

UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH DAKOTA
Northern Division

In re:)
) Bankr. Case No. 96-10070
WAYNE E. WASILK)
Social Security No.503-62-7860) Chapter 12
)
and)
) MEMORANDUM OF DECISION RE:
) DEBTORS' MOTION TO APPROVE
MARLYS R. WASILK) FARM LEASE AND CONFIRMATION
Social Security No. 504-66-4638) OF PLAN DATED JUNE 21, 1996
)
)
Debtors.)

The matters before the Court are Debtors' Motion to Approve Farm Lease and the confirmation of Debtors' plan dated June 21, 1996. These are core proceedings under 28 U.S.C. § 157(b)(2). This Memorandum 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' Motion to Approve Farm Lease must be denied and that Debtors' plan dated June 21, 1996 cannot be confirmed.

I.

Debtors filed a Chapter 12 petition on April 24, 1995. The case was dismissed February 15, 1996 upon the motion of Eureka State Bank (Bank) because Debtors were unable to propose a confirmable plan.

Debtors filed another Chapter 12 petition March 26, 1996. They filed a plan dated June 21, 1996. In their plan, Debtors proposed *inter alia* to pay the Bank's first secured claim of \$105,045.46 (secured by real property) over twenty years at 9 percent interest. The first payment on this claim would be made

one year after confirmation. As to the Bank's second secured claim of \$38,407.50 (secured by machinery and feed), Debtors offered to pay it over ten years at 9 percent interest. Debtors also proposed to turnover to the Bank a 1978 Oldsmobile car, a 1979 GMC pickup, and a 1985 Chevy four-wheel drive truck in which the Bank had a secured interest.

Debtors had several other secured creditors. They proposed to return or had already returned collateral to F&M Bank of Watertown, Ford Motor Credit, and Hand County State Bank. Debtors proposed to pay creditors First National Bank of Eden and J.I. Case over three years on their claims secured, respectively, by a car and some machinery.

Unsecured claims total \$251,684.06, of which the Bank is owed \$233,047.04. Debtors proposed to pay unsecured creditors \$9,714.00 over three years (a .04% dividend) based on the best interest of creditors test set forth at 11 U.S.C. § 1225(a)(4). Debtors did not offer disposable income in their plan.

A month after they filed and served their proposed plan, Debtors filed a Motion to Approve Farm Lease. Therein, they sought the Court's approval for a lease between them and their son, Chad. Debtors wanted to lease their farm's barn, silo, and dairy-related personalty to Chad. Chad would then obtain milk cows and milking equipment so that he could operate a dairy on Debtors' farm. Forty-five percent of his gross monthly milk check would be paid to Debtors. Debtors would continue to pay the real estate taxes and insurance on the property and they would supply all Chad's forage

and grain needs from their farm's crops. If the farm did not produce enough feed, Debtors would purchase more and Chad would repay them for any cost over \$80.00 per ton.

The Bank objected both to Debtors' plan and their Motion to Approve Farm Lease. The Bank argued against the lease on the grounds that Debtors should not be allowed to lease out the Bank's collateral, that the lease did not cover the pay-out term of its claim under the plan, that the lease arrangement did not guaranty payments to Debtors from Chad since it was based on a percentage of gross receipts, that the lease did not account for feed already consumed by Chad's cows, that the lease was not clear on insurance on improvements, and that Debtors are trying to get after-the-fact approval for their deal with Chad.

The Bank objected to the June 21, 1996 plan on the grounds that Debtors would no longer be farming but would be or had turned over the operation to their son, that the plan is not proposed in good faith because Debtors paid a debt to an insider between the two Chapter 12 cases, that payments on the Bank's secured claim were not equal to the present value of the collateral, that the plan is not feasible, that the trustee's fees are not properly accounted for, that no default terms are included, that adequate protection is not provided for the Bank's collateral, that the first payment on the Bank's real property claim will be delayed until August 1997, that Debtors did not offer disposable income, and that their present farm valuation does not reflect milking equipment worth \$15,000.00 that they purchased during the first

bankruptcy case.

Trustee John S. Lovald conducted a pre-confirmation meeting on July 19, 1996. Debtors filed a response to the Bank's objections on August 5, 1996.

An evidentiary hearing was held August 6, 1996. Appearances included Harry A. Engberg for Debtors and Carlyle E. Richards for the Bank. Debtor Marlys Wasilk testified that their son Chad, age 19, will lease the farm buildings and that Chad will furnish the cows and milking equipment. Debtors will keep the farm ground and manage the crops and provide the forage that Chad's milk cows need. Debtors will insure the buildings and farm personalty. Debtors, for cash income, will sell any excess crops. Chad will get the proceeds from any dairy calves sold. Debtors will receive 45 percent of the milk income. The lease will run five years. Debtor Marlys Wasilk acknowledged that Chad probably did not know how much milk he needed to produce to insure that Debtors' plan was successful.

Debtor Marlys Wasilk also testified that if Chad defaults on the lease or wants to quit milking, then Debtors and Chad have an agreement that they can lease Chad's cows from him and continue milking. That provision is not in the written lease.

Debtor Marlys Wasilk said the last time Debtors operated a dairy was in 1988 when they quit due to a barn fire. She stated her son has had dairy cows on the place since April 1996 and that the cows have been fed with the farm's forage. To date, Chad has not paid Debtors anything for the buildings he has used or the feed

his cattle have consumed.

Besides running the dairy, Debtor testified that her son will work forty hours per week plus every other weekend for the South Dakota Wheat Growers and that she will continue her forty-hour a week job at an area nursing home. Debtor Wayne Wasilk will continue his trucking business. Debtor Marlys Wasilk agreed that Chad will be unable to do all the calving and the crop farming without assistance from her and the rest of the family.

Chad Wasilk testified that he borrowed \$30,000.00 from his grandmother to purchase dairy heifers. Chad's mother drafted the note for Chad's grandmother to sign. Chad's father accompanied him to the sale barn to buy the heifers. Chad said he purchased all the milking equipment, except a bulk tank, with cash.

Chad Wasilk testified that he now has forty cows and operates a Grade B dairy. Currently, Chad is milking eighteen of the forty cows. Chad said the family has kept records of the milk produced and feed consumed since his cows came on the place. He has had a 100 percent calf crop to date. He said his goal is to get to sixty head of cows and to produce Grade A milk. There was no clear evidence on how or when Chad's herd would increase to sixty head or when his dairy would qualify as a Grade A dairy.

Chad explained that he will milk at 4:30 a.m. and 6:00 p.m. and work between 8:00 a.m. and 5:30 p.m. weekdays. He has had no post secondary schooling and still lives at home. Chad said he gained dairy experience from working at home, for a neighbor, and for his uncle. He has no experience managing a dairy or keeping

the necessary herd records.

Based on his milk production from eighteen cows the day before the hearing, Chad said he averages fifty-six pounds of milk per day per cow or about 17,000 pounds per year per cow (305 days of lactation). Based on these current production rates, Chad can produce \$98,600.00 in gross milk income per year if he milks forty cows. Debtors' forty-five percent share of that gross milk income would be \$44,370.00. Debtors' plan contemplates livestock income of \$56,160.00, non farm income of \$17,436.00, and other farm income of \$14,720.00.

II.

Lease of Estate Property.

Under 11 U.S.C. § 363(b), a Chapter 12 debtor-in-possession must receive court approval before he may lease estate property to another out of the ordinary course of business. Notice of the motion to lease estate property must be given to all creditors and other parties in interest, including any creditor who may have a secured interest in the property to be leased. See F.Rs.Bankr.P. 2002(a)(2) and 6004(a). A creditor holding an interest in the property may request adequate protection for that interest and the Court may prohibit or condition the lease to insure that the creditor's interest is protected. 11 U.S.C. § 363(e).

Confirmation of a Chapter 12 Plan.

Two of the six required elements to a Chapter 12 plan presently are at issue in this case: Whether the plan is proposed in good faith and whether the plan is feasible. See 11 U.S.C.

§§ 1225(a)(3) and (a)(5). Even if no one objects, the Court has a separate mandatory duty to determine whether the confirmation requirements have been met. *In re Weldin-Lynn, Inc.*, 79 B.R. 409, 410 (Bankr. E.D. Ark. 1987). Only good faith may be presumed if no objection is filed. F.R.Bankr.P. 3015(f).

Good faith is a factual determination in which the Court must examine the totality of the circumstances. *Schuldies v. United States (In re Schuldies)*, 122 B.R. 100, 102-03 (D.S.D. 1990). Bad faith may include concealment, evasion, direct violations of the Code or a court order, and self-dealing and asset manipulation without court approval that clearly establish an improper motive. *First National Bank v. Kerr (In re Kerr)*, 980 F.2d 400, 404 (8th Cir. 1990); *In re Coones Ranch, Inc.*, 138 B.R. 251, 258 (Bankr. D.S.D. 1991); see also *Euerle Farms, Inc. v. State Bank in Eden Valley (In re Euerle Farms, Inc.)*, 861 F.2d 1089, 1091-92 (8th Cir. 1988). The concept of good faith is reflected in the Chapter 12 debtor in possession's fiduciary duty to creditors.

As a fiduciary, the debtor in possession may not self-deal in the subject matter of the trust; it is legally chargeable with acting to preserve and enhance the estate's value so creditors' returns will be maximized.

In re Erickson, 183 B.R. 189, 193-94 (Bankr. D. Minn. 1995).

Feasibility is a question of fact. *In re Foertsch*, 167 B.R. 555, 566 (Bankr. D.N.D. 1994). A Chapter 12 plan must offer a reasonable prospect of success and be workable. *Id.* at 565. An "iron clad guarantee" is not required but the plan should not be overly optimistic nor belabor the inevitable demise of a hopelessly

insolvent debtor. *Id.* at 565-66 (cite therein); *In re Oster*, 152 B.R. 960, 964 (Bankr. D.N.D. 1993). Future income and expense projections, including crop production and market rate predictions, should be rooted on objective fact. *Foertsch*, 167 B.R. at 565-67. Off-farm income may be considered. *In re Barnett*, 162 B.R. 535, 538 (Bankr. W.D. Mo. 1993). "Sincerity, honesty and willingness are not sufficient to make [a] plan feasible and neither are visionary promises. The test is whether the things which are to be done after confirmation can be done as a practical matter under the facts." *Clarkson v. Cooke Sales & Service Co. (In re Clarkson)*, 767 F.2d 417, 420 (8th Cir. 1985) (quoting *In re Bergman*, 585 F.2d 1171, 1179 (2d Cir. 1978)). A plan must be probable, not merely technically possible. *Foertsch*, 167 B.R. at 566. The Court may, however, resolve conflicts in the evidence in the debtor's favor due to the underlying purpose of Chapter 12.

III.

Debtors' Proposed Lease

Debtors' proposed lease must be rejected because Debtors have not shown that it is a sound financial option for the bankruptcy estate. Debtors are supplying the farm buildings, corrals, pasture, and feed. Debtors are paying the taxes and much of the necessary insurance. Debtors are continuing to furnish dairy-related labor, including record keeping by Debtor Marlys Wasilk. In return, Debtors will receive 45 percent of the milk proceeds. The lessee will supply the dairy cows and milking equipment, some insurance, some labor, and operating expenses such a veterinary

care. Besides 55 percent of the milk proceeds, the lessee also will receive all the proceeds from the sale of dairy calves. There has not been, however, a showing that Debtors' contributions to this dairy endeavor correlate to their 45 percent share of the milk proceeds or that the lessee's contributions reflect his 55 percent share of proceeds. Consequently, the Court cannot approve the agreement. Too many questions are unanswered. Foremost, how does their projected income from the lease compare with the total expenses they will incur to meet their end of the bargain? Are better lease options available to maximize income?

Debtors also have failed to show that their proposed lease with their son reflects area standards for such leases. While this lease may be atypical, there must be some industry norms to which Debtors can compare it. What do others pay to lease dairy barns and pasture? Is a "percentage of profits" method usual for compensating the real property holder or are fixed payments more typical? These unanswered questions leave the soundness of the lease in question.

Debtors' Proposed June 21, 1996 Plan

Besides the reasons set forth above for not approving the lease of estate property to Chad Wasilk, which is an integral part of Debtors' proposed plan, the Court concludes that Debtors' proposed plan cannot be confirmed because it is not feasible. Lack of feasibility is demonstrated in two ways.

First, Debtors did not provide sufficient evidence in support of their projected income statement. Besides the lease income from

Chad, there was little evidence on the projected income from Marlys' and Wayne's off-farm jobs and on the projected \$14,720.00 in other farm income? There was no evidence that these projections of off-farm income and other farm income were grounded in historical yields or profits. As to the livestock/milk income, Debtors' lessee is not currently milking sufficient cows to produce the income projected. There was no clear evidence of how or when Chad's dairy herd size would increase to meet that projection. If Chad is milking only forty head (the number of cows he now has), Debtors' projected livestock income of \$56,160.00 will not be met based on Chad's current production levels.

Second, Debtors are asking creditors to rely on income provided by a lessee who has no track record. While Chad's efforts and intentions are laudable, he is barely out of high school. He has not independently operated a dairy before. He has not kept the necessary business and dairy herd records. All the adults in the family have off-farm jobs that will make the dairy a second job for them. In essence, while it may be technically possible that the lease arrangement with their son will work and that Debtors can meet their plan payments, there is not a reasonable possibility that they will do so. See *Foertsch*, 167 B.R. at 566; see also *Abbott Bank-Thedford v. Hanna (In re Hanna)*, 912 F.2d 945, 951 (8th Cir. 1990) (confirmation requirements when secured creditor's interest is to be protected by a continuing lien).

Debtors' good faith in offering this plan is also not demonstrated. Foremost, there has been no explanation why Debtor's

young son is purchasing the cows instead of Debtors. Since a family member is providing financing to Chad at a low rate of interest and since all family members intend to contribute labor to the dairy endeavor, the only reason the Court can find for Chad to purchase the cows is that it may allow the family to shelter some milk income, including funds that could be used for disposable income payments. The lease with Chad also allows the bankruptcy estate to avoid acquiring any equity in the cows. The Court cannot condone such efforts.

Lack of good faith is also shown in the plan by Debtors failure to make a payment on the Bank's claim secured by realty until 1997. There has been no explanation why this delay is necessary. Further, the Bank's collateral is not being adequately protected in the plan because Debtors have not established a reliable source of income over the twenty and ten year payout terms proposed on the Bank's two claims. The lease with their son runs only five years. Debtors have not shown how they will make payments to the Bank after the lease expires. Similarly, Debtors have not maximized their ability to repay unsecured creditors, including the Bank, because they have not offered disposable income. In this case, where the plan relies heavily on a lease with an insider and where payments to unsecured creditors pursuant to § 1225(a)(4) is very small, good faith would dictate an offer of disposable income.

Finally, Debtors' lack of good faith in proposing this plan is demonstrated by their disjointed approach to reorganization. As

was the problem in their previous Chapter 12 case, Debtors did not come into this case ready or able to reorganize. Debtors are proposing yet another stratagem to pay their creditors. As stated in the feasibility discussion above, this new plan -- like the others before it -- is not practical nor probable. See *Clarkson*, 767 F.2d at 420, and *Foertsch*, 167 B.R. at 566.

An appropriate order will be entered.

Dated this _____ day of October, 1996.

BY THE COURT:

Irvin N. Hoyt
Chief Bankruptcy Judge

ATTEST:
Charles L. Nail, Jr., Clerk

By: _____
Deputy Clerk

(SEAL)