UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH DAKOTA
Northern Division

In re:	
HERBERT WARREN ALLEN, III Social Security No. [redacted]-6617	Bankr. Case No. 87-10052 Chapter 12
and	MEMORANDUM OF DECISION RE: DISCHARGE AND TRUSTEE'S MOTION FOR REMOVAL OF DEBTOR-IN-POSSESSION
DONNA MAE ALLEN Social Security No. [redacted]-2131	
Debtors.	

The matters before the Court are Debtors' discharge and the Motion for Removal of Debtors as Debtor in Possession filed by Trustee A. Thomas Pokela. These are core proceedings under 28 U.S.C. § 157(b)(2). This Memorandum Decision and accompanying Order shall constitute findings and conclusions under F.R.Bankr.P. 7052. As set forth more fully below, the Court concludes that the real property inherited by Debtors post-confirmation does not constitute disposable income under 11 U.S.C. § 1225(b) but should be recognized under a modified plan's best interest of creditors test. Trustee's Motion for Removal of Debtor as Debtor in Possession will be denied.

I.

On October 20, 1987, Debtors filed an amended plan.[1] The plan acknowledged that Debtors farmed 4,186 acres. Of those 4,186 acres, 535 were tillable, 70 acres were in a set-aside program, and 3,651 acres were in pasture. Debtors owned 1,129.24 acres and leased the remainder.

The plan listed two unsecured creditors: Richard Bjerk and Hoysler Associates. These claims totaled $61,637.84. The amended plan also acknowledged that Eureka State Bank likely would have an undersecured claim but that the amount was not determined, yet.

[1] The plan was dated July 23, 1987.

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Debtors' plan was confirmed by Order entered November 20, 1987 under the proviso that Debtors and Eureka State Bank would continue to negotiate treatment of the Bank's claim. Under the terms of the plan, Debtors agreed to apply all disposable income "realized" in the three-year plan to under and unsecured claims.

The plan was modified by a stipulation between Debtors and Eureka State Bank that was approved December 27, 1988. The stipulation did not state that the Bank had an undersecured claim or that any unsecured portion of the Bank's claim would be paid from disposable income.

Debtor Herbert Allen's mother died on February 17, 1990. Debtor Herbert Allen inherited his mother real property, which he had been farming for nearly forty years. Debtors did not file an amended schedule of real property to recognize this inheritance, as required by F.R.Bankr.R. 1007(h).

Debtors filed their final report and account on November 15, 1991. FmHA objected to Debtors receiving a discharge because Debtors had failed to pay pre- and post-confirmation real estate taxes. Trustee A. Thomas Pokela objected on the grounds that disposable income may exist. Hearings on the objections were continued several times to allow completion of the probate of estate of Debtor Herbert Allen's mother. When the inactivity in the probate estate continued to delay the administration of the bankruptcy estate, Trustee Pokela filed a Motion for Removal of Debtor a Debtor-in-possession on September 28, 1993. This Motion and Debtors' discharge were held in abeyance for almost a year as the probate of Debtor's mother's estate continued.

An evidentiary hearing on Debtor's discharge and the Trustee's Motion for Removal of Debtor a Debtor-in-possession finally was

held August 23, 1994. Trustee Pokela argued that the land inherited by Debtor Herbert Allen, less encumbrances thereon for taxes and probate costs, constituted disposable income. Debtors argued the land was necessary for the continued operation of Debtors' farm operation and, therefore, was not disposable income. The Court took the matter under advisement after receiving from Debtors a current financial statement and the Trustee's response to the financial statement.

As of September 1, 1994, Debtors stated they had:

ASSETS	FAIR MARKET VALUE
1,129 acres	$115,120.00
3,057 acres (inherited)	290.740.00
machinery	50,000.00
grain	10,000.00
household goods and personalty	5,000.00
Total	$470,860.00

LIABILITIES	FAIR MARKET VALUE
Eden/Eureka Bank (estimate)	$100,000.00
FmHA	12,500.00
real estate taxes	55,286.00
state inheritance taxes	28,888.00
accounts payable (post-petition)	84,540.00
unsecured claims under plan	154,612.00
Total	$497,463.00

Thus, Debtors reported a negative net worth of $26,603.00.

II.

Modification of a confirmed Chapter 12 plan. A confirmed Chapter 12 plan may be modified to increase or reduce payments, to extend or reduce the time for making payments, or to recognize payments made to a creditor other than under the debtor's confirmed plan. 11 U.S.C. § 1229(a). A modified plan must meet the general confirmation requirements set forth at 11 U.S.C. §§ 1222(a), 1222(b), 1223(c), and 1225(a), including the best interest of creditors test set forth at § 1225(a)(4). The best interest of creditors test provides that an unsecured creditor paid under a Chapter 12 plan must receive as much as he would if the debtor's

estate was liquidated under Chapter 7 *as of the effective date of the plan*.

The weight of authority indicates that a modified plan must meet the best interest of creditors test on the date of the proposed modification; that is, the effective date of the modified plan is the day the modification takes effect. *See In re Bremer*, 104 B.R. 999 (Bankr. W.D. Mo. 1989); *In re Musil*, 99 B.R. 448 (Bankr. D. Kan. 1988); *In re Perdue*, 95 B.R. 475 (Bankr. W.D. Ky. 1988); *In re Bluridg Farms, Inc.*, 93 B.R. 648 (Bankr. S.D. Iowa 1988); *contra In re Nielsen*, 86 B.R. 177 (Bankr. E.D. Mo. 1988), *overruled by In re Hopwood*, 124 B.R. 82, 85 (E.D. Mo. 1991). This conclusion is in accord with § 1229, which states a modified plan must comply with § 1225(a). This conclusion also is supported by 11 U.S.C. § 1207(a), which states property of a Chapter 12 estate includes property and income that accumulates after the petition is filed but before the case is closed, dismissed, or converted to Chapter 7.[2]

Determining Disposable Income. Disposable income is the difference between available income and necessary expenses during the disposable income payment period. 11 U.S.C. § 1225(b)(2).

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[2] The Court of Appeals for the Eighth Circuit addressed a similar question in *Hollytex Carpet Mills v. Tedford*, 691 F.2d 392 (8th Cir. 1982). That decision, however, is limited to the conclusion that exemptions are to be determined based on the law applicable on the petition date. In *Hollytex*, the court relied on a Bankruptcy Court decision which held that the best interest of creditors test in a modified plan is determined on the petition date. *In re Statmore*, 22 B.R. 37 (Bankr. D. Neb. 1982). This Court joins several others in concluding that *Hollytex* and *Statmore* should not be read or applied too broadly. *Bremer*, 104 B.R. at 1003-05; *Musil*, 99 B.R. at 450-51; *see also Hopwood*, 124 B.R. at 85, and *Bluridg Farms, Inc.*, 93 B.R. at 651-653. Further, a later decision by the Bankruptcy Court in Nebraska that defines the effective date of a Chapter 12 plan to be the date the plan takes effect -- not the petition date -- questions the continued viability of *Statmore*. *In re Milleson*, 83 B.R. 696, 699 (Bankr. D. Neb. 1988).

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.*

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 unless there was no available income in excess of necessary expenses. 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).

Payment of disposable income to unsecured claim holders is a requirement separate from the best interest of creditors test and it 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 it its assets could unjustly deprive creditors of the income enjoyed under a successful plan.

Id. at 112-13.

III.

In their September 1, 1994 financial statement, Debtors have overstated the amount of unsecured claims to be paid under their plan. As noted above, in a stipulation approved after confirmation of Debtors' plan, Eureka State Bank was not given any under or unsecured claim. Instead, the stipulation and testimony of

Debtors' bankruptcy counsel, Philip Morgan, indicates the Bank received a higher secured claim in exchange for not being included in the class of unsecured claim holders. Thus, the only unsecured plan creditors are Richard Bjerk and Hoysler Associates, whose claims total $61,637.84.

Debtors are not entitled to a discharge because all plan payments, which include real estate taxes, have not been paid. Debtors' confirmed plan specifically provided that Debtors would pay pre-petition real estate taxes over the term of the plan and also keep post-petition real estate taxes current. Further, the plan and confirmation order provided that secured claim holders would retain their liens and would "receive property that has a value not less than the allowed amount" of their claims. Thus, in order to protect the value of claims secured by real property, Debtors again obligated themselves to keep real estate taxes current post-petition. That has not been done. As revealed by Debtors in their financial statement filed September 27, 1994, Debtors owe $55,286.00 in real estate taxes.[3] Accordingly, discharge may not be granted since all plan payments have not been completed.

Debtors' plan should be modified to recognize the value of the inherited land. As discussed in *In re Berger*, Bankr. No.87-10289, slip op. (Bankr. D.S.D. January 7, 1994), a Chapter 12 debtor's plan should be modified to reflect property a debtor acquires post petition.

> Recognition of post-confirmation assets in a modified plan is consistent with § 1207 which states that a Chapter 12 debtor's estate includes all property and

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[3] Debtors estimate that $32,229.00 of the $55,286.00 in real estate taxes due are attributable to the land Debtors inherited from his mother.

> income obtained by the debtor post-petition but prior to the closing of the case. When §§ 1207 and 1229 were applied in this case, they allowed the Trustee to seek additional plan payments for unsecured creditors under the best interest of creditors test. In another case where the debtor's assets unexpectedly decline in value or are destroyed, the debtor make seek modification of his plan to reduce plan payments to unsecured creditors. *Compare In re Oletzke*, Bankr. No. 186-00254, slip op.(Bankr. D.S.D. December 11, 1990)(secured creditor's motion to modify plan denied where creditor attempted to revalue its secured claim when the debtor's real property increased in value); *In re Pearson*, 96 B.R. 990 (Bankr. D.S.D. 1989)(Chapter 12 plan may not be modified to address valuation issue that could have been raised at the original confirmation hearing); *see also In re Frost*, 96 B.R. 804, 808 (Bankr.S.D. Ohio 1989).
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> The Court acknowledges that Debtors' confirmed plan is being modified at the eleventh hour. But for the fact that Debtors owe disposable income (*see* Part III., B., below), all plan payments would have been made by now and Trustee Pokela would be foreclosed from seeking a modification of the plan. 11 U.S.C. § 1129(a). However, Debtors contributed to the problem because they did not file timely amended property or exemption schedules as required by F.R.Bankr.P. 1007(h) when the mortgage was forgiven, when they received the insurance benefits, or when they purchased estate property with the insurance funds. Equity dictates that Debtors be allowed to schedule the post-confirmation property and apply their exemptions to it but also that the Trustee be allowed to seek any equity in the property for unsecured creditors.

Id. at 16-17. Here, Debtors' inheritance during the plan term is similar to the property the debtors in *Berger* acquired post-confirmation with insurance proceeds. It is estate property that should be recognized in a best interest of creditors test under a modified plan. While the modification may be proposed late in the plan term, just as in *Berger*, Debtors contributed to the delay by not amending their schedules timely as required by F.R.Bankr.P. 1007(h). When the best interest of creditors test is re-calculated, the modified plan should recognize sufficient equity to allow for plan payments to the two unsecured claim holders.

The inherited land is not disposable income under 11 U.S.C. § 1225(b)(2) in this case. The parties have not disputed that Debtors' farm did not operate in the black post-confirmation.

While Debtors were able to make most plan payments, real estate taxes remained delinquent and Debtors apparently did not accumulate any excess funds to pay creditors. Also, the land Debtors inherited from his mother is necessary for the continued operation of the farm. Any chance Debtors have for a fresh start would be impeded if they could not continue to farm that land. Most important, the Code contemplates that Debtors' equity in the inherited property be recognized through the best interest of creditors test at § 1225(a)(4), not through disposable income under § 1225(b). *See* 11 U.S.C. § 1207(a). The end result for unsecured creditors essentially should be the same, however.

Absent a modification of Debtors' confirmed plan by an agreement under Local Bankr. R. 309(G), an Order will be entered giving Debtors fifteen days to file amended schedules under Rule 1007(h). Trustee Pokela or an unsecured creditor will then have twenty days to file a motion to modify Debtors' confirmed plan. The five-year limit for a plan expired under § 1222(c) while all parties were waiting for resolution of the probate estate. While this Court is reluctant to extend the plan term, Debtors will be allowed up to two additional years to complete plan payments. The over-two year abeyance of the bankruptcy case caused by the slow resolution of the probate estate should not penalize both Debtors and their plan creditors.

Dated this 13 day of January, 1995.

BY THE COURT:

Irvin N. Hoyt
Chief Bankruptcy Judge

ATTEST:
PATRICIA MERRITT, CLERK,
By _____ Deputy Clerk
(SEAL)

NOTICE OF ENTRY
Under F.R.Bankr.P. 9022(a)
Entered
JAN 13 1995
Patricia Merritt, Clerk
U.S. Bankruptcy Court, District of S.D.

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