

In the United States Bankruptcy Court

for the Northern District of Iowa

DONOVAN MOTORS INC.

Debtor(s).

Bankruptcy No. X91-00232F

Chapter 11

DONOVAN MOTORS INC.

Plaintiff(s)

Adversary No. X91-0022F

vs.

EMMET COUNTY STATE BANK

Defendant(s)

MEMORANDUM OF DECISION AND ORDER RE: TEMPORARY INJUNCTION

Donovan Motors, Inc. (DEBTOR) seeks a court order enjoining Emmet County State Bank (BANK) from pursuing a state court lawsuit against the personal guarantors of debtor's debt to Bank. Trial was held on May 28, 1991 in Sioux City, Iowa. The court now issues its findings of fact and conclusions of law as required by Fed. R.Bankr. P. 7052. This is a core proceeding under 28 U.S.C. § 157(b) (2) (a).

I.

Donovan Motors, Inc. filed its voluntary chapter 11 petition on February 7, 1991. Patrick J. Donovan and Edwin J. Donovan, Patrick's father, are the sole shareholders of the debtor. Patrick J. Donovan and his wife, Patricia, and Edwin J. Donovan and his wife, Loretta, have guaranteed debtor's indebtedness to Bank. At the time of the trial, that indebtedness was approximately \$450,000.00. Bank claims a security interest in personal property assets of the debtor. There is a dispute between Bank and Chrysler Credit Corporation (CHRYSLER), another secured creditor, as to the priority of their interests in such property. Bank President James Currell testified that if Chrysler prevails in that dispute, the assets of the debtor in which Bank holds an apparently undisputed first priority security interest would be valued, in his opinion, at \$50,000.00 or less. Patrick and Edwin Donovan and their wives have guaranteed corporate indebtedness also to Chrysler and Ford Motor Credit (FORD).

Sometime prior to the filing of the bankruptcy, upon the demand or request of Chrysler, Patrick Donovan granted Chrysler mortgages on several parcels of business real estate owned by his wife and him. Prior mortgages on these properties aggregate no more than approximately \$54,000.00. Chrysler shored up its secured position considerably by obtaining such mortgages. Donovan says he was induced into executing the mortgages by Chrysler's verbal agreement to continue its financing of the debtor. Donovan now disputes Chrysler's lien. Donovan is willing to forego this dispute and accede to the validity of Chrysler's liens against the real estate as part of debtor's plan.

In order to bolster the secured positions of Ford and Emmet County State Bank, both of which may be undersecured, Edwin is willing, as part of a reorganization plan, to grant these creditors mortgages on real estate owned by him individually. Edwin is willing to grant Bank a mortgage on an 80-acre farm and a lake home at Lake Okoboji, Iowa. He is willing also to grant Ford a mortgage on Donovan's main garage location in Estherville. It is leased by him to the debtor.

Plan elements currently under consideration by Patrick and Edwin Donovan include paying Chrysler, Ford and Bank, its three main secured creditors, in full over time. Donovans also intend that the debtor propose paying unsecured creditors

100 per cent of their allowed claims. They propose no use of their own property, real or personal, for the payment of the unsecured claims. The plan presently under consideration by Donovans was introduced into evidence as part of a disclosure statement. This plan is apparently unworkable because it contemplates a continuing line of credit from Bank which Bank is unable to provide because of state law lending limitations.

Patrick Donovan has been president of Donovan Motors for the past 19 years. He is involved in the day-to-day operations of the debtor. His father is also involved with the business but to a much lesser extent. He is semi-retired and is receiving social Security income benefits. However, he does work at Donovan Motors fulfilling duties which include public relations. Neither Patricia or Loretta Donovan are involved in the operation of the business.

Patricia Donovan recently sold a lake front property at Lake Okoboji which she was purchasing on contract. The sale price exceeded the amount unpaid on the contract. The sale took place approximately April 30, 1991.

Debtor has hired a financial adviser and accountant and intends to hire a comptroller to help with the internal business reorganization of the company, dividing it into divisions and departments. According to Patrick Donovan, the company has slashed its operating expenses and plans more cuts. Donoran believes that car sales projections are realistic, and a reorganization can succeed. He understands the inability of Bank to lend an amount exceeding its limits and is searching for other sources of financing. None have yet been found.

Prior to the filing of the bankruptcy case, Bank had initiated suit in Iowa District Court for Emmet County on its claim against Donovan and the four guarantors. Although the action against debtor has been stayed, Bank has continued its action against the guarantors and has filed a motion for summary judgment. The motion has been resisted. Patricia and Loretta Donovan have raised defenses and a counterclaim under the Equal Credit Opportunity Act. The motion for Summary Judgment has been argued; it is currently under submission to the state court judge.

II.

Debtor asks this court to enjoin Bank from continuing its action against the guarantors for a period of 240 days from filing of the chapter 11 case. This would stay Bank's action until October 5, 1991, and according to debtor, would give it time to propose, modify, and obtain confirmation of a plan of reorganization. Debtor says that failure to stay Bank's suit would have an adverse impact on its ability to reorganize. Debtor predicts that the three main secured creditors, all uncertain of being fully secured, would engage in a litigation scramble against the guarantors to assure payment in full of their claims. All three of these major creditors have obtained guarantees from the four family members. More particularly, debtor contends that if Bank obtains a judgment, Chrysler and Ford would need to compete for similar positions against the guarantor's assets, making it more difficult for guarantors to aid in the reorganization.

Debtor seeks an injunction pursuant to 11 U.S.C. § 105. Counsel for the debtor states to the court that upon conversation with Edwin and Patrick Donovan, the four guarantors would be willing to consent to the conditioning of any injunction with a prohibition of their voluntary transfer, alienation or encumbrance of their properties.

Bank contends that the burden for obtaining a stay of actions against co-debtors is a heavy one, and that debtor has failed to meet it. Bank also claims that if it is prevented from pursuing the guarantors and their properties, there is no assurance that it will not be prejudiced by actions of other creditors seeking to encumber the properties.

This court may enjoin state court proceedings by Bank against guarantors upon a clear showing that the continuation of those state court proceedings would have a substantial and adverse impact upon the debtor's ability to reorganize. River Family Farms, Inc. v. Federal Land Bank of Omaha (In re River Family Farms, Inc.), 85 B.R. 816, 819 (Bankr. N.D. Iowa 1987).

In determining whether an injunction should issue, the court must consider the following factors: (1) the threat of irreparable harm to debtor if the injunction does not issue; (2) likelihood of success of debtor's reorganization; and (3) the harm to the party sought to be enjoined. This harm must be balanced against the potential harm to the debtor. Otero Mills, Inc. v. Security Bank & Trust (In re Otero Mills, Inc.), 21 B.R. 777, 779 (Bankr. D. N.M. 1982) *aff'd*, 25 B.R. 1018 (D.C.N.M. 1982). See also, Dataphase Systems, Inc. v. CL Systems, Inc., 640 F.2d 109, 113 (Sth Cir. 1981).

It has been held that as to the threat of irreparable harm, the "debtor must show that the creditor is not pursuing its legitimate right to collect on its judgment from the guarantors, but is using the action to unduly pressure the debtor. (Citation omitted.) It is not enough to merely allege that the action against the third party will adversely affect the debtor." River Family Farms, Inc. v. Federal Land Bank of Omaha (In re River Family Farms, Inc.), 85 B.R. 816, 819 (Bankr. N.D. Iowa 1987).

III.

It appears that the debtor's ability to reach a negotiated plan settlement with each of its main secured creditors, Chrysler, Ford and Bank, may depend on debtors satisfying each of those creditors that it is fully secured or that its interests are adequately protected. The plan proposes to pay each of these secured creditors in full. However, in order to shore up the secured positions of each of these creditors, it has been or will be necessary for the shareholders, Patrick and Edwin Donovan, and for their spouses to contribute their interests in personally owned real property as security for corporate debt. Debtor contends that if Bank obtains a judgment lien against these individually owned properties, it will be much more difficult for the debtor and the shareholders to structure a plan satisfying each of the secured creditors. This is much less the case with Chrysler which shored up its secured position by obtaining mortgages on individually owned real estate prior to the bankruptcy case. However, debtor argues that Chrysler may also take action against the guarantors if Bank obtains even a junior position to Chrysler's mortgage. This is because of a priority dispute between Bank and Chrysler and because of Patrick Donovan's contention that Chrysler obtained the mortgages on the personally owned real estate by misrepresentations regarding future financing of the debtor. Thus, the motive for the debtor in obtaining the stay is to prevent Bank from obtaining a lien on personally owned real estate which could be used to obtain a confirmed plan. Inability to structure a plan is the factual basis for a showing of irreparable harm.

Bank, on the other hand, wishes to proceed with the state court action to bolster a security position that is disputed by Chrysler and which may be seriously undersecured. The court can find nothing in the evidence to impute to the Bank an improper motive in proceeding against the guarantors. Clear potential for harm exists if the injunction is granted. If the court enjoins the Bank from further proceedings in state court for an extended period of time, Bank could lose valuable time in liquidating and satisfying any valid claim it may have against the guarantors. To the extent the state court motion for summary judgment is overruled, a long period of discovery and litigation may face Bank. Other creditors of the guarantors might obtain positions prior to Bank on the real estate in question. Although the guarantors are willing to be bound by conditions of the injunction preventing the voluntary transfer or encumbrance of their land, they cannot necessarily prevent involuntary encumbrances which could be established prior to any judgment in favor of Bank. The court cannot completely control or reduce this risk because of the timing differences that may exist between the Bank's litigation and any actions by third parties.

The court finds the threatened harm to the debtor and the potential harm to the Bank to be very closely balanced. The potential harm to the debtor's reorganization opportunity cannot be easily resolved absent the granting of the injunction. However, the potential harm to the Bank can be diminished by limiting the terms of any injunction. Because the court can fashion an injunction in narrow terms, the balance of harm weighs in favor of the debtor. At this relatively early stage of the proceedings, the court finds, based upon Donovan's testimony and the debtor's exhibits, that there is a likelihood of a successful reorganization sufficient to warrant an injunction order. The court does not consider the public interest test to be a significant factor in the court's decision.

IV.

This is a core proceeding under 28 U.S.C. § 157(b) (2)(A). The court has jurisdiction to enter an injunction pursuant to 11 U.S.C. § 105. An injunction should issue pursuant to 11 U.S.C. § 105 but only for a reasonable time and with reasonable limitations as to what activity is enjoined. The motion for summary judgment has already been process. Whatever his order on that motion, it should not affect the ability of the debtor to reorganize so long as judgment itself does not enter. If the motion for summary judgment is overruled, Bank should be entitled to pursue discovery and engage in trial.. The court cannot find, based on the evidence, that Bank's proceeding with discovery or trying its action would be detrimental to the debtor's ability to reorganize. Based on the arguments of debtor and the evidence, the only detrimental effect of Bank's continuing with its state court action is an entry of judgment which would become a lien against the property of the guarantors. The court concludes that debtor has made a sufficient showing to obtain an

injunction preventing the entry of judgment against the guarantors. However, debtor has failed to make a sufficient showing that Bank should be enjoined from pursuing its litigation against the guarantors up to but not including the entry of judgment.

Bank expressed concern at trial regarding the guarantors' ability to alienate or encumber their properties while an injunction prevents Bank's civil action. As the court also expressed concern over this prospect, counsel for the debtor informed the court that the guarantors would be willing to submit to restrictions preventing the sale, alienation, conveyance or voluntary encumbrance of property during the pendency of an injunction. Because of the limited scope of this injunction, such restrictions at this time should not be necessary. Bank is not prevented from pursuing discovery and trial if the motion for summary judgment is not granted. If the motion is granted, or if Bank obtains a verdict or decision after trial within the period of this injunction, Bank may seek immediate modification of the injunction to restrict guarantor's ability to transfer or encumber property in order to continue the injunction in effect. Hearing on any motion to modify filed by debtor or Bank will be heard on an expedited basis. In the meantime, because Bank may continue its action in state court with the exception only that judgment may not enter against the guarantors. Present restrictions on alienation will not be required. However, to the extent that Bank believes grounds may exist for a state court attachment pursuant to Iowa Code § § 639.2 and 639.3, it may seek modification of this injunction to pursue such remedy. The period of this injunction shall be to and including September 3, 1991.

ORDER

IT IS ORDERED that the Iowa District Court in and for Emmet County is hereby enjoined from entering judgment in favor of Emmet County State Bank and against Patrick J. Donovan, Patricia S. Donovan, Edwin J. Donovan and Loretta V. Donovan in Equity No. 14642. This injunction shall remain in effect to and including September 3, 1991 unless this injunction is modified or dissolved by this court. Judgment shall enter accordingly.

SO ORDERED ON THIS 10th DAY OF JUNE, 1991.

William L. Edmonds
Chief Bankruptcy Judge