United States Bankruptcy Court
District of New Mexico

Document Verification

Case Title: **Robert P. Miller and Mitzi Miller**
Case Number: **98-13174**
Chapter : **12**
Judge Code: **MR**
First Meeting Location: **Roswell**
Reference Number: **12 - 98-13174 - MR**

Document Information		
Number: 102		
Description: Findings of Fact and Conclusions of Law and Memorandum Opinion on Confirmation		
Size: 30 pages (56k)		
Date Received: 04/09/1999 02:44:34 PM	**Date Filed:** 04/09/1999	**Date Entered On Docket:** 04/12/1999

Court Digital Signature View History

2f 42 d5 b9 0a cd b2 78 e3 b7 06 16 9d f8 14 b1 c7 e4 f4 93 df f0 48 40 7d 92 49 a7 68 93 11 3b c8 32 b6 e4 6f c8 11 7a a6 9a f6 7e 51 c5 68 03 54 cf d1 fe ce a6 14 a1 98 16 5e 27 c8 63 3c d6 08 05 7e f0 d1 aa 46 95 0b a9 81 70 f9 17 be 41 ec 5c bb e3 51 10 2b 3d 0d 03 a0 e8 58 3e 97 2e 38 98 23 31 8e 6b 34 fd 43 14 93 70 48 1d 78 4c fd 3e 32 d3 09 e8 98 07 11 88 e5 db 19 48 0b 7e

Filer Information

Submitted By:

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UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEW MEXICO

In re:
ROBERT & MITZI MILLER,
Debtors. No. 12-98-13174 SR

FINDINGS OF FACT, CONCLUSIONS OF LAW,
AND MEMORANDUM OPINION ON CONFIRMATION

This matter came before the Court to consider confirmation of Debtors' Second Amended Chapter 12 Plan. Debtors appeared through their counsel J.D. Behles & Associates (Jennie D. Behles and Linda Ellison). Objecting creditor Western Bank of Clovis ("Bank") appeared through its attorney Joe Parker. The United States Trustee, acting as Chapter 12 Trustee, appeared through the Assistant United States Trustee Ron Andazola.

Having reviewed the testimony, documents and photographs introduced into evidence, and having taken judicial notice of the file, and having reviewed the exhibits and testimony of prior hearings in the case, the Court enters these findings of fact, conclusions of law, and memorandum opinion. This is a core proceeding under 28 USC 157(b)(2)(A), (B), (K) and (L). For the reasons set forth below, the Court denies confirmation of the plan.

Debtors' Plan

The Plan contains eight classes of creditors:

1. Administrative claims.

2. Priority claims.

There are no known priority claims.

3. Claims of Western Bank of Clovis.

This class consists of the Bank's claims in the total approximate amount of $809,707.25, secured by a first lien against all of debtors' cattle, planes, farm equipment, a first lien on three 160 acre parcels (NW/4, Section 9, T1S, R33E, "East place"; SW/4, Section 31, T1N, R32E, "West Place"; SW/4 Section 31, T1N, R33E, "Mid-East place"), a second lien against 160 acres (NW/4, Section 31, T1N, R33E, "Helmer Place"), a second lien against 80 acres (S/2 SW/4, Section 30, T1N, R33E, "grasslands"), and a second lien on 320 acres of land (E/2, Section 33, T1N, R32E, "homeplace").

4. Claim of Farm Credit of New Mexico.

This class consists of Farm Credit's claims in the amount of $39,617.34, secured by a first mortgage lien against the homeplace.

5. Claim of W.E. Helmer.

This class consists of Helmer's claim in the amount of $32,700 secured by a first lien against the Helmer Place.

6. Claim of John Deere Credit.

This class consists of claims of John Deere Credit in the approximate amount of $15,473.92 secured by a lien on a 930 mower/conditioner.

7. Claim of Ford Credit.

This class consists of the claims of Ford Credit in the approximate amounts of $23,327 and $4,589 secured by first liens against a 1998 Ford F-150 Pickup and a 1995 Ford F-150 Pickup.

8. Unsecured and Deficiency Claims.

This class consists of the general unsecured claims and allowed deficiency claims. There are three credit cards in the total amount of $18,595 plus unknown deficiency claims.

The Plan proposes to pay the creditors as follows:

1. Administrative creditors.

Administrative claims are to be paid, after approval of the Court, within 30 days of the Order approving the fees, unless the parties agree otherwise in writing. No fees have yet been approved, but the debtors' first counsel is seeking payment of approximately $14,000 and debtors' second counsel (JD Behles and Associates) have informed the Court that their bills to the estate total approximately $40,600.

2. No priority claims.

3. Western Bank of Clovis.

In their second modification to plan, the debtors intend to execute notes and security agreements to the Bank in the amount of the Bank's secured claims after surrender of the following five items of property:

a. Equipment valued by debtors and Bank at $25,750.

b. Piper PA-34-200T airplane, valued at $72,090.

c. Real estate valued at $150,080 by the Debtors. (In the findings below, the Court finds the value to be less; more importantly, however, the Court also finds that the land retained has a correspondingly higher value, increasing the Bank's secured claim.)

1. Mid-East Place (160 acres) without peanut quota
2. East Place (160 acres) without peanut quota (improvements on this parcel are $4518 per Bank exhibit 10)

d. Feeder Cattle, valued at $32,000 (the cattle will not be surrendered; rather $32,000 of cattle sale proceeds currently held by the Debtors will be turned over as a partial payment.)

The notes would be as follows:

a. $192,271.52, 25 years, 8% interest, secured by a lien on all real estate. First payment $11,872 on July 1, 1999 then subsequent annual payments of $17,808 until paid in full.

b. $306,909, 10 years, 8% interest, secured by lien on cattle, airplane, and equipment. First payment $32,000 upon confirmation, $29,798 due July 1, 1999, then annual payments of $44,463 until paid in full.

c. Classes 4, 5, 6, and 7 claimants will be paid according to the terms of the respective agreements and will retain their liens.

d. Class 8 will be paid through annual lump sum payments to the trustee. The payments will be the debtors' disposable income; if disposable income exceeds $5,000 the debtors retain the excess in a set-aside account to cover shortfalls in successive years.

e. Confirmation of the plan would constitute authorization for the debtors to sign up and participate in federal farm programs. All post-petition crops would be free and clear of any pre-petition lien or security interest unless otherwise retained in the plan.

Stipulations regarding collateral

The parties stipulated to the collateralization and perfection of certain collateral:

1. Bank is perfected on airplanes, real estate, irrigation sprinklers (fixtures) and equipment.
2. Bank is not perfected in accounts receivables from airplane business.
3. The value of airplane to be returned is $72,000; the cattle proceeds $32,000; the farm equipment $25,000.
4. The parties implicitly acknowledge that Bank is undersecured.

Disputes regarding collateral

Debtors actively dispute perfection in various collateral:

1. Whether crops or their proceeds are perfected.
2. Whether cattle or their proceeds are perfected.
3. Whether the peanut quota or government payments are perfected.

Real Estate

A central issue in confirming this Chapter 12 plan is the value of the real estate subject to Bank's lien. As noted above, there is no issue relating to the perfection of Bank's mortgages. The value of the land given back pursuant to the plan is not as important as the value of the land being retained under the plan, because under 11 USC §1225(a)(5)(ii) in order to confirm, the Bank must receive the value of its secured claim.

Bank's secured real estate claim

The Debtors relied on the Bank's appraisal, Bank Exhibit 10, the examination of the Bank's appraiser Bill Cotton ("Cotton"), and their rebuttal real estate witness Kenneth Beddinger ("Beddinger"). Bank Exhibit 10 uses three different approaches to value the real estate: under the market approach the value was $488,000; under a cost approach the value was $515,840; under an income approach the value was $392,000. The appraisal considered the market approach to be the best indication of value. Having

heard the testimony of the witnesses, the Court agrees.[1] This valuation also comports with the guidelines set forth in Associates Commercial Corporation v. Rash, 117 S.Ct. 1879, 1884 n.2 (1997):

> [T]he ... repayment plan proposed, pursuant to §1325(a)(5)(B), continued use of the property in question, i.e. the truck, in the debtor's trade or business. In such a "cram down" case, we hold, the value of the property (and thus the amount of the secured claim under §506(a)) is the price a willing buyer in the debtor's trade, business, or situation would pay to obtain like property from a willing seller.

Based on the method used for the appraisal, the Court needs to make certain adjustments to determine the remaining value of real estate after the plan's giveback provision. For example, Bank Exhibit 10 includes the peanut quota as part of the value of the real estate. Debtors retain the peanut quota under the proposed plan. The land proposed to be given back is, for the most part, unimproved, but the overall land values on the Bank's appraisal include the improvements.

The appraisal, and the testimony, indicate that the value of the peanut quota is $42,000, based on a quota of 168,381 pounds, valued at $0.25 per pound. See Bank Exhibit 10 page 17. The Court finds this value reasonable.

Cotton's appraisal and testimony indicate that the value of the improvements is $181,500. See Bank Exhibit 10 addenda page

[1]Debtors' rebuttal witness Beddinger also believed the market approach was the best indication of value.

5. This consists of $159,000 on the homeplace[2], $18,000 on the Helmer Place, that is, the northern part of Bank's tract 3, and $4,500 on the East place. This value is based on cost, less depreciation. The Bank's appraiser Cotton testified that this is an acceptable methodology to use for rural farm properties. Debtors' rebuttal real estate testimony questioned these values and the approach used by Cotton claiming the value should be $105,705 based on comparable sales with adjustments for acreage and distance to the nearest town. The Court finds, however, that Cotton's testimony was credible and appropriate and adopts the $181,500 value.

Both Cotton and Beddinger testified to the value of the unimproved real estate. Cotton valued the entire 1040 acre parcel at $488,000, including improvements and peanut quota. See Bank exhibit 10 page 25 and 32. Therefore, the land alone would be worth $488,000 less $42,000 peanut quota and less $181,500 improvements, or $264,500. This is $254 per acre. Beddinger valued the entire parcel at $354,000, including improvements (of $105,705) but excluding the peanut quota. Taking this value and subtracting the improvements leaves $248,295 for the bare 1040 acres, or $239 per acre. The Court finds that the value of the bare real estate is somewhere between $239 and $254 per acre, and

[2]Bank Exhibit 10 refers to parcels 1 through 4. Parcel 1 is the homeplace. Parcel 2 is the West place. Parcel 3 consists of the Mid-East place, the Helmer place and the grasslands. Parcel 4 is the East place.

will also find that for purposes of confirmation the overall bare land is worth $247 per acre.[3]

Therefore, for confirmation purposes, the Court determines Western Bank's secured real estate position after the giveback of Mid-East place and East place as follows:

ASSET	VALUE
160 acres (West Place)@ 247	$ 39520
80 acres (grassland) @ 247	19760
160 acres (Helmer Place) @ 247 less Helmer lien of $32,700	6820
320 acres (homeplace) @ 247 less Farm Credit lien of $39,617	39423
Total Improvements less $4,500 on East Place given back	177000
Western Bank Secured Real Estate Claim	$ 282523

Personal Property

The parties stipulated to perfection of the airplanes and farm machinery and equipment. The debtors dispute perfection of cattle, crops and peanut quotas and other government payments. For the reasons set out below, the Court finds that Bank is perfected in cattle and proceeds thereof, and not perfected in

[3]The Court notes that the land being given back was described by Mr. Miller as a "bad area" that has not been productive. Bank's appraiser also testified that the parcels to be given back had the poorest irrigation (tract 3) and the poorest soil (tract 4). Logically, if the give-back land is less valuable than the average acre, then the retained land would be more valuable than the average acre, but there is insufficient evidence to determine how much more the retained land is worth. The Court therefore views the $247 as a minimum reasonable value.

the crops, crop proceeds, peanut quota or government payments. The government payments at issue include a disaster payment received by the debtors and their interest in a production flexibility contract program.

Bank's secured personal property claim

A. Findings and Conclusions Regarding Cattle

Cattle are "farm products." Section 55-9-109(3) NMSA 1978 (1997 Repl.) provides that goods are "farm products" if they are crops or livestock or supplies used or produced in farming operations or if they are products of crops or livestock in their unmanufactured states... and if they are in the possession of a debtor engaged in raising, fattening, grazing or other farming operations.

The proper place to file in order to perfect a security interest in farm products or accounts or general intangibles arising from or related to the sale of farm products is in the office of the county clerk in the county of the debtor's residence; and when the collateral is crops growing or to be grown, in the office of the county clerk in the county where the land is located. See Section 55-9-401(1) NMSA 1978 (1997 Repl).

Debtors executed security agreements on March 19, 1992, March 23, 1995, and April 4, 1997 that all grant as collateral "All livestock branded or unbranded now owned or in possession of debtor or hereafter acquired by way of replacement, substitution,

increase or addition" and "all additions, accessions, replacements, substitutions, proceeds and products therefrom including natural increase of livestock." See Bank exhibit 7.

Bank filed a financing statement with the Roosevelt County Clerk on March 26, 1992 that listed "all livestock" and proceeds and products thereof. This financing statement was continued by a continuation statement filed in Roosevelt County on February 13, 1997. See Debtor Exhibit 51 and Bank Cash Collateral Hearing Exhibit 15 page 20.

Debtors challenge perfection, however, claiming that Bank also had to file an Effective Financing Statement ("EFS") pursuant to the Farm Products Secured Interest Act, Sections 56-13-1 through -14 NMSA 1978 to perfect, in addition to the perfection requirements of the Uniform Commercial Code. They also argue that an EFS must be supported by new value, as opposed to a re-securing of a prior extension of credit.[4] The Court disagrees.

First, creditors do not need to file an EFS to perfect a security interest in farm products under state law. Section 56-13-2 NMSA only provides that "security interest holders be encouraged to use [the central filing] system in lieu of any other notice provided by Section 1324 of the Food Security Act of 1985." See also Battle Creek State Bank v. Preusker, 571 N.W.2d

[4]Debtors received no new credit in 1998.

294, 300 (Ne. 1997)(The purpose of the FSA "is to protect buyers in the ordinary course of business from being required to pay twice for farm products, while retaining other state law U.C.C. provisions regarding the creation, perfection, and priority of security interests."); Farmers & Merchants State Bank v. Teveldal, 524 N.W.2d 874, 878-79 (S.D. 1994)("Other than eliminating double payment liability for a buyer in ordinary course in farm products, Congress did not intend to preempt state law relating to the creation, perfection, or priority of security interests."); First Bank of Okarche v. Lepak, 961 P.2d 194, 197 (Ok. 1998)("[Food Security Act of 1985] did not preempt basic state law concerning the creation, perfection, or priority of security interests."); Food Services of America v. Royal Heights, Inc., 850 P.2d 585, 588 (Wash. App. 1993) *affd.* 870 P.2d 590 (1994) (same).

However, even if a creditor needed to file an EFS to perfect under state law, Bank did file one on February 23, 1998. See Bank Cash Collateral Hearing Exhibit 15 page 29; debtor #3. Debtors claim this EFS should be declared invalid under 16 USC 590h(g) because it did not secure a new advance of funds.

Title 16 Section 590h(g), which implements the payment provisions of the Food Security Act of 1985, provides in full:

> A payment that may be made to a producer under this section may be assigned only in accordance with regulations issued by the Secretary. This subsection shall not authorize any suit against or

> impose any liability on the Secretary, any disbursing agent, or any agency of the United States if payment is made to the producer without regard to the existence of any such agreement.[5]

7 CFR Part 1404 contains the current regulations issued by the Secretary. 7 CFR 1404.1 states "This part sets forth the manner in which a person may assign a cash payment which is made by the Farm Service Agency (FSA) or Commodity Credit Corporation (CCC). Such payments may only be assigned in the manner set forth in this part." 7 CFR 1404.3 provides that "except as otherwise provided in this part or in individual program regulations, contracts and agreements entered into by FSA or CCC, any payment due a person from FSA or CCC may be assigned." In summary, neither the statute on its face or 7 CFR part 1404 prohibits assignment to pay or secure indebtedness, preexisting or not. The cases relied on by debtor predate the 1990 amendment, and are therefore inapt: In re Holman, 85 B.R. 869 (Bankr. D. Ka. 1987), In re Halls, 79 B.R. 417 (Bankr. S.D. Ia. 1987).

Alternatively, Debtors argue that the EFS was obtained through fraud because Bank never intended to advance new funds

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[5]Compare the text of 16 USC 590h(g) prior to its amendment in 1990:

> A payment which may be made to a farmer under this section, may be assigned, without discount, by him in writing as security for cash or advances to finance making a crop... Such assignment shall not be made to pay or secure any preexisting indebtedness. (Emphasis added.)

The 1990 amendment specifically removed the prohibition.

when it obtained new loan documents in early 1998. The Court finds no fraud on the part of the bank in obtaining the February 1998 EFS. The undisputed testimony was that Bank obtained new loan documents and security agreements each year as its normal business practice. The single fact that a new loan was not made in 1998 does not contradict the fact that the Bank had a normal business practice of redocumenting its loans every year.

In summary, the Court finds that Bank has a valid and perfected lien on cattle and proceeds of cattle.

B. Findings and Conclusions Regarding Crops

The 1992, 1995, and 1997 Security Agreements all grant security interests in crops and proceeds. See Bank Exhibit 7. Bank filed a financing statement in Roosevelt County on March 26, 1992 that lists crops and proceeds, but this statement failed to include a description of the real estate. That failure was fatal to perfection. See Section 55-9-402(1) NMSA 1978 (1997 Repl.). See also In re Waters, 90 B.R. 946, 964 (Bankr. N.D. Ia. 1988). Apparently Bank realized its error because it filed a second financing statement in Roosevelt County on September 17, 1992 that attached legal descriptions for land on which the crops were growing. See Debtor Exhibit 45, Bank Cash Collateral Hearing Exhibit 15 pages 21-22. This filing cured the defect with respect to crops, but perfection was only as of the September 1992 filing. See Section 55-9-402(4) NMSA 1978 (1997 Repl.)("If any amendment adds collateral, it is effective as to the added

collateral only from the filing date of the amendment.") See also Miami Valley Production Credit Association v. Kiley, 536 N.E.2d 1182, 1185 (Ct. App. Oh. 1987). Therefore, only as of September 17, 1992 Bank did obtain a perfected interest in crops and crop proceeds.

Bank filed a continuation statement with Roosevelt County on February 13, 1997. A continuation statement must be filed within six months prior to the expiration of the five year period of perfection. See Section 55-9-403(3) NMSA 1978 (1997 Repl.). Bank's continuation statement, as to crops, was filed too early and is void. See e.g. NBD Bank, N.A. v. Timberjack, Inc., 527 N.W.2d 50, 53 (Mich. App. 1994) (Noting that Courts have "uniformly" held that a continuation statement filed before the six month period is not timely and cannot have the effect of continuing the effectiveness of the original financing statement.); In re Isringhausen, 151 B.R. 203, 207 (Bankr. S.D. Ill. 1993)(premature continuation statement ineffective.)

Alternatively, the continuation statement refers only back to the original filing, which did not include the real estate description, and is therefore unperfected as to the crops.

In summary, Bank does not have a perfected interest in crops.

C. Findings and Conclusions Regarding Peanut Quota and Government Payments

Debtors testified that during the case they received a "disaster payment" from the Farm Service Agency for drought relief, based on a percentage of their prior year's production flexibility contract[6]. They also own a peanut quota.

The 1992, 1995, and 1997 security agreements executed by debtors include grants of interest in "all accounts and general intangibles ... including ... all accounts receivable, and all ASCS government payments ..." There was no evidence that Bank filed financing statements with the Secretary of State. The financing statements filed in Roosevelt County include:

Date	Asset	Bank Cash Collateral Hearing Exhibit 15 Page
March 26, 1992 (continued February 13, 1997)	inventory and "accounts receivables, notes, drafts, contracts and contract rights... under contracts to sell goods or render services"	19
March 26, 1992 (continued February 13, 1997)	livestock and crops (no legal description)	20

[6]The Court took under advisement the admissibility of debtors' exhibit 26, a USDA Notice regarding Market Loss Assistance Payments. Bank objected to admission on the grounds of hearsay. The Court finds that the exhibit was not offered to establish the truth of the contents of the document; rather, it was offered only as something the debtors received, on which they based their belief that this check was a government payment related to the drought they had experienced. The Court therefore overrules the objection, and admits exhibit 26.

September 17, 1992 (not continued)	livestock, crops, water rights, irrigation equipment, sprinkler systems, crop allotments and peanut quotas (with legals)	21-22
March 26, 1992 (continued February 13, 1997)	irrigation equipment and sprinkler systems	23
March 26, 1992 (continued February 13, 1997)	aviation equipment	24

None of these financing statements include the category general intangibles. The peanut quota and the disaster payments are general intangibles under the UCC. In re Hunerdosse, 85 B.R. 999, 1005 (Bankr. S.D. Ia. 1988)("In the context of the UCC, contractual rights to farm program benefits are 'general intangibles.'"); In re Schneider, 864 F.2d 683, 685 (10th Cir. 1988)("Agricultural entitlement payments which result from the actual disposition of a planted crop are proceeds... payments based on an agreement not to plant crops arise from accounts or general intangibles."); Covey v. Ipava State Bank (In re Ladd), 106 B.R. 174, 176 (Bankr. C.D. Ill. 1989)("Disaster payments are not proceeds", they are general intangibles.). See also In re Jackson, 169 B.R. 742, 748)(Bankr. N.D. Fl. 1994)(Peanut quota is not real property; it is a type of intangible personal property and therefore not protected by Florida's homestead exemption.); Combustion Engineering, Inc. v. Norris, 271 S.E.2d 813, 815 n. 2 (Ga. 1980)(Agricultural allotments are a special

type of intangible personal property.) But see In re Nivens, 22 B.R. 287, 291 (Bankr. N.D. Tx. 1982)(Subsidy payments such as deficiency and disaster payments are proceeds of crops).

In summary, the peanut quota and government contracts are intangibles and the Bank is not perfected because its currently valid financing statements fail to list intangibles. The financing statement that specifically mentioned the peanut quota lapsed. However, even if the peanut quota were a crop or its proceeds, the Bank is not perfected. See discussion above regarding crop perfection.

The Bank did file Joint Payment Authorizations with the Roosevelt County FSA Office for “PFC Payments” and “Production Flexibility Contracts”. These Joint Payment Authorizations do not substitute for state law perfection, however. See First Bank of Okarche v. Lepak, 961 P.2d at 197.

In summary, the Bank has the following secured personal property claim:

ASSET	VALUE
airplane - Piper PA250-150 SN: 25-565	$ 11,742
airplane - Cessna TR182 SN: R1820058	73,370
airplane - Cessna 152 SN: 15282184	17,790
farm equipment 57550 less giveback of 25750	31,800
cattle	155,386

Western Bank secured personal property claim	$ 290,088

ISSUE REGARDING CHAPTER 12 TRUSTEE FEES

The United States Trustee's Office, acting as the Chapter 12 Trustee in this case, urges the Court to require trustee fees on all payments made during the life of the case, including direct payments to be made by debtors to Western Bank on the new notes to be issued under the plan. The Trustee urges the Court to apply the reasoning of In re Logemann, 88 B.R. 938 (Bankr. S.D. 1988), In re Cannon, 93 B.R. 746 (Bankr. N.D. Fl. 1988), and In re Martens, 98 B.R. 530 (Bankr. D. Co. 1989). The Court acknowledges that there is a split among the courts that have faced this issue. See Michel v. Beard (In re Beard), 45 F.3d 113, 116 (6th Cir. 1995). Although Beard cites the Tenth Circuit case of In re Schollett, 980 F.2d 639 (10th Cir. 1992) as falling into the line of cases that prohibit a debtor from bypassing the trustee by allowing direct payments on impaired debts, 45 F.3d at 116, Schollett deals with the Court's ability to review or change a trustee's percentage fee, not on how to arrive at the number on which the fee is based. 980 F.2d at 645. It does not specifically prohibit direct payment plans.

The Court has reviewed both lines of cases, and finds that the reasoning of Beard is more persuasive. That case holds that nothing in the code prohibits direct payments, and that the language of 11 U.S.C. actually anticipates direct payments. 45

F.3d at 120. See also Matter of Kline, 94 B.R. 557, 560 (Bankr. N.D. In. 1988); In re Land, 82 B.R. 572, 579 (Bankr. D. Co. 1988) *affd.* 96 B.R. 310 (D. Co. 1988). This is also the position taken by a majority of the Courts of Appeals that have faced the issue. See Michaela M. White, *Direct Payment Plans*, 29 Creighton L. Rev. 583, 583-84 (1996).

Consequently, the Chapter 12 Trustee is allowed a commission only on "payments received" by the Trustee. 28 U.S.C. §586(e)(2). Land 82 B.R. at 580. The Trustee is not entitled to fees on the entire income of the operation. In re Janssen Charolais Ranch, 73 B.R. 125, 129 (Bankr. D. Mo. 1987).

APPLICABLE INTEREST RATE

Section 1225(a)(5)(B)(ii) requires that the creditor receive a value, as of the effective date of the plan, of not less than the allowed amount of its secured claim. Debtors 2nd Amended Plan proposed an 8.0% interest rate, which Western Bank found acceptable. During the trial Debtors filed a 3rd Amended Plan which dropped the interest rate to 7.05%, to which Western Bank objected claiming the modification was untimely, and that the rate was unacceptable. At the close of their case in chief, the debtors asked the Court to take judicial notice of that day's Wall Street Journal, which showed a 30-year Treasury bond rate of 5.05%, and suggested that a 2% risk factor added to the Treasury bond rate should be the appropriate interest rate. Attorney for

debtors stated that they would rely solely on case precedent in this District that holds that two percent over the Treasury bond rate is acceptable. The debtors did not provide any case citations for this rule.

The Court of Appeals for the Tenth Circuit has considered and specifically rejected this rate plus 2% method of determining interest rates in a chapter 12 case:

> The Eight Circuit has addressed the problem before us in the case of United States v. Doud, 869 F.2d 1144 (8th Cir. 1989). This decision endorsed the "market rate" approach while approving a method of determination of the "market cost" by first determining the rate of a risk-free loan, such as the yield on treasury bonds, and adding thereto two per cent as a risk factor. ... We cannot agree that this represents a "market rate."

Harzog v. Federal Land Bank of Wichita, 901 F.2d 858, 860 (10th Cir. 1990). The Court held that bankruptcy courts should use the "market rate" of interest used for similar loans in the region:

> [W]hen a dispute arises, the market rate should be easily susceptible of determination by means of a hearing where each party is given the opportunity to submit evidence concerning the current market rate of interest for similar loans in the region... Chapter 12 is predicated upon the theory that the lender is making a new loan to the debtor. It therefore follows that the most appropriate interest rate is the current market rate for similar loans made in the region at the time the new loan is made.

Id. See also In re Seguro, 216 B.R. 166, 171 (Bankr. N.D. Ok. 1998)(interpreting Harzog as the "rule" in the Tenth Circuit.)

Debtors' plan, which was noticed to creditors, listed an 8% interest rate, and no parties filed objections. During

confirmation, however, debtors attempted to change the interest rate, but provided no evidence of the market rate. When the debtors sought to question Ray Melton, Bank's agent, about the Bank's cost of funds, Bank's attorney objected, claiming that the cost of funds was not relevant to the fair market rate of interest, or the 8% proposed in the plan. The Bank stipulated that it would not object to 8%, and the debtors' attorney then stated that therefore there was no need to prove that 8% was the applicable rate. The Court understood this to mean that the Bank and debtors were stipulating to the 8% rate, of which all creditors had notice. However, the debtors' subsequent attempt to obtain approval of a lower interest rate suggests that the debtors had not stipulated. If that is so, then the debtors continued to have the burden of proving the market rate of interest.

At least in the absence of a stipulation, the Court finds no other evidence on which to determine that 8% is the applicable market rate. If the interest rate were set too low, the Bank would not receive its full claim as required by §1225(a)(5)(B)(ii); if the rate were too high, then unsecured creditors would not receive their full entitlement under §1225(b)(1)(B). The Court therefore finds that the debtors have failed to meet their burden of proof on the issue of what the appropriate interest rate should be, as is required by §1225(b)(1)(A). Alternatively, the Court finds that the 8% rate

of interest, which the Bank and the debtors stipulated to and as to which no other creditors objected after receiving notice (by means of the plan), is an appropriate rate of interest.

FEASIBILITY

For the purposes of considering feasibility of the plan, the Court will use the figures from the Plan, which are based on the 8% interest rate originally proposed. The Court has reviewed the projections attached as Exhibit A to the 2nd amended Plan, and the Amended Projection submitted with the affidavit of debtors' attorney after conclusion of the confirmation hearing.[7] The debtors included projections for the year 1999 only. The testimony indicated that debtors had prepared projections for future year(s), but those projections were not introduced into evidence. Both Mr. and Mrs. Miller testified that they expected income for the year 2000 to be about the same as that projected this year, and for expenses to remain about the same. The projection submitted is summarized as follows, and adjusted by the Court to account for the valuations arrived at above.

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[7]At the conclusion of the confirmation hearing, the Court asked for supplemental materials on Debtors' application to employ attorneys, specifically amounts due to the prior attorney for the debtors, the rates and experience of the current attorneys, and the billings accrued to date. Attached to the Affidavit of Jennie Deden Behles as Exhibit E is a revised projection of income and expenses for 1999. The Court realizes that Bank has not had the opportunity to cross-examine on these materials, but given the ruling herein, Bank is not harmed by this lack of opportunity.

	PER PLAN FOR 1999, PER EXHIBIT A TO 2ND AMENDED PLAN	PER AMENDED PROJECTION FILED AS EXHIBIT E TO AFFIDAVIT OF JD BEHLES, 12/30/98	YEAR 2000 (no projection in evidence, only testimony that things should remain about the same.)
Revenues from Aviation Service	$ 167,681	$ 167,681	$ 167,681
Farm Income	353,125	267,483[8]	267,483
Total projected income	520,806	435,164	435,164
Aviation Expense	95,722	95,722	95,722
Farm Expenses	274,476	182,176[9]	182,176
Total Personal	20,006	20,006	20,006

[8]The changes are: income from heifers decreases from $285,987 to $159,420, income from steers increases from $5,250 to $5,600, and income from hay increases from $15,000 to $56,575 and now includes an entry "oat/triticale hay" of $40,575 in the 3rd quarter of 1999. All other elements of the income projection remain the same. The increase in $40,000 is explained to be a result of having fewer cattle during 1999; the pastures can instead be harvested, resulting in $40,000 of additional income. There was no testimony regarding these values at the confirmation hearing; indeed, this sale was not even anticipated at that time. The projection does not tell how the $40,000 figure was arrived at, and the Court wonders how much of this projection is based on the debtors stated intention of growing a new type of grazing mix with which they have no experience. The Court finds this $40,000 speculative.

[9]The changes are: Cattle expense decreases from $15,340 to $9,340, cattle purchased decreases from $190,000 to $100,000; fertilizer expense increases from $4,500 to $8,500; seed expense increases from $8,000 to $9,700. All other expense remain the same.

	PER PLAN FOR 1999, PER EXHIBIT A TO 2ND AMENDED PLAN	PER AMENDED PROJECTION FILED AS EXHIBIT E TO AFFIDAVIT OF JD BEHLES, 12/30/98	YEAR 2000 (no projection in evidence, only testimony that things should remain about the same.)
Admin Expenses[10]	6,000	26,000	26,000
Payments on secured debt:			
John Deere	3,868	3,868	3,868
Ford Motor	7,468	7,468	7,468
Farm Credit	15,000	15,000	15,000
Helmer Land Payment	12,900	12,900	12,900
Western Bank - Real Estate (per plan)	11,872	10,806	25,241
Western Bank - Personal property (one time payment)	32,000	32,000	0
Western Bank - Equipment, Airplane and Cows (per plan)	29,789	18,231	42,230
TOTAL EXPENSES AND PAYMENTS	509,101	424,177	430,611
CASH FLOW PER PLAN	11,705	10,987	4,553
PAYMENTS TO UNSECURED CREDITORS	5,000	5,000	5,000
NET CASH FLOW	6,705	5,987	< 47>

[10]As noted above, however, prior and current counsel have outstanding attorney fees of approximately $54,600.

	PER PLAN FOR 1999, PER EXHIBIT A TO 2ND AMENDED PLAN	PER AMENDED PROJECTION FILED AS EXHIBIT E TO AFFIDAVIT OF JD BEHLES, 12/30/98	YEAR 2000 (no projection in evidence, only testimony that things should remain about the same.)
<INCREASE> IN REAL ESTATE PAYMENTS PER VALUATION[11]		<5,567>	<8,352>
DECREASE IN PERSONAL PROPERTY PAYMENTS PER COURT'S VALUATION[12]		1,639	2,548
<LESS> CHAPTER 12 TRUSTEE FEES[13]		<1,550>	<1,550>
CASH FLOW AS ADJUSTED FOR VALUATIONS		$ 509	$ -7,307

In summary, assuming that the debtors' projected income and expenses were accurate and assuming that 8% would be a proper interest rate, the Court finds that based on the valuations the debtors' plan would not cash flow and is not feasible. The Court

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[11]Secured Claim per Valuation/Secured Claim per Plan = 282,523/192,272 = 1.469.
The year 1999 payment per Plan times 1.469 = 11,872 times 1.469 = 17,439 (increase of 17439-11872 = 5,567).
The year 2000 payment per Plan times 1.469 = 17,808 times 1.469 = 26,160 (increase of 26160-17808 = 8,352).

[12]Secured Claim per Valuation/Secured Claim per Plan = 290,088/306,909 = 0.945.
The year 1999 payment per Plan times 1.469=29,798 times .945 = 28,159 (decrease of 29798-28159 = 1,639).
The year 2000 payment per Plan times 1.469=44,683 times .945 = 42,225 (decrease of 44683-42225 = 2,548).

[13]Trustee fees at 5% of budgeted administrative expenses and payments to unsecured creditors.

has doubts about the projected income and expenses, however, that make the plan even less feasible. Those doubts are summarized as follows:

1. As the Bank pointed out in cross examination, every projection in the debtors' loan applications for the past several years has not been met.
2. The projections in debtors' first and second plans have not been met for 1999.
3. The Court found the testimony of Mrs. Miller regarding projected revenues from aviation credible; the net income from aviation accounts for less than half of the total net income, however.
4. The second amended plan called for revenues from the sale of livestock at 324% over the 5-year average. Debtors have never realized this level of sales. Debtors are surrendering 320 acres of land, so there will be less space and less pasture to support this level of cattle. The Court is unconvinced this level of revenues is achievable.
5. Part of the cow operation's projected future success is directly related to the debtors planting a new type of grazing mix; having no experience with this mix, the debtors' projection seems more speculative than reliable.
6. Bank's expert witness, Blake Prather, offered an analysis of debtors' prior financial affairs and his opinions on the projections. In his view, the projected increase in cattle

revenues would be impossible, given the fact that debtors intend to surrender roughly one-third of their land. Also, despite having less land, and more cattle, lease expense dropped from a $19,000 average for the past two years to $4,000 in the projection, and the projection for feed was dropped to $0. He questioned whether debtors projected chemical expenses, which were $13,000 less than the five-year average, would be adequate; and whether the supplies figure was realistic at $12,000 projected versus the $32,000 five-year average. The operating reports demonstrate that the cattle expense, which includes veterinary bills, were $21 to $22 per head of cattle for 1998; the projection called for only $12 per head. The Court found Prather's testimony to be sufficiently credible to put the bottom line of debtors' projected net farm income in doubt. His conclusion was that the debtors' farm and cattle operation was simply not profitable. If any of Mr. Prather's predictions are correct, the plan would be seriously impacted.

In summary, the Court cannot find that the debtors will be able to make all payments under the plan and to comply with the plan, as required by §1225(a)(6).

ISSUE OF GOOD FAITH

Because the Court finds that the debtors plan is not feasible, and that the interest rate has not been proved, the Court does not need to reach the issue of good faith in proposing the plan. This issue was strenuously argued by both sides. Although not reaching a decision, the Court admits that it had several major concerns regarding the good faith element. First, there is uncontroverted testimony that there was a sale of cattle post-petition and that this sale was not disclosed, and that the funds, which were cash collateral, were used to buy replacement cows and for use on cattle expenses. There remains a question whether all the funds have been accounted for. Second, there was testimony that a pasture lease was paid after the filing of the case to a creditor who was not disclosed on the schedules. Third, the existence of sharecrop arrangements were not disclosed on the schedules filed, have still not been disclosed in writing to the Court, and may have not been disclosed to the Bank which argued it had a lien on crops. Finally, the debtors' treatment of the real estate under the plan raises the question of whether it was good faith to return the "bad" land to the Bank while

attributing to it the same value as the “good” land which the debtors proposed to retain. See footnote 3.

CONCLUSION

The debtors have not met their burden of proving the plan is confirmable, and confirmation is hereby denied. An Order denying confirmation will be entered.

Hon. James S. Starzynski
United States Bankruptcy Judge

I hereby certify that, on the date file stamped above, a true and correct copy of the foregoing was either electronically transmitted, faxed, mailed, or delivered to Jennie Behles, Joe Parker and Ron Andazola, Trustee.