

**FILED**

**AUG 30 1994**

*W. R. Felt*  
CLERK

UNITED STATES DISTRICT COURT  
DISTRICT OF SOUTH DAKOTA  
SOUTHERN DIVISION

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 In re: \* Case No. 94-1006  
 ARTHUR A. AND CHERYL J. \* Chapter 12  
 BERGER, \*  
 Debtors. \*  
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 ARTHUR A. BERGER and \* CIV 94-1006  
 CHERYL J. BERGER, \*  
 \*  
 Appellants, \* *Page 33*  
 \*  
 -vs- \* MEMORANDUM OPINION  
 \*  
 A. THOMAS POKELA, \*  
 Chapter 12 Trustee \*  
 \*  
 Appellee. \*  
 \*\*\*\*\*

This bankruptcy appeal arises from the pending Chapter 12 proceeding of Arthur and Cheryl Berger. Arthur and Cheryl Berger, Debtors, appeal the Bankruptcy Court's decision on several issues, which fall into three broad categories. First, Debtors challenge the authority of the Bankruptcy Court to deny discharge, modify Debtors' Chapter 12 plan and require payments to be made five years after the first payment under the confirmed plan. Second, the Debtors appeal the calculation of the net disposable income by the Bankruptcy Court. Third, the Debtors appeal the Bankruptcy Court's determination of the effect of spending exempt money on a Steiger tractor and the effect of a satisfaction of mortgage. Having carefully considered the parties' briefs, the Court affirms the

decision of the Bankruptcy Court.

### I. Background

Debtors filed their voluntary Chapter 12 petition for farm reorganization on September 29, 1987. Their debt adjustment plan was confirmed on October 2, 1988. Debtors filed a notice of filing final report and final account on April 8, 1992. An objection to the final report and final account was timely filed on May 1, 1992, by A. Thomas Pokela, Chapter 12 trustee. A notice of hearing was served and filed on May 12, 1992. During the trial Debtors argued that \$102,000.00 received in double indemnity benefits under Debtors' son's Aid Association for Lutherans policy, as a result of Debtors' son's death by automobile accident in 1989, were exempt. At the Bankruptcy Court's request, Debtors filed an amendment of their personal property schedule to include the \$102,000.00 in life insurance benefits.

On November 25, 1992, Trustee Pokela filed a motion to modify Debtors' confirmed plan to recognize the \$45,000.00 secured debt that was released when Debtor Arthur Berger's mother filed a satisfaction of her mortgage. From October 19, 1992, until May 18, 1993, several hearings were conducted on the objections to the Chapter 12 discharge. On May 19, 1993, the Bankruptcy Court entered an order setting the deadline for written arguments. On January 7, 1994, the Bankruptcy Court entered its Memorandum of Decision and Order Re: Debtors' Discharge, Trustee's Motion to Modify Confirmed Plan, and Trustee's Objection to Exemption.

A timely notice of appeal of the Bankruptcy Court's order was

filed by Debtors on January 14, 1994. District court jurisdiction is properly premised upon 28 U.S.C. § 158(a).

## II. Discussion

This Court reviews the Bankruptcy Court's findings of fact for clear error and reviews its legal conclusions de novo. Wegner v. Grunewaldt, 821 F.2d 1317, 1320 (8th Cir. 1987).

### Net Disposable Income 11 U.S.C. § 1225(b)

Debtors argue that the Bankruptcy Court erred in improperly calculating the amount of net disposable income. They argue that the Bankruptcy Court did not have sufficient evidence to find the amount of net disposable income it found, that it erred in not calculating other expenses and obligations, and that it failed to offset any increase in net disposable income against operating deficit.

Section 1225(b)(2) defines "disposable income" as "income which is received by the debtor and which is not reasonably necessary to be expended--

- (A) for the maintenance or support of the debtor or a dependent of the debtor; or
- (B) for the payment of expenditures necessary for the continuation, preservation, and operation of the debtor's business."

A determination of net disposable income "... is simply a question of fact as to their reasonable necessity." In re Wood, 122 B.R. 107, 115 (Bankr. D. Idaho 1990). Section 1225(b)(2)(B) requires the Court to conduct a subjective analysis of a debtor's expenditures, actual and proposed, to determine if the expenditures are reasonably necessary. In doing so, the case law has uniformly adopted an examination of the "totality of circumstances" based

upon the evidence presented. In re Kuhlman, 118 B.R. 731, 739 (Bankr. D.S.D. 1990). The determination must be made on a case by case basis, and represents a purely factual inquiry. In re Coffman, 90 B.R. 878, 883 (W.D. Tenn. 1988). As the court in Coffman noted:

Overall, this must be an inquiry, both by the trustee and the court, into what is commercially reasonable under all the facts and circumstances. The debtor must not be permitted to evade the payment of disposable income by improper expenditures. However, this is not a simple cash flow inquiry. The Court is mindful that the debtors should not accumulate an unreasonably large reserve of funds which could be a windfall at the time of discharge. Neither should the debtors be unreasonably hindered from reaching their reorganizational goal.

90 B.R. at 886 (citation omitted). As such, the review of the Bankruptcy Court's determination of net disposable income, as it relates to the reasonable necessity of the expenditures, is for clear error.

The Bankruptcy Court determined that 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). Both parties agreed that Debtors' available income at the end of the disposable income payment period is \$88,657.31. The bankruptcy court allowed all Debtors' expenses during the disposable income payment period except for race car expenses of \$16,861.00.

The Bankruptcy Court next took into consideration not only those amounts expended by Debtors during the term of the plan, but also those amounts which would be required in the future for the continuation, preservation, and operation of the business. 11 U.S.C. § 1225(b)(2)(B). The logic of this statutory construction

has been articulated in several decisions:

The specific reference in § 1225(b)(2)(B) to expenses necessary for the "continuation" of the debtor's business indicates that deductible expenses need not be restricted to those incurred during the period of the plan. This provision, which contemplates the use of plan income to sustain the debtor's farming operation beyond a particular operating year, is in keeping with the objective of Chapter 12 to help farmers reorganize so that they may retain their land and continue farming. It cannot be seriously contended that Congress intended that a debtor's farming operation continue during the life of the plan but not beyond the period of the plan.

In re Bowlby, 113 B.R. 983, 988 (Bankr. S.D. Ill. 1990). This conclusion is consistent with those cases which allow Chapter 12 debtors to carry over income from one year to the next during the term of a plan. See In re Coffman, 90 B.R. at 885 (requiring all net income to be distributed each plan year to creditors would ignore the realities of farming).

Debtors argue that the Bankruptcy Court improperly discounted immediately due short term loans as long term loan obligations in arriving at the carry over figure of \$71,121.00, to be used to meet some 1992 expenses. The Bankruptcy Court noted that neither the demand notes nor the repayment terms relating to the debts owed to D. Revon, D. Tohidi and Ken Ness were in evidence, but that Exhibit CCC provided by Debtors indicated that the notes were not paid in 1992. Therefore, Debtors were not allowed to carry over funds for these obligations. Likewise, the Bankruptcy Court found that only about one-half of the amount of the debt owed to Peoples State Bank was paid in 1992 with the balance being renewed. The Bankruptcy Court, therefore, only allowed the actual amount paid to Peoples State Bank as a short-term obligation.

Debtors argue that this constitutes a mischaracterization of

the nature of the debts they owed and improperly penalizes Debtors. Debtors argue that the debts owed to Revon, Tohidi and Ness, as well as the debt owed to Peoples State Bank, should all be used to offset any disposable income which those debts produced. This fails to take into account the definition of net disposable income under § 1225(b).

The purpose of carry over allowances, as discussed above, is to allow for continued operation and payment of amounts due in the next year. Thus, the Bankruptcy Court's allowing a deduction for the actual amount of debt paid to Peoples State Bank is appropriate, in that the Bankruptcy Court, no other information being available to it, allowed the amount that was required by Debtors to refinance their obligation with Peoples State Bank to be deducted from net disposable income as the amount which was necessary to carry over. Since the actual amount paid was, obviously, the amount needed to refinance the debt, such amount is in fact the necessary carry over amount.

Debtors bear the burden of persuasion to show that all payments have been made under the plan. In Re Kuhlman at 738. The terms of the notes owed to the Revon, Tohidi and Ness were not in evidence and apparently no payments had been made in 1992. Debtors failed to demonstrate that money was needed to carry over into 1992 for the payment of those debts. Therefore, the Bankruptcy Court did not err in its calculation of net disposable income.

#### **Offset of Disposable Income Against Operating Loss**

Debtors also contend that any extra net disposable income should have been set off against the operating losses for 1991. As

the bankruptcy court correctly points out, the calculation of net disposable income is a question of fact and distinct from cashflow calculations since a debtor should not be able to evade payment of disposable income by improper expenditures. See In re Coffman, 90 B.R. at 883, 886. The method of calculating disposable income is clearly set out by statute. 11 U.S.C. § 1225(b). The argument regarding an off set is without merit.

#### **Modification of Debtor's Plan**

A confirmed Chapter 12 plan may be modified to increase or reduce payments, to extend or reduce the time of making payments, or to recognize payments made to a creditor other than under the debtor's confirmed plan. 11 U.S.C. § 1229(a). Section 1229(b) requires the bankruptcy court, in examining a post-confirmation modification, to satisfy itself that other specific sections of the Bankruptcy Code governing Chapter 12 are met, including the requirements of §§ 1222(b), 1223(c), and 1225(a). This includes the best interest of the creditors test set forth at § 1225(a)(4).

Debtors argue that the Bankruptcy Court erred in modifying the payment plan, in extending payments for five years past the date of first payment and abused its discretion by denying appellants' discharge, because, appellants had already made all payments under the plan before the court entered its modification order.

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. at 738. Debtors argument is thus premised on the fact in question before the Bankruptcy Court, that all payments required under the plan were made. The Bankruptcy Court found, after properly computing the net disposable income, that all payments had not been made, and thus the Bankruptcy Court was not in error to approve a modification of the Chapter 12 plan.

**Effect of Use of Exempt Proceeds to Purchase Equipment and Effect of Forgiveness of Mortgage**

Debtors received \$102,000.00 from Aid Association for Lutherans (AAL) in 1989 after their son was killed in an automobile accident. The Bankruptcy Court determined that the entire life insurance proceeds Debtors received upon their son's death were exempt pursuant to SDCL 58-37-68.<sup>1</sup> 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 interests of creditors test under § 1225(a)(4).

In its Memorandum of Decision Re: Debtors' Discharge, Trustee's Motion to Modify Confirmed Plan, and Trustee's Objection to Exemption, the bankruptcy court determined that a Steiger

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<sup>1</sup>Section 58-37-68 provides:

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



Tractor, purchased with the proceeds, was a non-exempt asset and that any equity which Debtors had in the tractor should be included in the disposable income under the best interests of the creditors test. (Memorandum of Decision, 15-16.)

Debtors contend that this is impermissible as the Steiger tractor itself should continue to be exempt as the proceeds which were used to buy it were. This argument is not supported by the text of SDCL 58-37-68, which specifically provides protection for benefits or money derived from an organization such as AAL, but does not provide for protection of property purchased with such funds. The South Dakota Code provisions governing personal property exemptions are found at Chapter 43-45 of the South Dakota Codified Laws. Debtors have not explained how any equity in the Steiger tractor would be exempt, other than by the provisions of SDCL 58-37-68 which do not apply. Nor do any of the personal property exemptions in Chapter 43-45.

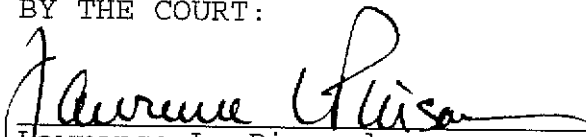
Debtors likewise argue that the Bankruptcy Court erred in finding that modification of the Debtors plan should include the equity Debtors realized, if any, when the satisfaction of a mortgage on Debtors land by Mr. Berger's mother occurred post-confirmation. Debtors argue that the debt was not simply forgiven, but was exchanged for additional promises and that the forgiveness of the debt applies to exempted homestead property. These are factual determinations concerning which the Bankruptcy Court had no evidence and which this Court cannot reach since there has been no final order or determination in regard to those facts by the Bankruptcy Court. The Bankruptcy Court did not make any rulings or

findings on the revaluation of either the land or the Steiger tractor, since there was no evidence on the current value of either. The Bankruptcy Court deferred such a determination until an evidentiary hearing could be held if Trustee and Debtors did not reach a stipulation on these issues. (Memorandum of Decision 15-16.) It was not error, for the reasons stated above, for the Bankruptcy Court to determine that equity in either property, if such exists, would necessitate a modification of debtors Chapter 12 plan. Therefore, Debtors argument is without merit.

Accordingly, the decision of the Bankruptcy Court is AFFIRMED.

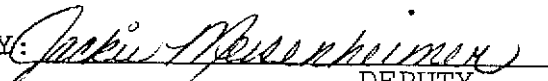
Dated this 29<sup>th</sup> day of August, 1994.

BY THE COURT:

  
Lawrence L. Piersol  
United States District Judge

ATTEST:

WILLIAM F. CLAYTON, CLERK

BY:   
DEPUTY

(SEAL)