

UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH DAKOTA
Northern Division

In re:) Bankr. Case No. 87-10289
)
ARTHUR ADOLPH BERGER) Chapter 12
Social Security No. [REDACTED]-9520)
) MEMORANDUM OF DECISION RE:
and) DEBTORS' DISCHARGE, TRUSTEE'S
) MOTION TO MODIFY CONFIRMED
) PLAN, AND TRUSTEE'S
CHERYL JEAN BERGER) OBJECTION TO EXEMPTION
Social Security No. [REDACTED]-7746)
)
Debtors.)

The matter before the Court is Debtors' discharge, the motion to modify confirmed plan and the objection to exemption filed by Chapter 12 Trustee A. Thomas Pokela, and Debtors' responses to the Trustee's motions. These are core proceedings under 28 U.S.C. § 157(b) (2). This Memorandum and accompanying Order shall constitute findings and conclusions as required by F.R.Bankr.R. 7052.

I.

Debtors Arthur A. and Cheryl J. Berger filed a Chapter 12 petition on September 29, 1987. Their debt adjustment plan was confirmed on August 2, 1988¹. The first payment under the plan was scheduled for October 15, 1988. The plan recognized twenty-one unsecured creditors whose claims totaled \$127,766.10. The plan provided that these unsecured creditors would receive \$5,642.61 each December 31 of 1989, 1990, and 1991. The plan further provided:

¹ The confirmed plan was modified once regarding attorney's fees.

[A]fter making payments to these fully secured creditors outside the Plan, and to impaired creditors and to the Chapter 12 Trustee's fees and unsecured creditors, if any additional funds become available to the Debtors, in addition to those set forth above, from the effective date of the Plan [August 11, 1988] through December 31, 1991, those additional disposable funds shall likewise be delivered to the Chapter 12 Trustee for distribution of the same to himself for his fees, as provided by law, and for payment of the balance to the unsecured claimants on a pro rata basis. The Debtors anticipate that there will not be any payments over and above those amounts herein above set forth on the unsecured debt. After distribution of dividends from the last made through the office of the Chapter 12 Trustee on or before December 31, 1991, all remaining unsecured and undersecured indebtedness, and all indebtedness to the Chapter 12 Trustee, will be deemed paid and satisfied in full, except to the extent of the liquidation value of the unencumbered nonexempt property as specifically hereinbefore set forth.

Debtors filed their Final Account and Report on April 8, 1992. On April 29, 1992, Farm Credit Bank of Omaha (FCBO) filed an objection to Debtors' discharge on the grounds that disposable income payments had not been made. Standing Chapter 12 Trustee A. Thomas Pokela filed a similar objection on May 1, 1992. FCBO filed an amended objection on May 7, 1992. A hearing on these objections was held October 19 and 20, 1992. Appearances included William J. Pfeiffer for Debtors, Robert M. Ronayne for FCBO, and Trustee Pokela. At the hearing, Debtors moved that the objection of FCBO be stricken because FCBO was not an unsecured creditor entitled to disposable income. The trial was continued to November 23, 1992 to allow the parties to prepare necessary evidence, as delineated by the Court in a letter to counsel dated

and entered October 22, 1992². The issue of whether FCBO could object to discharge was taken under advisement. By Order entered October 23, 1992, the Court struck FCBO's objection to discharge.

Debtors received \$102,000.00 from Aid Association for Lutherans (AAL) in 1989 after their son was killed in an automobile accident. At the October 1992 hearing, Debtors asserted that \$20,000.00 of these insurance proceeds were exempt under S.D.C.L.

58-12-4. By letter filed November 19, 1992, Attorney Pfeiffer reported that Debtors and Trustee Pokela had agreed that:

- 1.AAL is a fraternal benefit society under S.D.C.L. § 58-37-1;
- 2.Debtors were members of AAL under policies of insurance each had upon him or herself since the early 1980's;
- 3.Debtors' son had his own policy since age sixteen;
- 4.Debtors' son died in an accident in 1989 at age eighteen and \$102,000.00 in double indemnity benefits under the son's AAL policy was paid to Debtors.

Debtors went on to assert that the entire \$102,000.00 in proceeds was exempt under S.D.C.L. § 58-37-68 because the funds were received from a qualified fraternal benefit society and because S.D.C.L. § 58-12-4 did not limit the exemption of these benefits to \$20,000.00.

² In its October 22, 1992 letter, the Court outlined three issues that the parties needed to address at the continued hearing on November 23, 1992: (1) whether Debtors received funds from the Aid Association for Lutherans when their son died because they were "members" or because they were beneficiaries under their son's policy; (2) what accounting methods were used by Debtors' accountant in preparation of Exhibit B.; and (3) how has Debtors' operation varied from their plan projections.

By letter received and filed November 23, 1992, Trustee Pokela argued that any exempt life insurance proceeds under § 58-37-68 were limited to \$20,000.00 by § 58-12-4. He also argued that the personal property that Debtors had acquired with the insurance proceeds was not protected by § 58-37-68.

At the scheduled hearing time on November 23, 1992, the Court reviewed the posture of the case with counsel in chambers. The Court advised counsel that the life insurance issue was distinct from the disposable income question and should be addressed through an objection to amended exemptions and a motion to modify the plan. By consent of the parties, the November 23, 1992 hearing was continued to December 2 and 3, 1992.

On November 25, 1992, Debtors amended their personal property schedule and their schedule of exempt property to include the \$102,000.00 in life insurance benefits. On December 1, 1992, Trustee Pokela objected to Debtors' claim that the \$102,000.00 in benefits are exempt.

On November 25, 1992, Trustee Pokela filed a motion to modify Debtors' confirmed plan to recognize the \$45,000.00 secured debt that Debtor Arthur Berger's mother allegedly forgave and the \$102,000.00 in life insurance benefits that Debtors' received. The net effect of these changes would be an increase in the amount of payments that Debtors must make to unsecured creditors under the best interest of creditors test at 11 U.S.C. § 1225 (a) (4).

Debtors filed a response to Trustee's motion to modify on December 8, 1992. They state Debtor Arthur Berger's mother did not forgive a \$41,000.00 mortgage but instead let the note be acknowledged as satisfied to "protect Debtors' interest in the property." Debtors also argue that any increase in their equity in the land due to the debt forgiveness would apply to their homestead exemption. Finally, Debtors argue that the \$102,000.00 in life insurance benefits was spent primarily on farm expenses and that such expenditures did not create disposable income.

Debtors' discharge, Trustee's motion to modify the plan, and Trustee's objection to exemptions were all scheduled for hearing December 14 through 16, 1992. On December 14, 1992, Debtors presented testimony from a soil scientist regarding Debtors' decision to adopt no-till farming. Due to the parties' efforts to stipulate to facts and resolve some issues, the hearing was continued to January 19, 1993.

The parties presented several exhibits and witnesses on January 19 and 20, 1993. At the conclusion of the hearing, Debtors consolidated their key evidence into Debtors' Exhibit ZZ, which set forth Debtors' disposable income and their liabilities at the end of 1991³. By Order entered January 21, 1993, the Court

³ Exhibit ZZ states that as of December 31, 1991, Debtors had the following liquid assets and liabilities:

<u>Inventory</u>		<u>Obligations</u>	
Cash on hand (as reconciled)	\$ 5,576.33	Accrued property tax(~ year)	\$ 960.00
Corn - 19,000 bushels	41,593.66	Short-term debt:	29,177.45
Soybeans- 2,900 bushels	13,000.00	Peoples State Bank	1,000.00
Barley- 7,000 bushels	12,205.30	Demand loan-D. Redon [Revon]	16,000.00
Hay- 200 round bales	2,000.00	Demand loan-D. Tohidi	15,000.00

gave Trustee Pokela ten days to file a response to Debtors' Exhibit ZZ. The Court also ordered Debtors to file and serve a spreadsheet of their monthly income and expenses for 1992 to show what funds Debtors needed to carryover from the disposable income term to continue operation of the farm as allowed by § 1225(b) (2) (B).

On February 1, 1993, Debtors' certified public accountant, Larry A. Jerde, filed a spreadsheet of Debtors' 1992 income and expenses. He also filed an explanatory cover letter. The spreadsheets and cover letter were identified as Debtors' Exhibit AAA. By letter dated February 10, 1993, Trustee Pokela advised the Court that he was unable to verify the information presented by Accountant Jerde. Consequently, the Court set a continued hearing for February 17, 1993.

By consent of the parties, the February 17, 1993 hearing was not held. Instead, the parties agreed to meet with Accountant Jerde so that Trustee Pokela could review the accountant's documents.

Trustee Pokela filed a letter response to Accountant Jerde's

28 calves	14,282.02	Demand loan-Ken Ness	24,226.44
		ASCS Sealed Grain:	
		Corn	11,290.59
		Soybeans	18,621.61
		Account payable-Elahere Spray (for 1991 chemical)	<u>\$116,276.09</u>
Totals:	<u>\$88,657.31</u>		
	Total Inventory	\$ 88,657.31	
	less Obligations	<u>116,276.09</u>	
	Deficit (no net disposable income)	<u><u>\$(27,618.78)</u></u>	

1992 income and expense spreadsheet on February 25, 1993. Trustee Pokela set forth Debtors' income and expenses for 1992 based on his own calculations. Trustee Pokela also raised four questions: (1) what income-producing inventory (grain and livestock) did Debtors have at the end of 1992; (2) what did Debtors do with the 4800 pounds of navy beans purchased on May 6, 1992; (3) what is the history of Debtors' bank account number 0215335; and (4) why did Debtors pay expenses for a Mary Eidet. Trustee Pokela also noted that Accountant Jerde had not independently verified the 1992 income and expense numbers given to him by Debtors.

The Court conducted another telephonic status conference on February 25, 1993. Based on the record before the Court and in response to the parties' statements during the conference call, the Court outlined the "evidentiary gaps" the parties needed to fill before the Court could rule on whether Debtors owe disposable income. The Court also listed the documents that Debtors needed to provide to Trustee Pokela to insure that Exhibit AAA was accurate. Further, the Court answered two pending legal questions. First, the Court concluded that expenses for maintaining Debtor Arthur Berger's race car would not be allowed as necessary business expenses. Second, the Court held that the entire life insurance proceeds Debtors received upon their son's death were exempt.⁴

⁴ Chapter 58-37 of the South Dakota Code defines and governs fraternal benefit societies. Section 58-37-68 states:

No money or other benefit, charity, relief, or aid to be paid, provided or rendered by any society, shall be

The Court, however, also stated that the value of the exempt benefits could be recognized in a modified plan if Trustee Pokela showed that non exempt property purchased with the exempt benefits altered the best interest of creditors test under § 1225 (a) (4).

Accountant Jerde responded to the Court's questions by letter dated March 17, 1993. On March 23, 1993, he also provided a statement of "Quick or Liquid Assets Compared to Liabilities" as of December 31, 1992. A telephonic status conference on the

liable to attachment, garnishment or other process, or to be seized, taken, appropriated or applied by any legal or equitable process or operation of law to pay any debt or liability of a member or beneficiary, or any other person who may have a right thereunder, either before or after payment by the society.

The law was declared constitutional by the South Dakota Supreme Court in First National Bank v. Halstead, 229 N.W. 294 (S.D. 1930).

Section 58-12-4 of the South Dakota Code provides generally for the exemption of life insurance proceeds to the extent of \$20,000.00. Section 58-37-142 recognizes that other statutes under Title 58, which governs insurance generally, potentially affect Chapter 58-37, which governs fraternal benefit societies. Section 58-37-142 enumerates the several sections of Title 58 that "shall apply to fraternal benefit societies, to the extent applicable and not in conflict with the express provisions of [Chapter 58-37] and the reasonable implications thereof[.]" Section 58-12-4, the life insurance exemption limitation, is not addressed by § 58-37-142. Moreover, § 58-1-3 says that other provisions of Title 58 shall not apply to fraternal benefit societies except as provided by Chapter 58-37. Chapter 58-37 does not make § 58-12-4 applicable to fraternal benefit societies. Therefore, the life insurance benefits that Debtors received from Aid Association for Lutherans is exempt under § 58-37-68 and is not limited to \$20,000.00 by § 58-12-4.

At the time Debtors filed their amended schedule of exempt property, it appears Debtors had expended most of the funds. Only the unexpended funds are protected by § 58-37-68. The property purchased with the funds is not protected unless some other exemption is claimed.

supplementary evidence was held April 8, 1993 and the Court set a final hearing on Exhibits ZZ and AAA and Accountant Jerde's supporting materials for April 20, 1993. That hearing was continued to May 18, 1993 because of a death in Accountant Jerde's family. Debtors filed a copy of their 1992 income tax return on May 13, 1993. The final hearing on Debtors' discharge, the Trustee's motion to modify plan, and the Trustee's objection to exemptions was held May 18, 1993. Debtors presented a year-end balance sheet for 1992 and some revised cash flow documents for 1992. The parties were ordered to submit their final arguments in writing.

In his written arguments, Trustee Pokela contends Debtors owe \$51,082.82 in disposable income. He computed this figure by taking the \$27,618.78 deficit from Exhibit ZZ and "adding back" the following items:

\$16,681.00 for race car expenses incurred during plan term
10,520.60 for debt forgiveness from Debtor's mother
39,000.00 for uncollected pasture rent from Debtors' sons
12,500.00 for gift of one-half interest in tractor to son

In their written arguments, Debtors contend that the \$27,618.78 deficit from Exhibit ZZ is the final disposable income figure. They state the additions proposed by Trustee are not appropriate because:

(1) the race car expenses were a legitimate diversion for Debtor and should have been expected since the race car was included in Debtors' schedule of assets and plan and because he had raced for many years prior to filing;

(2) the debt forgiveness by Debtor's mother should not be included because: (a) it did not generate any cash for the bankruptcy estate; (b) Debtors assumed an even greater obligation in return for the mortgage release because they agreed to provide for the mother in her old age; and (c) any cash saved by the mortgage forgiveness has already been included in the analysis of Exhibit ZZ;

(3) the plan did not contemplate that Debtors would receive cash rent for pasture from their sons so that issue is res judicata and, moreover, any payments to their sons were appropriate compensation for labor or for Debtors' use of their sons' machinery; and

(4) following a complaint by FCBO, Debtors decided not to give their son one-half interest in the Steiger tractor and Debtors amended their tax return to reflect the retracted gift.

Two questions remain unanswered. First, should Debtors' confirmed plan be modified so that the best interest of creditors test required by § 1225 (a) (4) reflects the debt forgiven by Debtors' mother and any equity in personal or real property that Debtors acquired post-confirmation with the life insurance proceeds? Second, have Debtors devoted all disposable income payments to unsecured claims as required by their confirmed plan?

A. 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 as of 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 BR 648 (Bankr. S.D. Iowa 1988); contra *In re Nielsen*, 86 BR. 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 is also 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 but before the case is closed, dismissed, or converted to Chapter 7.

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.⁵ *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).

B. Determining Disposable Income. Disposable income is the difference between available income and necessary expenses during

⁵ This Court's decision in *In re Oletzke*, Bankr. No. 186-00254, slip op; (Bankr. D.S.D. December 11, 1990), is overruled to the extent that it held that a modification of a Chapter 12 plan may not alter the effective date of the plan for the purpose of applying the best interest of creditors test.

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.* 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 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). 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.

Undocumented numbers or mere estimates of past years' income and expenses will not be accepted. Projections of income and expenses offered to show the funds needed to continue the operation (such as seed and fertilizer for the coming crop year) must be grounded on historical figures.

The trustee, as well as the Court and creditors, should be able to rely on the accuracy of the monthly and annual financial reports prepared by Debtors. . . . [A] debtor's failure to turn over disposable income or his efforts to hide assets or otherwise hinder the trustee's verification of financial information may constitute fraud.

Id. at 739.

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 in its assets could unjustly deprive creditors of the income enjoyed under a successful plan.

Id. at 112-13.

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 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. (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. (June 9, 1993), appeal filed, *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 necessary expenses during the disposable income payment period and the funds necessary for the continuation of the business.

III.

A. *Debtors' plan should be modified to include the equity Debtors realized when the real estate mortgage was forgiven post-confirmation and when assets were brought into the estate post-confirmation.* When Debtors' plan was confirmed, Debtors' liquidation analysis of their real property recognized a second mortgage to Arnold and Delores Berger (Debtor Arthur Berger's parents) on a certain 334 acres. Debtors valued the 334 acres at \$97,475.00. After liquidation fees, taxes, and a first mortgage to

State Bank of Waubay were subtracted, \$45,000.00 was applied to Arnold and Delores Berger's secured claim. The balance was applied to FmHA's third mortgage and FCBO's (formerly PCA's) fourth mortgage. Post-confirmation, Delores Berger, now a widow, allowed the mortgage to be satisfied. Therefore, Debtors now may have equity in the 334 acres which should be recognized for the benefit of unsecured creditors under the best interest of creditors' test in a modified plan.

FCBO still has a lien on the real property, as well as some personal property, as provided by a stipulation with Debtors that was approved February 29, 1988. Neither party presented any evidence on the current value of the 334 acres nor the extent of FCBO's lien on the land or on Debtors' personal property due to the improvement in FCBO's secured position on the real property.⁶ Further, Debtors claim a portion of the forgiven debt should be attributed to their homestead exemption. Therefore, the Court is unable to determine the amount of equity, if any, that Debtors must recognize for unsecured creditors. If the parties are unable to stipulate to the amount, a hearing will be held to determine the present liquidation value of Debtors' property.

Debtors' plan also should be modified to recognize any equity Debtors may have realized when they acquired non exempt assets with the life insurance proceeds. Had Debtors merely kept the life

⁶ The value of FCBO's secured claim has not been altered. See *In re Martin*, 130 B.R. 951, 960-61 (Bankr. N.D. Iowa 1991).

insurance proceeds in their savings account or if they had only paid necessary family or business expenses with it, it is clear that the plan could not be modified to recognize those funds for unsecured creditors under the best interest of creditors test. There is, however, no exemption statute identified by Debtors that protects the life insurance benefits once Debtors purchased other non exempt assets with them.

According to Debtors' Exhibit PP, the only tangible, non exempt asset that Debtors purchased with the insurance funds was a 1984 Steiger tractor. The Court was not presented with any evidence of whether Debtors acquired equity in that tractor. There was some testimony that the Steiger has been sold or traded already. However, to the extent that Debtors acquired equity in the non exempt tractor, that value should be paid to unsecured creditors under the best interest of creditors test. The parties should confer to determine the amount of any equity Debtors acquired in the Steiger. If a consensus cannot be reached, a separate valuation hearing will be held.

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 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).

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.

Debtors' owe disposable income of \$34,397.00 and thus have not completed all plan payments. To say that it was difficult to

determine disposable income in this case would be a gross understatement. Debtors did not operate their farm during the plan term with an eye toward maximizing disposable income because they did not understand their disposable income obligation. Consequently, Debtors' records were poor and it was very difficult to identify and track all income and expenses. Nonetheless, the evidence before the Court shows that Debtors owe disposable income of \$34,397.00. This conclusion was reached by answering the four questions presented and discussed in *Schuldies* and *Broken Bow*.

1. The disposable income payment period in this case is from October 11, 1988 through December 31, 1991 according to the terms of the plan and § 1225(b) (1). The parties are in accord on this provision.

2. Debtors' available income at the end of the disposable income payment period, consisting of cash and the value of unsold but marketable farm commodities, is \$88,657.31. This figure is provided by Debtors' Exhibit ZZ. Trustee Pokela adopted it in his final written argument.

3. All Debtors' expenses during the disposable income payment period will be allowed except for the race car expenses of \$16,861.00. Trustee Pokela argues several of Debtors' post-confirmation expenses should not be allowed as reasonably necessary. He has questioned Debtor Arthur Berger's expenditures related to his race car, Debtors' cash payments to their sons for labor, the feed and pasture Debtors furnished for their sons'

cattle and Debtors' expansion of their machinery and equipment line. The Court previously ruled that the race car expenses would not be allowed.

Insufficient evidence was presented for the Court to conclude that the expenditures related to Debtors' sons were not necessary for the operation of the farm. The Court was never presented with tangible evidence of the total cash paid to the sons nor of the value of the feed and pasture provided. There also was no evidence that these expenditures exceeded the value of the labor that the sons provided to Debtors in return. Further, arrangements with grown children starting out in farming, such as Debtors' arrangement with their sons, are not uncommon. Debtors' business relationship with their sons was not hidden from creditors nor apparently abused at the expense of unsecured creditors.

Insufficient evidence was also presented on whether Debtors expanded their machinery and equipment line unnecessarily. The Court was not presented with clear evidence of the machinery and equipment bought post-confirmation, the terms of the sales or trades, or the intended use for the additional machinery and equipment. Consequently, the Trustee did not meet his initial burden of showing that these expenditures may not have been reasonably necessary.

Trustee Pokela did not specifically question how Debtors spent their insurance benefits. However, a large portion went to pay

business expenses⁷ or to purchase exempt assets. As to the non exempt Steiger tractor Debtors purchased, there was no evidence that the large tractor exceeded Debtors' needs or that the purchase was otherwise improvident. The evidence also shows that Debtors did not make a gift to their son of one-half interest in the tractor. Consequently, the Court concludes the Steiger tractor was necessary for the operation and continuation of the business and the expense will be allowed. [Unsecured creditors may still realize any equity in the tractor under the best interest of creditors test. See part III., A., above].

4. The income that Debtors needed to 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) is \$71,121.00 to meet some 1992 expenses. Generally, the cash or assets a Chapter 12 debtor may carry forward from the disposable income payment term should be an amount sufficient to meet forthcoming, necessary expenses that the Chapter 12 debtor cannot pay with future income or cannot finance until additional income is received. Here, the Court had the benefit of Debtors' actual 1992 income and expense statement, which showed that Debtors obtained

⁷ It appears Debtors may have directly paid some unsecured plan creditors, such as Elshere Spray, with their insurance benefits. If so, these creditors should not receive additional plan payments either under the best interest of creditors' provision or under the disposable income provision. See 11 U.S.C. § 1229 (a) (3).

crop financing in 1992 and also had sufficient income in 1992 to meet most of their short-term debt obligations and regular expenses, despite 1992 being a poor crop year. However, Exhibits BBB and DDD do not clearly state the source of the farm income (whether from 1991 or 1992 commodities) and the months in which Debtors received financing. Thus, the Court must return to Exhibits ZZ and CCC to determine what cash or liquid assets Debtors needed to carryover to meet 1992 obligations.

Exhibit CCC provides a good picture of what obligations were of a longer nature and did not need to be paid in full in 1992 at the expense of unsecured creditors. First, the demand notes to Mistery Revon, Tohidi, and Ness were not included as expenses for which carryover funds were needed because there was no evidence that these creditors had to be repaid in 1992. The notes and their repayment terms were not put into evidence. Moreover, Exhibit CCC shows the notes were not paid in 1992. Further, Debtors had sufficient financing or trucking income to meet their first half real estate taxes of \$960.00. Finally, Exhibit DDD and testimony received about Exhibits ZZ indicate that only about one-half of the debt to Peoples State Bank was paid in 1992 and that the balance was renewed. Consequently, only the actual amount paid to Peoples State Bank in 1992 will be allowed as a short-term obligation. Thus, the total 1992 obligations for which Debtors will be allowed to carryover funds are:

Peoples State Bank (amount paid in 1992)	\$ 16,982.00
ASCS	35,517.00
Elshere Spray	<u>18,622.00</u>
	<u>\$ 71,121.00</u>

The Court recognizes that Debtors' operation ran in the red during most of their disposable income payment term and in 1992. Calculating disposable income, however, is not merely a cash flow question. The inquiry must be what income is available for unsecured creditors if only necessary expenses are paid during the disposable income term and if carryover funds are allowed for necessary expenses that will not be covered by future income or by financing. Historical and projected cash flow documents are relevant only for determining what carryover funds are needed by looking at what expenses a debtor may expect, when those expenses will arise, and when the debtor will receive income. Disposable income (available income less necessary expenses and allowed carryover funds) is not added back to any cash flow deficit. The following example illustrates this concept.

Suppose a Chapter 12 debtor *unnecessarily* built a new dairy barn during the first month of his plan. He paid \$100,000.00 down and borrowed the rest. During the three years of the plan, he paid his lender \$50,000.00 each year in interest and principal on his dairy barn debt. At the end of the plan term, he had spent \$250,000.00 on the dairy barn. Each year of the plan he also ran in the red \$45,000.00 for a total cash flow deficit of \$135,000.00. The

disposable income in this example is \$250,000.00 -- the total of the unnecessary expenditures during the plan term. The \$250,000.00 is not "added back" to the \$135,000.00 deficit to achieve a net disposable income of \$115,000, as Trustee Pokela theorizes in his final written argument, because the unnecessary expenditures contributed to the deficit.

The final calculation in this case is Debtors' available income of \$88,657.00 plus the unnecessary race car expenses of \$16,861.00 less the carryover funds allowed of \$71,121.00 for a balance of \$34,397.00 in disposable income.

Since Debtors have not paid this disposable income to unsecured creditors as required by the terms of their confirmed plan, all plan payments have not been made and Debtors are not eligible for a discharge at this time. An appropriate order will be entered.

Dated this 7th day of January, 1994

BY THE COURT:

Irvin N. Hoyt
Chief Bankruptcy Judge

ATTEST:

PATRICIA MERRITT, CLERK

By _____
Deputy Clerk

(SEAL)

UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH DAKOTA
Northern Division

In re:)
ARTHUR ADOLPH BERGER) Bankr. Case No. 87-10289
Social Security No. [REDACTED]-9520)
and) Chapter 12
)
) ORDER RE: DEBTORS' DISCHARGE,
CHERYL JEAN BERGER) TRUSTEE'S MOTION TO MODIFY
Social Security No. [REDACTED]-7746) CONFIRMED PLAN, AND TRUSTEE'S
) OBJECTION TO EXEMPTION
Debtors.)

In compliance with and recognition of the Memorandum of Decision Re: Debtors' Discharge, Trustee's Motion to Modify Confirmed Plan, and Trustee's Objection to Exemption entered this day,

IT IS HEREBY ORDERED that Trustee A. Thomas Pokela's motion to modify Debtors' confirmed plan is granted to the extent that the plan shall be modified to increase the payments to unsecured creditors pursuant to 11 U.S.C. § 1225(a) (4) based on any increase in Debtors' equity in certain non exempt real property on which a mortgage was forgiven post-confirmation and based on any equity Debtors' obtained in a Steiger tractor that Debtors purchased post-confirmation; and

IT IS FURTHER ORDERED that Trustee A. Thomas Pokela's objection to exemption is sustained only to the extent that Debtors' obtained equity in non exempt estate property, specifically a Steiger tractor, that Debtors purchased with exempt life insurance benefits paid to them post-confirmation by Aid Association for Lutherans; and

IT IS FURTHER ORDERED that Debtors' request for a discharge is denied without prejudice because they owe \$34,397.00 in net disposable income to unsecured creditors.

So ordered this 7th of January, 1994.

BY THE COURT:

Irvin N. Hoyt
Chief Bankruptcy Judge

ATTEST:

PATRICIA MERRITT, CLERK

By _____
Deputy Clerk

(SEAL)