U .TED STATES BANKRUPTCY COUR.
DISTRICT OF SOUTH DAKOTA
ROOM 211
FEDERAL BUILDING AND U.S. POST OFFICE
225 SOUTH PIERRE STREET
PIERRE, SOUTH DAKOTA 57501

IRVIN N HOYT
CHIEF BANKRUPTCY JUDGE

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December 27, 1994

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Chapter 12 Trustee
Post Office Box 1102
Sioux Falls, South Dakota 57101

Subject: ***In re Junior S. and Joyce M. Hammrich,***
Chapter 12; Bankr. No. 87-10032

Dear Mr. Pfeiffer and Mr. Pokela:

On May 11, 1994, this Court entered a Memorandum of Decision and Order regarding Debtors' discharge and a determination of disposable income. Therein, the Court concluded that Debtors had not shown that all expenses incurred during the disposable income repayment period (October 17, 1989 to January 1, 1993) were necessary. The Court found that Debtors' actual expenses exceeded plan projections by $444,906.64 due to an expanded cattle operation. Since Debtors had operated at a deficit during the plan term, however, the Court was unable to conclude that the expanded operation was necessary. From the evidence presented it appeared that the unsecured creditors had involuntarily financed a post-confirmation expansion of Debtors' operation.

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The Court further concluded that Debtors had not shown sufficiently what income they needed to retain as "reasonably necessary . . . for the maintenance or support of [Debtors and their family]" or the "continuation, preservation, and operation" of Debtors' business" as permitted by 11 U.S.C. § 1225(b)(2). The Court found that Debtors had the following long-term, secured obligations on January 1, 1993 [the end of the disposable income period]:

School & Public Lands	$ 646.00	on April 1, 1993 (final payment)
FmHA	5,984.00	each Jan. 1, through 2005
First State Bank	70,182.00	each Feb. 1, through 2005
Farm Credit Bank	26,000.00	each Jan. 1, through 2014
Total:	$ 102,812.00	

The Court also recognized the following current obligations that Debtors had on January 1, 1993:

Ipswich Elevator	$ 3,115.00
Ipswich Farmers Ampride	2,536.00
Repairs and Supplies	791.00
Veterinarian	228.00
1992 Rent to Mike Geditz	2,400.00
Utilities	573.00
Peterson Stack Moving	7,337.00
Total:	$16,980.00

Finally, the Court found that as of January 1, 1993, Debtors had marketable livestock worth at least $236,322.00.[1] This included the yearlings and cull cows and bulls that Debtors marketed early

[1] This figure is based on livestock numbers and values urged by Debtors in their revised exhibits "A" and "B" presented on August 24, 1994. Based on similar exhibits and testimony, the Court had calculated that Debtors may have had as much as $267,301.00 in marketable livestock on January 1, 1993.

in 1993 for $112,452.00 in addition to 326 calves with a January 1, 1993 market value of at least $123,880.00 that Debtors intended to sell later at a higher weight.

The Court was unable to make a final calculation of disposable income because Debtors had not justified their operating expenses in excess of plan projections during the plan term and because Debtors had not shown what carryover funds were necessary. In particular, Debtors had not shown that carryover funds sufficient to insure the continuation of their *expanded* operation were warranted. As the Court stated, "Under § 1225(b)(2), Debtors are entitled to carry over the funds reasonably necessary to continue a *feasible* operation . . . ." Debtors, however, had not shown that the expanded operation was necessary or feasible.

The Court ordered a continued evidentiary hearing to be held so that Debtors could:

> present additional evidence to, first, justify their expenditure of operating funds during the disposable income period in excess of the $172,000.00 in annual expenses projected in their plan (this would include a justification for purchasing the Co-op stock if that purchase was made post-confirmation). While some increased expenses may be attributable to inflation, for example, higher feed costs or cattle prices, Debtors particularly must identify and justify all expenses attributable to an expansion of their operation. Second, Debtors must show what funds or marketable assets are needed as carryover to maintain a *feasible* operation. In answering this question, Debtors also may need to show that outside financing for their continued operation is not available.

A status conference was held July 26, 1994. The continued evidentiary hearing was held August 24, 1994.

At the continued evidentiary hearing, Debtors offered a revised balance sheet, their calculation of disposable income on December 31, 1992, and summaries of livestock purchases and sales for 1990, 1991, and 1992. Debtor Joyce Hammrich testified that the couple maintained a breeding herd of 220 to 225 cows during the plan term and that they sold only raised and purchased calves at a weight of approximately 750 pounds. She stated they had not obtained any post-confirmation financing.[2] Debtors did not present any evidence on whether they had attempted to obtain financing for operating expenses. Debtor Joyce Hammrich testified that they had not repaid a 1990 loan from Nathan Schaull. Debtor Joyce Hammrich and Attorney Pfeiffer explained that the Jalmar stock was Debtors' interest in an office building in Ipswich, South Dakota.

A recess was taken so that the Court could discuss with counsel in Chambers the remaining evidentiary shortfall, which was Debtors' need to show what carryover funds were required to maintain their operation. The parties agreed that the hearing would be recessed so that Debtors could prepare an income and expense statement for 1993. The Court would then do a disposable income analysis based on *Broken Bow Ranch, Inc. v. Farmers Home Administration (In re Broken Bow Ranch, Inc.)*, 33 F.3d 1005 (8th

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[2] Other evidence established that Debtors had borrowed $52,000.00 from Nathan Schaull in January 1990. This note was unsecured and was to be repaid (date not certain) with 8% interest.

Cir. 1994).

Debtors filed a report of 1993 income and expenses on September 14, 1994 and reiterated their arguments on why calves weighing less than 600 pounds on December 31, 1992 should not be valued for disposable income purposes. Trustee Pokela filed a response on September 20, 1994 in which he said he did not refute the 1993 numbers provided by Debtors.

By letter dated October 31, 1994, the Court asked Debtors to explain: (1) the 1993 labor expense of $12,000.00; (2) what the "miscellaneous" expenses of $2,270.16 included; (3) the payments "outside the plan" of $31,663.08 in 1993; and (4) the "plan payments" of $76,166.00 in 1993. Debtors' use of the term "plan payments" in their 1993 report was confusing since the plan ended on December 31, 1992. The Court also asked Debtors to list all government farm program payments they received in 1993.

By letter filed November 9, 1994, Debtors said the $12,000.00 labor expense was for a full-time hired hand. They stated the miscellaneous 1993 expenses included advertising bulls for sale, gravel, and brand inspection fees for cattle transported West River for pasture. Debtors listed the payees for their 1993 "plan" payments and their payments "outside the plan" but did not explain why those terms were used after December 31, 1992. Finally, Debtors stated they received $37,263.00 in government farm program payments in 1993.

After calculating disposable income in compliance with the formula adopted in *Broken Bow*, this Court now concludes that as of January 1, 1993, Debtors owe disposable income of $95,885.86.

In *Broken Bow*, the Court of Appeals upheld this Court's earlier formula for calculating disposable income. The formula is: ending inventory of cash and marketable commodities less outstanding obligations then due. *Broken Bow*, 33 F.3d at 1009. From that difference, the Court next subtracts the amount of funds needed as carryover to insure the "continuation, preservation, and operation" of the farm and support of the debtor's family. *Id.*

(CASH + MARKETABLE COMMODITIES - CURRENT EXPENSES) - CARRYOVER FUNDS = DISPOSABLE INCOME

Whether financing is available to meet operating expenses, instead of using additional carryover funds, also must be considered. *Id.* Factors to weigh include whether the debtor has historically borrowed operating funds and whether sufficient financing is available on reasonable terms. *In re Schmidt*, 145 B.R. 983, (Bankr. D.S.D. 1991).

According to Debtors' Revised Exhibit "B" presented at the continued hearing on August 24, 1994, and Debtors' written closing arguments filed following the October 23, 1993 hearing, Debtors had cash of $29,200.00 ($30,000.00 less exempt cash of $800.00) and marketable livestock of $112,452.00 on December 31, 1992. The marketable livestock figure presented by Debtors, however, consists solely of the yearlings and cull cows and bulls that Debtors actually sold in early 1993. Debtors' figure fails to recognize the *present value* (that is, the December 31, 1992 value) of Debtors' other marketable livestock, specifically the weanlings from Debtors' 1992 calf crop, calves of various ages purchased during 1991 or 1992 but not sold yet, and other cull cows and bulls. While Debtors may sell these calves and culls later in 1993 or 1994 for more money than they are worth on January 1, 1993, these animals still have a market value on January 1, 1993 that must be considered in the disposable income calculation. Debtors' bred cows, herd bulls, and the calves to be born in 1993 are *not* considered marketable livestock to be valued on December 31, 1993 for the disposable income calculation.

In light of the evidence presented at the continued hearing on August 24, 1994, the Court finds no basis for altering its finding in the May 11, 1994 Memorandum Decision that on January 1, 1993 Debtors had marketable livestock worth $236,332.00.

When that figure is put into the *Broken Bow* formula, we find that at the end of the disposable income period Debtors had cash and marketable commodities of $281,601.00 ($29,200.00 cash + $236,332.00 marketable livestock + $16,069.00 for 1992 government farm program payments received in 1993[3]). From this amount the

[3] On November 9, 1994, Debtors reported that they received $16,069.00 in farm program payments from ASCS in 1993 and they received CRP payments of $21,194.00 in 1993. Lacking contrary evidence, the Court can only conclude that the $16,069.00 arose from Debtors' 1992 crop year. If Debtors can show to Trustee

Court must deduct current expenses of $16,980.00 and any necessary carryover funds Debtors may need in addition to 1993 income to maintain their operation and support their family.

The stumbling block in determining the necessary amount of carryover funds is what size of operation Debtors should be allowed to maintain. It is clear that Debtors' actual post-confirmation expenses vastly exceeded projected expenses. It also is clear that the bankruptcy estate benefitted little, if at all, from Debtors' expanded post-confirmation operation. Debtors' last full year of operation, 1993, appears typical of plan years 1990 through 1992 and, therefore, provides a good example of how Debtors' post-confirmation operation went astray.

As stated above, on December 31, 1992, Debtors had marketable livestock worth $236,332.00. During 1993, they purchased another $157,090.77 in livestock. Presumably, most of the livestock purchased were calves to be sold as yearlings in 1993 or early 1994 when they reached about 750 pounds. All livestock sales in 1993 generated $376,207.92 in income, or $139,875.92 more than the December 31, 1992 value of Debtors marketable livestock. However, Debtors spent an additional $157,090.77 to buy livestock in 1993. Further, the extra livestock purchased in 1993 also increased operating expenses in 1993 for feed, veterinary care, trucking,

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Pokela's satisfaction that these funds were for crop year 1993, that amount may be deducted from disposable income.

labor, etc.[4] Unfortunately, the additional livestock purchases did not generate additional income. In fact, based on the evidence presented, Debtors earned less than if they had not purchased the extra livestock because the cost of the cattle purchased in 1993 exceeded the extra income by $17,214.85.

The expanded operation apparently had a similar outcome in each of the three years of the plan. Debtors and their creditors may have been better off had Debtors kept cattle purchases and other expenses within the ranges projected in their plan. The Court can find no benefit to their expanded operation. Therefore, the Court will not allow carryover funds sufficient to continue the *expanded* operation. Instead, the Court will use Debtors' projected annual operating expenses of $172,000.00 from their plan in assessing the appropriate amount of carryover funds to allow. As provided in *Broken Bow*, the funds needed as carryover to insure the "continuation, preservation, and operation" of the farm and support of the family is best determined by considering, on a month by month basis, when a debtor receives income and when expenses are incurred during the year. The allowed carryover funds then are the amount necessary to meet expenses until sufficient income is received in the new year to cover them. Debtors, however, have not shown clearly when they receive income and when they accrue

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[4] The amount that Debtors' operating expenses increased due to the additional livestock purchased is unknown.

expenses in a typical year.

Based on a three-year average (1990 through 1992), in 1993 Debtors can expect to receive $40,267.21 in government payments (deficiency, disaster, and CRP), a Jalmar dividend of $2,966.67.00, miscellaneous income of $13,461.26, and $3,397.72 from grain and hay for a total of $60,092.86, *plus* any increase in the value of livestock when sold later in the year. When a reasonable gain on the livestock sold later in 1993 is calculated based on the cattle prices Debtors' received earlier in the year, Debtors should receive at least another $40,000.00 in income in 1993, for a total of $100,092.86.[5]

Debtors' expenses for 1993 should not exceed $268,828.00. Operating expenses of $172,000.00, which includes living expenses of $18,000.00; the Roscoe Bank payment of $70,182.00; the School and Public Lands payment of $646.00; and the FCBO payment of $26,000.00 are included.[6]

Based on these income and expense estimates for 1993,[7] the

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[5] On March 23, 1993, Debtors reported to FmHA that they had 338 yearlings with a present value of $475.00 a head. If actually sold that day, Debtors would have received $160,550.00.

[6] Debtors made their January 1, 1993 payment of $5,984.00 to FmHA in December 1992 so carryover funds are not needed to make that payment.

[7] These estimates are well-within the actual 1993 income reported by Debtors: $376,207.92 from livestock, $37,263.00 from government farm programs, $9,339.80 from miscellaneous sources, and $3,400.00 from their interest in Jalmar. Had Debtors' post-confirmation operation more closely followed plan projections, the

Court concludes that Debtors should be allowed carryover funds of $168,735.14. These carryover funds will insure that Debtors stay in business and that the family is supported in 1993. Over seventy-five percent of Debtors' operating and living expenses and all significant debt payments due for 1993 will be covered. When added to 1993 income, Debtors' operating and living expenses and debt repayment due in 1993 will be covered.

Debtors may seek outside financing for any *expanded* operation (where their operating expenses will exceed $172,000.00). However, while Debtors presented little direct evidence on this issue, the Court does not find that Debtors are a good candidate for any significant financing for their *regular* operating expenses up to $172,000.00. Most reputable lenders will be wary of these Debtors since a significant portion of their business involves speculation on the cattle markets. Further, Debtors have been unable to pay an earlier operating loan of $50,000.00. Finally, their operation has failed to yield a clear profit for the past few years. Accordingly, the Court will not reduce carryover funds and force Debtors to borrow some or all of their regular operating expenses. To do so would jeopardize their fresh start.

Court could have used actual 1993 income and expense figures to better determine how much carryover funds Debtors actually needed in 1993. Instead, the Court must assess necessary carryover funds based on what size of feasible operation Debtors should maintain post-discharge rather than what size of an operation they actually continued after the disposable income period ended.

The final question to be answered is whether any decrease in disposable income during the plan term caused by Debtors' expanded operation should be estimated and paid to unsecured creditors as disposable income. The answer *in this case* is, "No."

It is undisputed that Debtors' expenses exceeded plan projections. However, it also is true that creditors and the trustee could have questioned Debtors' excessive expenses during the plan term. They did not. Although Debtors prepared and filed better-than-average monthly and annual reports with the Trustee, it was not until the end of the plan that the consequences of Debtors' expanded operation were addressed. Had an interested party moved for modification or dismissal sooner, the problem of Debtors' expanded operation may have been remedied through a plan modification. Now the Court is left with the reality that Debtors' post-confirmation operation continued at a loss. There is no way to measure accurately what unsecured creditors may have received as disposable income if Debtors' expenses had stayed within projected limits. Moreover, there is no evidence that Debtors expanded their operation to avoid payments to plan creditors. They apparently thought the extra cattle were generating additional income.

Therefore, based on the findings and conclusions stated above, the resulting disposable income that Debtors must pay to unsecured creditors is $95,885.86 (marketable assets of $281,601.00 less current expenses of $16,980.00 and allowed carryover funds of

$168,735.14).

The Court is aware that two years have passed since Debtors' disposable income term ended. They may no longer have marketable assets that they readily can sell to meet this January 1, 1993 disposable income obligation. The burden of the delay must, therefore, be borne by all parties. The Court will leave it to Debtors and Trustee Pokela to determine how and when this disposable income should be paid by Debtors based on their present circumstances.

The parties shall within thirty days submit an agreed order that sets forth the terms for Debtors to make this disposable income payment and for entry of Debtors' discharge upon payment.

Sincerely,

Irvin N. Hoyt
Chief Bankruptcy Judge

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

DEC 27 1994

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

INH:sh

CC: Bankruptcy Clerk
United States Trustee
Thomas A. Lloyd,
Assistant U.S. Attorney