UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH DAKOTA
Southern Division

In re:	)	
	)	Bankr. Case No. 87-40157
LEONARD ALFRED ROWLEY	)	
Social Security No. 557-40-3085	)	Chapter 12
	)	
and	)	MEMORANDUM OF DECISION
	)	RE: DISPOSABLE INCOME
BEVERLY ANN ROWLEY	)	
Social Security No. 504-28-6329	)	
	)	
Debtors.	)	

The matter before the Court is a determination of the amount of disposable income, if any, that Debtors are obligated to pay unsecured creditors before they may receive a discharge under 11 U.S.C. § 1228(a). This is a core proceeding under 28 U.S.C. § 157(b)(2). This Memorandum of Decision and accompanying Order shall constitute the Court's findings and conclusions under F.R.Bankr.P. 7052. As set forth below, the Court concludes that Debtors must pay $183,231.23 in disposable income before a discharge may be entered under 11 U.S.C. § 1228(a).

I.

Debtors filed a Chapter 12 petition on March 16, 1987. A Chapter 12 plan was confirmed September 17, 1987.[1] On January 28,

[1] The confirmation order, entered by the Hon. Peder K. Ecker, described itself as "Provisional." However, a final confirmation order was never entered. Since the parties have not argued that Debtors have failed to comply with the plan, except for the payment of disposable income, and have not claimed that the "Provisional" confirmation order and related plan as confirmed are incomplete or inaccurate, the matter is moot. Accordingly, the Court will not enter a "final" confirmation order now, as the Trustee has requested, or penalize Debtors for this procedural miscue. Any party could have raised this issue any time over the nine-year life of this case.

227

1991, Debtors filed a Motion for § 1228(a) Discharge.[2] Trustee Rick A. Yarnall, the Farmers Home Administration (FmHA), and Production Credit Association (PCA) filed responses to the Motion. Shortly thereafter, Trustee Yarnall also commenced an adversary proceeding against Debtors seeking a determination of disposable income.[3] Legal questions, including whether Debtors were obligated to pay disposable income under the terms of their plan, ultimately were resolved on appeal. *See Yarnall v. Rowley (In re Rowley)*, 22 F.3d 190 (8th Cir. 1994). After the appellate decision, an evidentiary hearing by this Court was necessary to determine the amount of disposable income, if any, that Debtors must pay to receive a discharge.

After Debtors filed their final report and final account and, following delays for discovery and to allow Debtors to retain new counsel, an evidentiary hearing was held August 16 and 17, 1995. Appearances included John M. Wilka for Debtors, Trustee Yarnall, Assistant U.S. Attorney Craig P. Gaumer for FmHA (then the Rural Economic and Community Development Agency and now the Farm Service Agency), and Michael E. Ridgeway for PCA (now Production Credit Association of the Midlands). The parties filed several joint exhibits and each presented a calculation of disposable income. In their respective pre-hearing briefs, PCA argued disposable income

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[2]A review of disposable income is now determined pursuant to a motion to dismiss for failure to complete plan payments. Neither a motion for discharge by the Chapter 12 debtor nor an adversary complaint by a creditor or the trustee is required. *See* LBR 3072-1.

[3] *See supra* note 2.

was $260,260.00, FmHA argued it was $320,784.12, and Debtors conceded it was $14,307.00 ($11,413.00 for excess living expenses and $2,984.00 in excess cash).

Following the testimony of PCA Assistant Vice President Wayne Williamson, PCA argued disposable income was $225,504.00. FmHA and Trustee Yarnall continued to argue that the Court should take an equitable approach and determine disposable income based on Debtors' improved post-petition equity position.

Following adjournment on the first day and at the Court's request, Trustee Yarnall and counsel for FmHA and PCA reconciled differences in their numbers. Each also revised their disposable income calculation based on the day's testimony. These adjusted numbers and calculations were received the next day with closing arguments. For the most part, the parties did not dispute the numbers each used but disputed how those numbers should be factored into the disposable income calculation provided by 11 U.S.C. § 1225(b), *Broken Bow Ranch v. Farmers Home Administration (In re Broken Bow Ranch, Inc.)*, 33 F.3d 1005 (8th Cir. 1994), and earlier decisions by this Court. At the close of evidence, PCA argued Debtors owed disposable income of $149,615.00. FmHA argued Debtors owed $154,366.12. Trustee Yarnall urged that equitable principles and the "totality of the circumstances" dictated that Debtors pay the unsecured creditors in full or approximately $272,000.00.

Debtors stated they owed only $25,400.00 based on $11,400 in excess living expenses and $14,000.00 for the value of an unharvested winter wheat crop that existed at the end of the

disposable income period.

After the evidentiary hearing, the Court requested additional information from Debtors, including a clarification of the cash and commodities on hand December 31, 1990. Debtors fulfilled that request on June 6, 1996.

II.

If the trustee or an unsecured creditor files an appropriate objection, a Chapter 12 debtor's plan must include a provision for paying any disposable income during the plan term to unsecured claim holders. 11 U.S.C. § 1225(b)(1). Payment of disposable income to unsecured claim holders is a requirement separate from the best interest of creditors test and serves a distinct purpose. *In re Wood*, 122 B.R. 107, 112 (Bankr. D. Idaho 1990).

> Without regard to what creditors would receive in a liquidation setting, if a Chapter 12 debtor has the ability because of current income generated during the plan to pay the claims of unsecured creditors without jeopardizing his reorganization effort, the debtor should be required to do so. Otherwise, a debtor with little or no realizable equity in its assets could unjustly deprive creditors of the income enjoyed under a successful plan.

Id. at 112-13. It is designed to promote fairness and provide creditors "with an assurance that what can be done to protect their interests will be done. Disposable income is simply a measure of what can be done to promote fairness." *Rowley*, 22 F.3d at 193.

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 exemptible funds and is not limited to income as defined by the

federal tax code. *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.* at 964. The disposable income payment period begins on the date that the first plan payment is due and ends three years later, or up to five years later 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 during the plan term, 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 [the] 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 is the disposable

income payment period? Second, what was the value of the debtor's cash, marketable commodities, and accounts receivable, including any earned but not-yet-paid government farm program payments, at the end of the disposable income period? Third, did the debtor incur any expenses, make any capital purchases, or transact any other business during the disposable income period that was out of the ordinary course of business and that unnecessarily depleted disposable income? 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 Broken Bow Ranch, Inc.*, Bankr. No. 87-30137, slip op. (findings and conclusions entered on the record January 8, 1993 and order entered January 13, 1993), *aff'd, Broken Bow Ranch v. United States (In re Broken Bow Ranch, Inc.)*, Civ. No. 93-3016. slip op. (June 9, 1993), *aff'd, Broken Bow Ranch v. Farmers Home Administration (In re Broken Bow Ranch, Inc.)*, 33 F.3d 1005 (8th Cir. 1994); *In re Schmidt*, 145 B.R. 983, 987 (Bankr. D.S.D. 1991). The debtor's disposable income is then the value of cash, marketable commodities, and accounts receivable at the end of the disposable income period, plus any unjustified expenses, capital expenditures, or other transactions, less the carryover funds necessary for family support and the continuation of the business.

III.

A. *Disposable Income Payment Period.* The parties have agreed

that the disposable income payment period in this case is the calendar years 1988, 1989, and 1990.

B. The value of Debtors' cash, marketable commodities, and accounts receivable, including any earned but not-yet-paid government farm program payments, at the end of the disposable income period. At the commencement of the hearing all parties agreed that Debtors had $139,876.00 in cash on December 31, 1990. The only itemizations provided were in Exhibit G and Joint Exhibits 15 and 16, which disclosed Debtors had a "prime cash series" account balance of $73,724.00 with John G. Kinnard & Company, a $20,000.00 certificate of deposit with the Bank of New England, and a checking account balance of $46,152.62 at Fulton State Bank.

After the hearing, the Court asked Debtors for an itemization of all certificates of deposit, stocks, and bonds that Debtors held on December 31, 1990. In an April 5, 1996 letter, Debtors disclosed penny stocks worth $101.00, a Holly Ann Partnership Escrow interest worth $2,500.00, stock in Dynamic Oil, Ltd., valued at $2,000.00, a certificate of deposit with Metropolitan Bank for $2,500.00, an annuity with AMEV worth $8,924.00, a government bond of $1,226.00, a commodity trading account balance of $375.00, and a Bank of New England certificate of deposit worth $19,893.00. PCA responded in an April 18, 1996 letter, that $17,626.00 should be added to the stipulated amount based on the additional disclosures by Debtors. Debtors responded in a May 31, 1996 letter that their total cash and investments on December 31, 1990 was only

$128,440.00: Fulton State Bank, $4,349.00; Metropolitan, $2,500.00; AMEV, $10,472.00, cash of $73,600.00 [apparently the John G. Kinnard & Company "prime cash series" account]; and certificates of deposit, $37,519.00.

The Fulton State Bank and Kinnard "prime cash series" account numbers stated by Debtors conflict with the accounts' January 1991 statements in Exhibit G. When those amounts are corrected, the Court finds that Debtors' cash and investments on December 31, 1990 totaled $157,040.74: Kinnard "prime cash series" account [activities during January 1991 are deducted], $73,262.12; Bank of New England CD, $20,000.00; Fulton State Bank account balance, $46,152.62; penny stocks, $101.00; Holly Ann Partnership Escrow interest, $2,500.00; Dynamic Oil stock, $2,000.00; Metropolitan Bank CD, $2,500.00, AMEV annuity, $8,924.00; government bond, $1,226.00; and commodity trading account balance, $375.00. Debtors did not show how the funds disclosed after the hearing had already been included in the amount to which they had stipulated at the hearing.

The identity and value of the commodities and excess property listed below were provided by Debtors in their Exhibit 5 and post-hearing letters of April 5, May 31, and June 6, 1996. The other parties have not disputed them.

Summary:

Cash and investments	$157,040.74
Stored winter wheat	40,849.92
Stored soybeans	23,140.98
Stored spring wheat	11,177.85
Straw	545.60
Unharvested winter wheat crop	14,000.00

Excess truck	3,467.00
Excess soybean inoculant	192.00
Farm Program Payments earned through 12/31/90	19,339.40
Total:	$269,753.49

C. Transactions by Debtors during the disposable income period that were not in the ordinary course of business and which unnecessarily depleted disposable income. The parties have stipulated that Debtors had excess living expenses of $11,413.00 during the plan term ($6,164.00 in 1989 and $5,249.00 in 1990). That amount will be added to the available cash and marketable commodities.

As to farm expenses, FmHA and PCA initially argued that the majority of Debtors' capital purchases of machinery, equipment, and vehicles during the plan term, which totaled $104,391.00, were unnecessary. Following the first day's testimony, FmHA and PCA revised this figure to $28,502.00. Excluding a few items, Debtors offered testimony that all their purchases were necessary and reasonable in price.

Based on the testimony and exhibits presented, the Court will disallow several purchases: the lawn mower for $996.00 in May 1987, the red and white pickup for $250.00 in December 1987, and the car trailer for $702.00 in January 1989. Debtors offered insufficient evidence to support the necessity of these purchases.[4] The Court also will disallow the office furniture purchased for

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[4] There was little testimony about these items at the hearing, although some were discussed more in Debtor Leonard Rowley's deposition. The deposition was not put into evidence.

$1,928.00 in March 1988. While Debtors could certainly make use of the furniture, there was no evidence that their present system could not accommodate them through the disposable income period.

The Court will allow reasonable annual payments on the larger items: the club cab pickup in 1987, the JD 643 corn head and the 7720 combine in 1988, and the automobile in 1990. These items were all purchased from dealers (not at auction) and should have been financed over a longer period of time so that unsecured creditors did not provide the financing. *See In re Rose Ranch Operating Partnership*, Bankr. No. 90-30016, slip op. at 7 (Bankr. D.S.D. July 21, 1995).

Evidence on this financing option was limited. However, based on the purchase price and intended use, the Court finds reasonable a three-year amortization of the pickup and car and a four-year amortization of the combine and corn head.[5] Accordingly, the Court will allow the full $17,756.00 for the pickup (three annual payments in 1987, 1988, and 1989 of $5,918.67), one annual payment in 1990 of $2,746.67 for the car, and $30,273.75.00 for the 7720 combine and corn head (three annual payments in 1988, 1989, and 1990 of $10,091.25). The disallowed portions would then be $5,493.34 for the car and $10,091.25 for the 7720 combine and head.

The other purchases listed on Exhibit X will be allowed. Debtors showed that the purchase price of each was reasonable and

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[5] The Court would generally expect a combine and head to be financed over more than three years but this unit was used when purchased and had to be replaced in 1992.

that the purchase was necessary. Although some items, such as the drill fill, grain vac, and two-way radios, were only for Debtors' convenience, Debtor Leonard Rowley's age and hip problems and the fact that he often works alone justified their purchase.

Summary:

excess living expenses	$ 11,413.00
lawnmower	996.00
red and white pickup	250.00
car trailer	702.00
office furniture	1,928.00
car	5,493.34
7720 combine and corn head	10,091.25
Total:	$ 30,873.59

D. The amount of income, if any, Debtors 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).

Carryover funds for operating expenses. FmHA and PCA have conceded that carryover funds are needed to meet year-end operating expenses of $4,940.00 and the January 1, 1991 payments to plan creditors of $39,236.00. These will be allowed by the Court. Debtors also will be allowed to retain as carryover funds, the sum needed to pay any loan on the stored wheat and soybeans. As provided by Debtors in their June 6, 1996 post-hearing letter, the grain loans totaled $59,219.85. Finally, Debtors will be allowed to retain as carryover funds the value of the winter wheat crop in the field on January 1, 1991 valued at $14,000.00. This unharvested crop may be used as collateral for 1991 operating expenses.

For two reasons, the Court finds no need to allow additional

carryover funds for farm operating expenses. First, Debtors' financial situation at the close of the disposable income payment period shows they were excellent candidates for post-discharge financing of operating expenses. Debtors had equity in their real property and machinery that could be pledged to a creditor. Most important, Debtors also could give a security interest in each year's crops to finance crop inputs.

The testimony that Debtors could not obtain machinery financing from John Deere during the plan term is insufficient evidence that *after discharge* they could not obtain operating credit on reasonable terms. Likewise, the testimony of Michael Beyer, Vice President for Commercial Bank of Mitchell, and Rod Woolforth, President of Fulton State Bank, was not persuasive. While each had stated that their respective bank likely would not lend to Debtors while they were *in* bankruptcy, neither banker had received a formal loan application nor a financial statement from Debtors based on the fact they were eligible for discharge after December 31, 1990. Thus, these lenders had not considered Debtors' post-discharge status, the success of their Chapter 12 plan, nor their improved equity position.

The second reason Debtors do not need additional carryover funds to meet operating expenses is because they will generate sufficient income during the year to meet all expenses. In addition to income from the fall harvest, they also will receive $16,430.00 in 1991 government farm program benefits, as set forth in the 1991 annual report.

Carryover funds for living expenses. The Court recognizes that Debtors need carryover funds or "new" income in 1991 sufficient to meet reasonable living expenses in 1991 until crops are harvested beginning in mid-July. Based on Debtors' projected living expenses of $2,000.00 per month, Debtors need approximately $13,000.00. However, cash carryover funds are not necessary. Debtors' income of approximately $14,167.18 through July 1991, as set forth in their 1991 annual report and their April 5 and May 31, 1996 letters, plus their reported Social Security benefits of $961.00 per month, will cover these living expenses.

In their April 5, 1996 letter, Debtors listed their income for 1991 through July. Debtors' May 31, 1996 letter confirmed an additional $923.00 in miscellaneous income in March 1991. When considering what income Debtors could use to cover 1991 living expenses, the Court did not include grain or straw sales through June 1991 or the 1990 deficiency payment receipts because those sums have been included in the cash and commodities portion of the disposable income calculation. The income section of Exhibit 14 was illegible and Exhibit 21 and Debtors' letter did not state whether the wheat, wheat seed, and straw sold in July 1991 were from Debtors' 1990 or 1991 crop. Therefore, the Court could not determine with certainty whether the July 1991 sales were of 1990 commodities that should not be included in "new" income for 1991. If excluded as 1990 commodities, however, Debtors still had miscellaneous income of at least $2,205.69 and their monthly Social

Security benefits to provide living expenses until harvest began in July 1991.

Summary	
1990 year-end operating expenses	$ 4,940.00
January 1, 1991 plan payments	39,236.00
loans on sealed grain	59,219.85
unharvested winter wheat crop	14,000.00
Total	$117,395.85

Calculation of Disposable Income. Debtors owe disposable income of $183,231.23 (cash and marketable commodities on December 31, 1990 of $269,753.49 plus $30,873.59 for disallowed expenses less $117,395.85 in allowed carryover funds).

The Court will not require Debtors to recognize as disposable income any equity they may have acquired in their real or personal property during the disposable income period. Section 1225(b)(2) does not include such equity in its definition of disposable income. Under § 1229(a), Trustee Yarnall could have sought a modification of Debtors' confirmed plan if he thought post-petition equity should be recognized in a new best interest of creditors test, as provided by § 1225(a)(4). As discussed above, disposable income is a separate test from the best interest of creditors test.

Further, the Court will not adjust the calculation under § 1225(a)(4) based on the "totality of the circumstances" as urged by Trustee Yarnall. Again, the Code does not inject that subjective standard into the formula. The only subjective portion of the calculation is the consideration of necessary expenses during the disposable income period and the amount of necessary carryover funds. *See Kuhlman*, 118 B.R. at 739.

Finally, the Court does not find it appropriate to determine disposable income largely on a debtor's federal income tax returns, as urged by FmHA. If the debtor's Chapter 12 annual and final reports and tax returns are accurate, the amount of disposable income shown on each should be the same. That proved true in this case when counsel for FmHA and PCA reconciled their disposable income calculations and found a difference of only $4,751.12. The Court will continue to abide by the disposable income formula set forth in *Broken Bow Ranch*, 33 F.3d at 1005.

An appropriate order will be entered.

Dated this 29 day of July, 1996.

BY THE COURT:

Irvin N. Hoyt
Chief Bankruptcy Judge

ATTEST:
Charles L. Nail, Jr., Clerk

By: _____
Deputy Clerk

(SEAL)

NOTICE OF ENTRY
Under F.R.Bankr.P. 9022(a)
Entered

JUL 29 1996

Clerk
U.S. Bankruptcy Court, District of S.D.

CERTIFICATE OF SERVICE

I hereby certify that a copy of this document was mailed, hand delivered, or faxed this date to those creditors and other parties in interest identified on the attached service list.

U.S. Bankruptcy Clerk
District of South Dakota

By: _____
Date: 7-29-96

Case: 87-40157 Form id: 122 Ntc Date: 07/29/96 Off: 4 Page : 1
Total notices mailed: 8

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