis added.]

11 Mellman denied that there was any mistake on cross
12 examination:

13 [DEBTOR'S ATTORNEY:] [W]hen you did the analysis of
14 comparing that sale [of the Tear-Down Site] to my
15 client's sale [sic], didn't you, in fact, subtract
16 \$150,000 . . . ?

17 [MELLMAN:] Yes.

18 [DEBTOR'S ATTORNEY:] Why would you decrease the
19 value of my client's property from one that is
20 inoperable and vacant at the time of its sale?

21 [MELLMAN:] . . . I went ahead with good reason and
22 I took 150,000 off the price based on the fact that
23 they had to come in and do work, and they did, they
24 changed brands. As I explained to you, when I did my
25 kitchen on my house, though, it only -- the
26 recoverable on that was 20 to 30 percent of what I
27 spent. So based on my experience over 50 years, I
28 deducted \$150,000 from this purchase price, and that
29 gave me equivalent of the subject.

30 [DEBTOR'S ATTORNEY:] I'm totally lost.

31 [MELLMAN:] Well, I can understand, because you're
32 not experienced in this.

33 [DEBTOR'S ATTORNEY:] . . . [N]o. I'm fully lost at
34 your explanation. The property sold for \$532,000,
35 correct?

36 [MELLMAN:] Right.

37 [DEBTOR'S ATTORNEY:] At that time it was vacant. It

1 was inoperable.

2 [MELLMAN:] Right.

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

5 [MELLMAN:] Right.

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

9 [MELLMAN:] Of the comparable.

10 [DEBTOR'S ATTORNEY:] Right.

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

14 * * *

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

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

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

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

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

23 In rebuttal testimony Mellman changed his explanation.

24 Instead of repeating that the Tear-Down Site had to be "upgraded
25 to the point where it was comparable to the subject" he testified
26 that he "deducted [\$]150,000 from this tear-down site" because the
27 Tear-Down Site had more value "in relation to a vacant site."

28 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

1 the Subject Property, which is occupied, has all of its permits,
2 and is fully operable. Adding instead of subtracting Mellman's
3 \$150,000 estimate of the Unrecoverable Costs, the adjusted value
4 of the Subject Property based on the Tear-Down Site should be
5 \$731,500, not \$431,500.

6 On this appeal Kest's attorney argues that Debtors' attorney
7 has confused "bare land" with the vacant gas station on the Tear-
8 Down Site, and the latter is more valuable because it already had
9 a conditional use permit for a gas station. Transcript Feb. 13,
10 2004, p. 24:18-23. We assume without deciding that this
11 distinction is accurate, but this issue has nothing to do with
12 Mellman's \$300,000 mistake.

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

19 2. The error is material

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

23 Mellman calculated the value of the Subject Property by
24 taking the mathematical average of his three comparables --
25 \$443,000, \$441,500, and \$431,500 -- and rounding the result to
26 \$439,000. Mellman noted that "this estimate of value must be
27 adjusted for the cost of clearing the contamination," which the
28 parties later stipulated to be \$30,000. Based explicitly on

1 Mellman's appraisal the bankruptcy court found that "the Subject
2 Property had a fair market value on the Petition Date of
3 \$409,000." If Mellman had valued the Tear-Down Site at \$731,500,
4 consistent with the proper application of his own methodology,
5 then the mathematical valuation of the Subject Property would be
6 approximately \$509,000 ($\$443,000 + \$441,500 + 731,500 =$
7 $\$1,616,000$, divided by 3 = $\$538,667$, minus $\$30,000 = \$508,667$).
8 This is \$100,000 more than the valuation that the bankruptcy court
9 accepted.

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

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

1 alia, Daubert v. Merrell Dow Pharmaceuticals, Inc., 509 U.S. 579
2 (1993)). See also Kumho Tire Co., Ltd. v. Carmichael, 526 U.S.
3 137 (1999) (applying Daubert to non-scientific experts).

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

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

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

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

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

7 **V. CONCLUSION**

8 Simply being an undersecured creditor is not enough by itself
9 to establish a lack of adequate protection under Section
10 362(d)(1). The bankruptcy court made no finding that the Subject
11 Property was declining in value or other factors such as a lack of
12 hazard insurance that would establish a lack of adequate
13 protection.

14 Nor do the excerpts of record adequately support the
15 bankruptcy court's finding that Debtors lacked any equity in the
16 Subject Property for purposes of Section 362(d)(1) or (2). The
17 bankruptcy court made a clear error by not taking into account
18 Mellman's \$300,000 mistake and his refusal or inability to
19 acknowledge that mistake. We cannot say that this error was
20 immaterial to the bankruptcy court's valuation of the Subject
21 Property. The relative weights of the two appraisers' opinions
22 were critical to the bankruptcy court's valuation of the Subject
23 Property, and if the bankruptcy court had recognized Mellman's
24 \$300,000 mistake it might have been persuaded to accept Pynes'
25 \$700,000 valuation or something closer to it.

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

28