UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH DAKOTA
Northern Division

In re: JUNIOR SEBASTION HAMMRICH, Social Security No. 503-46-4094 and JOYCE MARIE HAMMRICH, Social Security No. 504-60-9253 Debtors.	Bankr. Case No. 87-10032 Chapter 12 MEMORANDUM OF DECISION RE: OBJECTIONS TO DEBTORS' DISCHARGE

The matter before the Court is Debtors' discharge and the objections thereto. This is a core proceeding under 28 U.S.C. § 157(b)(2). This Memorandum and accompanying Order shall constitute findings and conclusions under F.R.Bankr.P. 7052.

I.

Debtors Junior S. and Joyce M. Hammrich filed a Chapter 12 petition on January 26, 1987.[1] A confirmation Order was entered September 26, 1989. Debtors' plan, as modified by the confirmation order, recognized Debtors had $221,313.20 in undersecured claims and $44,169.31 in unsecured claims. Debtors offered these claim

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[1] In their schedules filed February 17, 1987, Debtors stated they had unsecured claims that totaled $45,169.31 and undersecured claims that totaled $521,546.78. Debtors stated their present livestock inventory included:

275 calves, 400 lbs. each at $280.00/head	$ 77,000.00
260 yearlings, 800 lbs. each at $.59/lb.	122,720.00
21 bulls, $500.00/head	10,500.00
260 cows, $400.00/head	104,000.00
43 "FmHA" cows, $400.00/head	17,200.00
4 "FmHA" yearlings, 800 lbs each at $.59/lb.	1,888.00
36 open cows at $300.00/head	10,800.00
Total:	$344,108.00

holders disposable income from the effective date of the plan (ten days after the confirmation order became non appealable or October 17, 1989) through January 1, 1993. The confirmed plan stated Debtors had livestock or proceeds totaling $383,894.31, machinery valued at $131,525.00, and vehicles valued at $26,470.00.

Debtors filed their final report and account on March 11, 1993. The final report contained a summary of plan payments, annual reports for 1990, 1991, and 1992, and some income tax returns.

Trustee A. Thomas Pokela filed an objection to discharge on March 12, 1993 and sought a disposable income determination. Farm Credit Bank of Omaha (FCBO) also sought a disposable income determination through an objection filed April 8, 1993. After some delays while the parties attempted to resolve the objections, an evidentiary hearing was held October 20, 1993. Appearances included William J. Pfeiffer for Debtors and Trustee Pokela. After receipt of testimony and exhibits, the Court ruled from the bench that Debtors' post-confirmation farming arrangement with their son Tom had not depleted the estate of disposable income. The Court directed the parties to submit their final arguments on remaining issues in writing. The Court specifically instructed counsel to identify any necessary corrections to or alleged errors in Debtors' Exhibit B or Trustee's Exhibit 6. The Court also directed the parties to state the value of Debtors' cattle inventory on December 31, 1992 and to identify the cattle by age, sex, and purpose (breeding or market), and to state which animals would be sold in 1993. Animals to be sold were to be identified by weight, if possible.

Based on Debtors' original Exhibit A and footnotes, the Court calculates Debtors' 1992 year-end livestock inventory was:

203 bred cows at $700.00 a head	$142,100.00
24 cows at $504.37 a head	12,104.88
32 bulls at $1,000.00 a head	32,000.00
9 bulls at $1,391.44 a head	12,522.96
326 calves at $475.00 a head	154,850.00
130 calves at $675.56 a head	87,822.80
Total value of livestock on January 1, 1993:	$441,400.64

In their final argument, Debtors set forth their average income and expenditures during the disposable income period and their present inventory of livestock (breeding herd and marketable calves). They argued that all 1992 year-end cash and marketable livestock were needed to meet year-end 1992 expenses and projected 1993 expenses. According to Debtors' final argument, their 1992 year-end inventory was:

130 calves at $675.56 a head	$ 87,824.00
9 bulls at $1,391.44 a head	12,523.00
24 cows at $504.37 a head	12,105.00
203 [bred] cows at $700.00 a head	142,100.00
29 bulls at $1,000.00 a head	29,000.00
326 calves at $380.00 a head	123,880.00
Total value of livestock on January 1, 1993:	$407,432.00

Debtors discounted the value of their calves to allow for weight gains between year-end 1992 and March 23, 1993, when FmHA took an inventory.

Trustee Pokela argued Debtors owe $189,236.00 in disposable income. He states Debtors' Exhibit B should be amended to provide that the value of Debtors' marketable livestock is $363,929.00, the value of Debtors' Co-op stock is $16,000.00, and the value of Debtors' Jalmar Corporation stock is $4,850.00. He further argues these assets should be recognized as liquid assets. Trustee Pokela also argues that Debtors' current obligations should *not* include 1992 real estate taxes due in 1993. Finally, Trustee Pokela argues Debtors' current obligations should include an interest only payment of $4,120.00 to Nathan Schaull that was due at the end of 1992 and that no $800.00 exemption should be allowed against Debtors' cash reserve of $30,000.00.

On February 16, 1994, the Court notified counsel by letter that attachments which were referenced in Debtors' annual reports were missing and asked them to supply this information. Trustee Pokela supplied some documents to the Court but they were not accepted because the information requested was not explicitly set forth and because Attorney Pfeiffer had not had an opportunity to review them A telephonic hearing on the matter was held March 2, 1994. In response, Debtors provided on March 3, 1994 a summary of the cost of livestock purchased in 1990, 1991, and 1992. These numbers differed from those presented in Debtors' final argument and so have not been relied upon herein.

II.

Disposable income is the difference between available income and necessary expenses during the disposable income payment period. 11 U.S.C. § 1225(b)(2). Available income includes all non exempt funds. It is not limited to income as defined by the federal tax laws. *In re Martin*, 130 B.R. 951, 964-66 (Bankr. N.D. Iowa 1991). Necessary expenses are those "reasonably necessary . . . for the maintenance or support of the debtor [and his family]" or "the continuation, preservation, and operation of the debtor's business." *Id.* The disposable income payment period begins on the date that the first payment is due under the plan and ends three years later or longer, if the term of the plan has been extended. 11 U.S.C. § 1225(b)(1)(B).

If a creditor or the trustee successfully argues that a Chapter 12 debtor has not paid all disposable income due under the plan, the debtor may not receive a discharge. 11 U.S.C. § 1228(a). The debtor has the ultimate burden of persuasion to show that all payments under the plan have been made, including payments of disposable income. *In re Kuhlman*, 118 B.R. 731, 738 (Bankr. D.S.D. 1990). Further,

> [w]hen a determination of disposable income is presented to the Court as a contested matter, each case must be examined upon the evidence presented. The Court will determine under the totality of the circumstances whether the debtor's expenses were reasonably necessary for family support and continuation, preservation, and operation of the farm, as required by § 1225(b)(2). Factors the Court may consider include the amount of and reason for any variance in a debtor's actual income and expenses from those projected in the plan, the debtor's past borrowing practices, the availability of credit, and

the necessity of any capital improvement.

Id. at 739.

In most Chapter 12 cases in which discharge is contested due to a debtor's alleged failure to pay disposable income, four questions need to be answered. First, what was the disposable income payment period? Second, what was the debtor's available income at the commencement of, during, and at the end of that disposable income payment period, including the value of unsold but marketable farm commodities? Third, what were the debtor's *necessary* expenses during that period? Fourth, what amount of income, if any, may be retained by the debtor as "reasonably necessary . . . for the maintenance or support of the debtor [and his family]" or "the continuation, preservation, and operation of the debtor's business" as permitted by § 1225(b)(2)? *In re Schmidt*, 145 B.R. 983, 987 (Bankr. D.S.D. 1991); *In re Broken Bow Ranch, Inc.*, Bankr. No. 87-30137, slip op. (Bankr. D.S.D. January 13, 1993)(findings and conclusions entered on the record January 8, 1993), *aff'd, Broken Bow Ranch v. United States (In re Broken Bow Ranch, Inc.)*, Civ. No. 93-3016, slip op. (D.S.D. June 9, 1993), *appeal pending, Broken Bow Ranch v. Farmers Home Administration (In re Broken Bow Ranch, Inc.)*, Civ. No. 93-2895 (8th Cir.). The debtor's disposable income is then the difference between the debtor's available income less the debtor's necessary expenses during the disposable income payment period and the funds necessary for the continuation of the business.

III.

Based on the evidence presented and the final arguments filed by each party, the Court concludes that Debtors have not made all disposable income available to unsecured creditors and, therefore, are not entitled to a discharge at this time. This conclusion is reached by answering the four questions first espoused in *Schmidt*, 145 B.R. at 987.

A. *The disposable income repayment period is October 17, 1989 to January 1, 1993 as provided in Debtors' confirmed plan.* The parties are in agreement on this issue.

B. *Debtors' available income throughout the disposable income repayment period was $1,259,077.00.* This figure was provided in Debtors' final argument and corresponds with Debtors' annual reports.[2] Trustee Pokela has not disputed this figure.

C. *Debtors have <u>not</u> shown that all business expenses incurred during the disposable income repayment term were necessary.* According to the figures presented in their final argument, Debtors had $506,957.00 in operating expenses in 1990, 1991, and 1992. In addition, they purchased cattle at a cost of $456,953.00.[3] Living

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[2] Debtors' tax returns for 1990, 1991, and 1992 indicate Debtors' income was $1,202,609.00 (excluding depreciation).

[3] On page 3 of their final argument, Debtors state they spent $373,377.00 to purchase cattle in 1990, 1991, and 1992. On page 4 of their final argument. Debtors stated they spent $456,953.00 for livestock. The latter number is used in this Memorandum because it is closer to the figure of $430,782.00 that Debtors reported on March 2, 1994.

expenses were reported at $18,000.00 per year.[4] Plan and mortgage payments totaled $319,639.00. Total expenses were $1,337,549.00.

Thus, Debtors' expenses exceeded income by $78,472.00 ($1,259.077.00 less $1,337,549.00). When their ending cash balance of $29,200.00 is added,[5] Debtors' records show they lost $49,272.00 from 1990 through 1992 and that they apparently did not generate any disposable income. However, this conclusion, based solely on Debtors' bank balance, does not provide a true picture of Debtors' post-confirmation operation nor tell us clearly whether any disposable income was generated.

The conclusion that Debtors did not generate any disposable income post-confirmation is dimmed by the fact that Debtors' actual expenses exceeded their projected expenses by $444,906.64. This difference may be summarized as follows:

	Projected	*Actual*	*Difference*
Livestock Purchased	$135,000.00	$ 456,953.00	$321,953.00
Operating	312,000.00	506,957.00	194,957.00
Living	54,000.00	54,000.00	0.00
Plan/Mort. Payments	376,642.36	319,639.00	< 57,003.36>
Capital Expenditures	15,000.00	0.00	< 15,000.00>
Total:	$ 892,642.36	$1,337,549.00	$444,906.64

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4 No evidence of Debtors' actual living expenses was presented.

5 Debtors claimed exempt $800.00 in cash. No timely objection to that claim was made and, thus, it is allowed. F.R.Bankr.P. 4003(b); *Taylor v. Freeland & Kronz*, 112 S.Ct. 1644 (1992).

Although actual income also exceeded projections by $381,377.00, the net result from Debtors' expanded post-confirmation operation was a cash deficit. Thus, the Chapter 12 estate did not benefit from Debtors' increased expenditures for purchasing cattle and operating expenses.[6] Consequently, the Court is not satisfied that all post-confirmation expenditures were *necessary* as required by § 1225(b)(2)(B). Lacking evidence to the contrary, it appears the unsecured creditors involuntarily financed an expansion of Debtors' cattle feeding operation without remuneration.

The burden rests with Debtors to come forward and show that all post-confirmation expenses were necessary. Most important, Debtors will need to justify the expenditure of all operating funds over their plan projection of $172,000.00 per year. They will need to differentiate between operating expenses that were higher than projected because of inflation and operating expenses that increased because Debtors expanded their operation. Only with this evidence can the Court determine under the totality of the

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[6] If Debtors' projected expenses in their plan are compared to their actual expenses as reported in their annual reports, the difference increases to $765,276.64 as follows:

	Projected	*Actual*	*Difference*
Livestock Purchased	$135,000.00	$456,953.00	$321,953.00
Operating	312,000.00	792,426.00	480,426.00
Living	54,000.00	54,000.00	0.00
Plan/Mort. Payments	376,642.36	329,171.00	< 47,471.36>
Capital Expenditures	15,000.00	25,369.00	10,369.00
Total:	$892,642.36	$1,657,919.00	$765,276.64

The cost of cattle purchased in the "Actual" column was gleaned from Debtors' final argument because that figure was not readily available in Debtors' annual reports.

circumstances whether the Debtors' expenses during the disposable income period were reasonably necessary for family support and the continuation, preservation, and operation of the farm as required by § 1225(b)(2). *See Kuhlman*, 118 B.R. at 739.

If Debtors purchased the Co-op stock post-confirmation [it was not scheduled or included in Debtors' liquidation analysis], that expense will need to be justified. Further, Debtors must also show that they need to retain this asset post-discharge.

Unlike the Co-op stock, Debtors listed the Jalmar stock in their schedules. The Jalmar stock should have been included in Debtors' liquidation analysis with their plan but was not. Debtors' failure to include the Jalmar stock in their liquidation analysis was an objection that the Trustee should have raised at confirmation, not at discharge. Consequently, the only argument that the Trustee can make now regarding the Jalmar stock is that it is a liquid asset that may be recognized as available income. However, insufficient evidence regarding the nature and value of the Jalmar stock was presented at the October 22, 1993 hearing so the Court cannot reach that conclusion.

D. The income Debtor may retain as "reasonably necessary . . . for the maintenance or support of the debtor [and his family]" or "the continuation, preservation, and operation of the debtor's business" as permitted by § 1225(b)(2) has not been shown. In the "Revised Exhibit 'B'" of their final argument, Debtors stated they had liquid assets on January 1, 1993 of $141,652.00 consisting of $29,200.00 in cash and $112,452.00 in marketable livestock (130 calves at $675.56 per head, 9 bulls at $1,391.44 per head, and 24 cull cows at $504.37 per head). Remaining livestock would include Debtors' base herd of 203 bred cows valued at $700.00 each or $142,100.00, 29 bulls valued at $1,000.00 each [more than enough to service Debtors' herd], and 326 calves to be marketed later in the year with a January 1, 1993 value of $380.00 each or $123,880.00. Based on their confirmed plan and final argument, Debtors stated they had the following long-term, secured obligations on January 1, 1993:

School & Public Lands	$ 646.00	on April 1, 1993 (final payment)
FmHA	5,984.00	each Jan. 1, 1993 through 2005
First State Bank, Rosco	70,182.00	each Feb. 1, 1993 through 2005
Farm Credit Bank	26,000.00[7]	each Jan. 1, 1994 through 2014
Total:	$102,812.00	

In their final argument, Debtors stated they had the following current obligations on January 1, 1993:

Ipswich Farmers Elevator	$ 3,115.00
Ipswich Farmers Ampride	2,536.00
Repairs and Supplies	791.00
Veterinarian	228.00
1992 Rent to Mike Geditz	2,400.00
Utilities	573.00
Peterson Stack Moving	7,337.00
Total:	$16,980.00

[7] FCBO has a secured interest in three parcels of land. The longest repayment term is 25 years from 1989. A new interest rate for the remaining term of the repayment schedule was to be determined January 1, 1992. That interest rate and a detailed repayment schedule of FCBO's secured claim was not been provided to the Court. Debtors state in their final argument that $26,000.00 was owed to FCBO at the end of the 1993 (due January 1, 1994) and that figure is used here.

Debtors' liquid assets on January 1, 1993 of $141,652.00 were sufficient to pay Debtors' 1992 year-end obligations *and* their long term obligations for 1993 and still leave a disposable income balance of $21,860.00 ($141,652.00 in liquid assets less $16,980.00 for 1992 year-end obligations and $102,812.00 for 1993 long-term obligations for a disposable income balance of $21,860.00). Further, Debtors would still possess 326 marketable calves with a January 1, 1993 value of $123,880.00, which should adequately meet projected annual operating and living expenses for 1993 of $172,000.00 when sold later in the year.[8] Moreover, if the calves marketed in 1993 are sold for more than $172,000.00, any excess funds would be disposable income to add to the $21,860.00 in disposable income identified above.[9]

Since the Court does not know the weight and price of the 326 calves when Debtors actually sold them in 1993, it cannot calculate what the maximum amount of disposable income might be. However, if these 326 calves were sold for $600.00, as an example, Debtors

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[8] Debtors will retain calves born in 1993 for sale in 1994 or later.

[9] These calculations assume Debtors' 1992 year-end marketable cattle numbers and values as stated in their final argument are correct. If the number of marketable calves on January 1, 1993 of 352 that the Court calculated is used [see page 2, *supra*], Debtors would have had more liquid assets on January 1, 1993 to meet projected operating and living expenses in 1993 and likely would have generated more disposable income. For example, if Debtors actually had 352 marketable calves and these calves were sold during 1993 for $600.00 each, Debtors would have received $211,200.00 in additional income. Disposable income from these calves would have been $39,200.00 ($211,200.00 less projected operating and living expenses of $172,000.00). Total disposable income would been $61,060.00 ($21,860.00 plus $39,200.00).

would have received $195,600.00 in income. Additional disposable income would have been another $23,600.00 ($195,600.00 in income less projected operating and living expenses of $172,000.00 equals $23,600.00). Total disposable income would have been $45,460.00 ($21,860.00 plus $23,600.00).

There is no evidence presently before the Court that would justify an allowance of additional carryover funds to permit Debtors to continue their farm operation on the scale they maintained from 1990 through 1992. Debtors stated in their plan that their farming operation was feasible with operating expenses of $172,000.00. Under § 1225(b)(2), Debtors are entitled to carry over the funds reasonably necessary to continue a *feasible* operation post-discharge, not an expanded operation. Debtors cannot expect the unsecured creditors to fund an expanded operation. If Debtors want to continue a background feeding operation that requires expenses in excess of what is needed for a feasible operation, they must seek outside financing. *Schmidt*, 145 B.R. at 991.

Trustee Pokela specifically argues Debtors should not be allowed carryover funds to pay all 1993 real estate taxes or to cover the entire loan repayment to Nathan Schaull. The Court agrees. Debtors' real estate taxes for 1992 may be paid in the normal course of business during 1993 and do not need to be considered a 1992 year-end expense. Further, the note with Nathan Schaull did not fix a repayment period. Therefore, the most that should be allowed as a 1992 year-end expense is an interest only payment of $12,480.00 for 1990, 1991, and 1992 (8% annual interest on $52,000.00 or $4,160.00 per year). The 1993 interest payment to Nathan Schaull of $4,160.00 can be made at year-end 1993 as one of Debtors' operating expenses.

An order will be entered denying Debtors a discharge without prejudice. A continued evidentiary hearing will be scheduled within sixty days. At that hearing, Debtors will need to present additional evidence to, first, justify their expenditure of operating funds during the disposable income period in excess of the $172,000.00 in annual expenses projected in their plan (this would include a justification for purchasing the Co-op stock if that purchase was made post-confirmation). While some increased expenses may be attributable to inflation, for example, higher feed costs or cattle prices, Debtors particularly must identify and justify all expenses attributable to an expansion of their operation. Second, Debtors must show what funds or marketable assets are needed as carryover to maintain a *feasible* operation. In answering this question, Debtors also may need to show that outside financing for their continued operation is not available.

The Court is as frustrated as counsel in trying to devise a less time consuming and expensive method of determining disposable income. This case had the advantage of above-average record-keeping by Debtors. Nonetheless, we are faced with the fact that Debtors' post-confirmation operation strayed afar from their plan projections. Consequently, we now must go back and analyze Debtors' deviations from their confirmed plan and determine whether those deviations were necessary.

This case is a good example of why Chapter 12 cases must be monitored closely during the plan term by the debtor's attorney, case trustee, and creditors to insure that the debtors are operating under the confines of their confirmed plan. The axiom that hindsight is 20/20 does not apply to Chapter 12 disposable income questions.

Dated this ___ day of May, 1994.

BY THE COURT:

Irvin N. Hoyt
Chief Bankruptcy Judge

ATTEST:

PATRICIA MERRITT, CLERK

By Shan O'Lea Hart
Deputy Clerk

(SEAL)

UNITED STATES BANKRUPTCY COURT ★ SEAL

NOTICE OF ENTRY
Pursuant to BR 9022
Entered on Docket MAY 11 1994
Date Mailed MAY 11 1994 By:

CERTIFICATE OF SERVICE
I hereby certify that a copy of this document was mailed, hand delivered, or faxed this date to all parties in interest set forth on the attached service list.
Patricia Merritt, Bankruptcy Clerk
By: /s/ SHAN O'LEA HART
Date: MAY 11 1994

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