

UNITED STATES BANKRUPTCY COURT  
DISTRICT OF SOUTH DAKOTA  
Central Division

In Re:	)	Bankr. Case No. 87-30162
	)	
WILBUR JOHN SMITH	)	Adversary Case No. 94-3010
BETTY JEAN SMITH	)	
	)	Chapter 12
Debtors.	)	
	)	
WILBUR JOHN SMITH	)	
BETTY JEAN SMITH	)	MEMORANDUM OF DECISION RE:
	)	MOTIONS FOR SUMMARY JUDGMENT
Plaintiffs,	)	
vs.	)	
	)	
UNITED STATES OF AMERICA/	)	
FARMERS HOME ADMINISTRATION	)	
	)	
Defendant.	)	

The matters before the Court are the Motions for Summary Judgment filed by each party. 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 more fully, the Court concludes that Plaintiffs' motion should be denied, that Defendant's motion should be granted, and that the complaint should be dismissed.

I.

Debtors Wilbur J. and Betty J. Smith's Chapter 12 plan was confirmed by Order entered July 28, 1988. The confirmation order and the confirmed plan provided that the Farmers Home Administration [now the Rural Economic and Community Development Agency (RE&CD)] had a secured claim of \$192,000.00 and an unsecured

claim of \$1,392,419.00.<sup>1</sup> On its secured claim, RE&CD was to receive annual payments of \$10,112.00 and \$8,982.00 over fifteen years. On its unsecured claim, RE&CD was to receive disposable income over the three-year term of the plan and a *pro rata* share of a one-time \$10,000.00 payment. Debtors completed their plan payments and received a discharge on August 24, 1993.

A related bankruptcy case was *In re Katcon, Inc.*, Bankr. No. 87-30158 (Bankr. D.S.D.), a Chapter 11 proceeding. Katcon was organized as a family farm corporation. The 100% shareholders of Katcon were Terrance Smith and Richard Smith, who also were Chapter 12 debtors. Wilbur Smith served as an officer of the corporation. Katcon was the holder of 1360 acres of land that was secured to BankWest and RE&CD.<sup>2</sup> BankWest had a first lien on 560 acres. RE&CD had a first lien on 800 acres and a second lien on the 560 acres.

In *Katcon*, the debtor and RE&CD entered into a stipulation for plan treatment. The stipulation provided that RE&CD would have a secured claim of \$132,700.00 to be repaid at 7% interest over 20 years.

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<sup>1</sup> Debtors Wilbur and Betty Smith's confirmed plan contains two different figures for RE&CD's unsecured claim. See pp. 2,3, and 4. The Court has used the figure that is mathematically correct when RE&CD's secured claim is subtracted from the total claim.

<sup>2</sup> The real estate mortgage attached to RE&CD's proof of claim in Debtors Wilbur and Betty Smith's Chapter 12 case was signed by, among others, Wilbur Smith as an individual and Wilbur Smith as the President of Katcon, Inc.

Pursuant to the stipulation, the value of RE&CD's unsecured claim was based on the value of RE&CD's full claim, less the value of Katcon's real property and less the value of Wilbur and Betty Smith's real property, as the Smiths also gave RE&CD a mortgage on their property to secure Katcon's debt. The stipulation further provided for a modified § 1111(b) election. The modified § 1111(b) election provisions stated:

(a) FmHA shall retain both its first and second mortgage interest in the debtor's real estate. If the debtor's real estate on which FmHA has a mortgage interest is sold at any time before or within ten years after confirmation of a plan, FmHA's mortgage interest shall entitle it to be paid proceeds from the sale in an amount up to its secured claim of \$1,588,524.73. The amount of the sale proceeds to be paid FmHA on the total claim will not exceed the proceeds of the sale.

(b) The total proceeds of the sale to be paid to the FmHA shall be calculated as:

The total amount of the allowed claim of \$1,588,524.73, which is the face amount of the principal and interest owing to the FmHA on the date of the filing of the petition, together with accrued interest from that date at the interest rate set out in the promissory notes with FmHA or the interest rate as agreed upon in the plan.

(c) The modified 1111(b) provisions shall apply if any sale occurs after confirmation of the plan and prior to payment in full of the allowed secured claim of the FmHA, except as further provided by provision g.

(d) The total sale proceeds paid to FmHA upon a sale of any portion of the real estate in which FmHA holds a mortgage behind any other prior mortgages may be released by the amount of any sale proceeds actually paid to such mortgagee.

(e) The Chapter 11 debtor shall be given credit against the total proceeds to be paid to the FmHA for any payments made by the Chapter 11 debtor after the filing of the petition.

(f) Upon payment of the proceeds to which FmHA is entitled under this provision, FmHA shall release its mortgages.

(g) If any sale of the real estate is for only a portion of the total real estate mortgaged to FmHA, the debtor and the FmHA shall apportion the remaining debt according to the value which the real estate sold represents to the total value of the mortgaged real estate. The debtor and the FmHA may either mutually agree on these values with or without appraisals or may have a court determine these values in any appropriate proceeding in any state or federal court of general jurisdiction or in the bankruptcy court.

(h) Regardless of debtor's prepayment of any plan payments to FmHA that fully satisfy Katcon's initial obligation to pay \$132,700.00 under its confirmed plan, FmHA shall be entitled to receive the above amounts if the debtor takes any action within the ten year period to sell its real estate mortgaged to FmHA, even if the sale proceeds are received by debtor beyond the ten year period.

(I) Upon payment in full of FmHA's secured claim of \$132,700.00 after the twenty years, and provided debtor retains the real estate, FmHA agrees to release the mortgages against the property although the string of payments will not equal \$1,558,554.73.

Katcon's Revised Second Amended Plan incorporated the stipulation with RE&CD. The plan further stated that RE&CD's undersecured claim would be allowed in the Katcon plan's class of unsecured claims "and also [in the] Richard Smith, Wilbur and Betty Smith, and Terrance Smith Chapter 12 cases." Katcon's plan was confirmed by Order entered March 8, 1989. A final decree was entered November 4, 1991.

On December 22, 1994, Debtors Wilbur and Betty Smith filed a complaint against RE&CD seeking a declaratory judgment, damages, and attorney's fees. Debtors stated they had made arrangements to obtain other financing and wanted to pay RE&CD in full on their

secured claim. Debtors claimed that RE&CD demanded the full amount due under the real estate mortgages given in their Chapter 12 case and in *Katcon* pursuant to the § 1111(b) election in *Katcon* and that RE&CD thereby attempted to defeat Debtors' ability to pay their secured balance as provided in Debtors' Chapter 12 plan. Debtors claim the § 1111(b) election applied only to *Katcon's* real property and that RE&CD cannot assess the full debt due against Debtors' real property because the undersecured claim against Debtors ceased when the Chapter 12 discharge was entered. Debtors further argue that RE&CD's attempts to frustrate Debtors' refinancing effort is a willful violation of § 362 that subjects RE&CD to attorneys fees, costs, and punitive damages. Debtors asked the Court to determine the remaining indebtedness due RE&CD, as reduced by any government program payments, and to require RE&CD to satisfy its mortgages upon payment of the remaining secured debt. Debtors moved for summary judgment on April 13, 1995.

RE&CD answered on April 19, 1995 and acknowledged that Debtors' discharge released their personal liability except on long-term debts where payments are being made under 11 U.S.C. § 1225(b)(5). RE&CD argued the Chapter 12 discharge did not discharge or void RE&CD's *in rem* rights under the mortgages. RE&CD further argued that under the § 1111(b) election in *Katcon*, RE&CD's full claim remained secured by both Debtor Wilbur and Betty Smith's and *Katcon's* real property.

A hearing on Debtors' Motion for Summary Judgment was held May 15, 1995. By agreement, the parties presented only the issue of whether Debtors were entitled to a satisfaction of RE&CD's mortgage on Debtors property if they paid the balance due to RE&CD on their secured claim as provided by their plan. The remaining issues of how much was due and whether Debtors were entitled to attorneys fees, costs, and punitive damages were not included since a ruling contrary to Plaintiffs' assertions would moot the remaining issues. RE&CD filed a cross motion for summary judgment on June 15, 1995. Upon receipt of post-hearing briefs, the Court took the motions under advisement.

## II.

A Chapter 12 discharge is entered after all plan payments are completed. 11 U.S.C. § 1228(a). It does not discharge a debtor from any debt provided for under § 1222(b)(5). 11 U.S.C. § 1228(a)(1). A debt under § 1222(b)(5) is one in which the last payment is due after the date of which the final payment under the plan is due.

A Chapter 11 discharge generally is effective upon confirmation of a plan. 11 U.S.C. § 1141(d). Except as provided by the confirmed plan or confirmation order, at confirmation the property dealt with in the plan is free and clear of all claims and interests of creditors.

A creditor in a Chapter 11 case who holds security in estate property may elect special treatment under 11 U.S.C. § 1111(b)(2).

Under this section, the electing class is entitled to have the entire allowed amount of the debt related to such property secured by a lien even if the value of the collateral is less than the amount of the debt. 124 Cong Rec H11103-05 (daily ed. Sept. 28, 1978); S17420-22 (daily ed. Oct. 6, 1978). If the property is later sold, the creditor can apply his lien against the proceeds, and realize any appreciation in the property. See *United States v. Cook*, 147 B.R. 513, 515-16 (D.S.D. 1992).

### III.

The modified § 1111(b) election by RE&CD in *Katcon* covers both *Katcon's* and Debtors Wilbur and Betty Smith's real property. That election is not abated by Debtors' Chapter 12 discharge. When Debtors Wilbur and Betty Smith pay RE&CD the amount due on RE&CD's secured claim as provided in their plan, their personal liability on the note will be removed.<sup>3</sup> However, RE&CD still holds its modified § 1111(b) election in *Katcon* that covers both Debtors' and *Katcon's* real property. Therefore, Debtors are not entitled to have the real property mortgages satisfied and the liens removed as the mortgages and lien relate to *Katcon's* debt. The mortgages given to RE&CD as part of *Katcon's* plan can only be satisfied if the terms of the modified § 1111(b) provision in *Katcon's* plan are met.

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<sup>3</sup> Since payments by Debtors Wilbur and Betty Smith continued post-discharge on RE&CD's secured claim, that debt was not discharged on August 24, 1993. 11 U.S.C. §§ 1222(b)(5) and 1228(a).

Had a straight § 1111(b) election been made by RE&CD in *Katcon*, the Smiths' property may not have been included since § 1111(b) applies to "property of the estate" and Debtors' real property is not part of *Katcon* bankruptcy estate. However, *Katcon* and its principals agreed to the modified election that covered all mortgages given to secure *Katcon*'s debt. Therefore, the parties are bound by the terms of *Katcon*'s plan. Although not artfully drafted, the clear intent of the plan provision is that both the Debtors' and *Katcon*'s real property are included in the § 1111(b) election.

The issue of whether the lien stripping provision of § 506 are applicable in Debtors' Chapter 12 case is not reached since the § 1111(b) election in *Katcon* further modified RE&CD's relationship with Debtors' estate property. Ideally, Debtors' Chapter 12 plan should have been modified when *Katcon*'s Chapter 11 plan was confirmed so that both plans clearly reflected RE&CD's claims against Debtors.

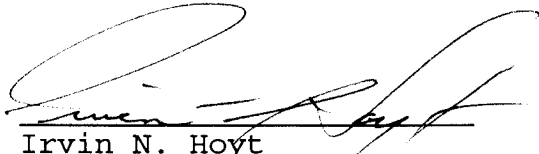
The Court does not herein determine what amount Debtors Wilbur and Betty Smith must pay to satisfy RE&CD's secured claim under their plan. Since a discharge has been entered and their Chapter 12 case has been closed, this Court does not have continued jurisdiction. The parties may litigate elsewhere if a settlement cannot be reached.



Plaintiffs-Debtors' motion for summary judgment will be denied, Defendant-RE&CD's motion for summary judgment will be granted, and the complaint will be dismissed. Neither party will be awarded costs or damages. An appropriate order will be entered.


Dated this 24 day of July, 1995.

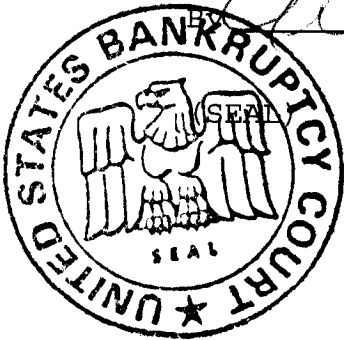
BY THE COURT:

  
Irvin N. Hoyt  
Chief Bankruptcy Judge

ATTEST:

PATRICIA A. JOHNSON, ACTING CLERK

  
Deputy Clerk



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

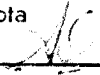
**JUL 24 1995**

**Clerk**  
U.S. Bankruptcy Court, District of **S.D.**

**CERTIFICATE OF SERVICE**

I hereby certify that a copy of this document was mailed, hand delivered, or faxed this date to all parties in interest set forth on the attached service list.

U.S. Bankruptcy Clerk  
District of South Dakota

By:   
Date: 07-24-95

Case: 94-03010 Form id: 122 Ntc Date: 07/24/95 Off: 3 Page : 1  
Total notices mailed: 5

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