

IN THE UNITED STATES BANKRUPTCY COURT FOR THE NORTHERN DISTRICT OF
IOWA

IN RE:)

) Chapter 12 ROBERT KENNETH RICHARDS)
NANCY CAROL RICHARDS,) Bankruptcy No. 03-02487
)
Debtors.)

ORDER RE CONFIRMATION OF PLAN

This matter came before the undersigned on March 11, 2004 for final hearing on confirmation of Debtors' Amended Chapter 12 Plan. Debtors Robert and Nancy Richards appeared with attorney Dale Putnam. Iowa State Bank was represented by attorney Rod Kubat. Carol Dunbar appeared as Chapter 12 Trustee. After hearing evidence and arguments of counsel, the Court took the matter under advisement. The parties have filed their proposed findings and conclusions, and this matter is ready for resolution. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(L).

STATEMENT OF THE CASE

Debtors filed their Amended Chapter 12 Plan on December 30, 2003. Iowa State Bank and Trustee filed objections to the Plan. At the hearing, the parties disclosed that Trustee's objections have now been resolved. Some of the Bank's objections have also been resolved, as set out on the record. The Bank's remaining objections concern feasibility of the plan and the appropriate treatment of the Bank's secured claim. The Bank wishes to protect its current equity cushion in collateral and reduce the length of payments in certain categories of its secured claim. It challenges Debtors' income and expense projections, and their ability to make plan payments.

FINDINGS OF FACT

Debtors run a dairy operation. They are currently milking 157 cows. They also breed cattle to increase their herd and replace cull cows. Their total herd count is 387 head. Debtors also raise crops and lease 286 acres of land to feed and pasture the cattle.

In 2001, Debtors' dairy operations began to have difficulties. In the past year, they have taken steps to remedy a problem with stray voltage. The quality of their herd has now risen from a 3 or 4 to a 7 on a scale of one to ten, with ten being highest. Debtors assert their death losses are currently minimal compared to past years. Now that winter is over, no further cattle deaths are expected. Debtors have reduced expenses and instituted changes to make their operation more efficient. They have used the services of a nutritionist, Dewayne Brake, who has worked with them to increase the quality of their herd and reduce the death rate.

Debtors assert their milking cows will increase to 200 head before the end of the year. They project they can fund their plan with 200 head giving 55 lbs./day of milk for 325 days a year at a price of \$12.75/100 wt. Debtors intend to lock in a price of \$14.60/100 wt. on the Chicago Mercantile Exchange for 80% of their milk production, which will produce more income than the plan

projections anticipate. Debtors have other income from cull cow, calf and steer sales and government payments. Additionally, they make about \$2,000 per month from protein and butter fat. Also, cash gifts from family members will be available in the future as they have been in the past.

Debtors testified that they have been able to keep their expenses down and have had no credit card use since 2002. They have paid the Bank monthly payments postpetition and accumulated some profits. They also paid delinquent real estate taxes. Debtors argue that the Bank's secured claim is protected by the monthly plan payments, including interest, and by provisions for inspections and monthly reports. The Bank is retaining its liens and, after the first three years of the plan, all the terms of the original notes would be applicable, providing for full cross-collateralization on all notes. At that time, Debtors will also begin paying the Bank's court-approved attorney fees and costs.

The Bank asserts Debtors' projections are unrealistic. Debtors have not taken into account that their milking herd will be reduced by culling and death. Historically, Debtors have had a 15% per year death loss. The Bank estimates that Debtors will be able to sustain a milking herd of approximately 160 head, rather than the 200 head Debtors project. It also asserts that Debtors' estimate of their milking cows producing 55 lbs./day, or 17,875 lbs. per year is overly optimistic. The Bank states that 2003 actual milk production was 14,583 lbs. per cow per year. Although Debtors have evidence of recent production of 54.9 lbs./day/cow, the Bank points out that was only for one day and on the same day eight cows produced only 12 lbs., resulting in an average output of only 52.76 lbs./cow.

The Bank also takes issue with other income and expenses projected by Debtors. Annual government payments will decrease from \$5400 to approximately \$2500. The Bank asserts Debtors have failed to take into account previous expenses charged to credit cards, which would increase projected annual expenses from Debtors' estimate of \$359,000 to \$419,000. The Bank also argues that, based on historical figures, projected expenses fail to accurately reflect the age of Debtors' farm equipment, labor costs, real estate taxes, veterinary expenses and feed costs.

Prepetition, the Bank was oversecured with an equity cushion of approximately 12.5%. The Bank argues that Debtors must protect the Bank's security interest in this equity cushion in their Plan. It asserts the Plan must provide that it retains its lien on the equity cushion, not just a lien on the property to the extent of the unpaid balance of its allowed secured claims as the Plan provides.

The Bank also objects to the length of the payments on some of the categories of its collateral. Debtors propose to amortize the livestock debt over 10 years; the Bank seeks a 5- year term. Debtors propose to amortize miscellaneous debt over 10 years; the Bank seeks a 3-year term, plus immediate turnover of a \$12,032 multi-peril insurance check currently in Debtors' possession. The Court notes that both Debtors testified that they agree the \$12,032 check will be turned over to the Bank immediately. They have been holding the check pending a decision on confirmation.

The Bank proposes a revised breakout of the separate categories of debts as set out on page 17 of its Proposed Findings and Conclusions. It asserts that the

shorter terms for the livestock and miscellaneous loans are normal in farm lending for these types of collateral.

CONCLUSIONS OF LAW

A chapter 12 debtor has the burden of proving that the proposed plan of reorganization meets all confirmation requirements. In re Krause, 261 B.R. 218, 222 (B.A.P. 8th Cir. 2001). One of the requirements for confirmation is that the debtor "be able to make all payments under the plan and to comply with the plan." 11 U.S.C. § 1225(a)(6). To determine the feasibility of a plan, the court must ascertain the probability of actual performance of the provisions of the plan. In re Mosbrucker, 227 B.R. 434, 437 (B.A.P. 8th Cir. 1998), aff'd 198 F.3d 250 (8th Cir. 1999). Feasibility of a debtor's plan is a factual determination. Id.

This feasibility standard requires the Court to determine whether the plan offers a reasonable prospect of success and is workable. In re Monnier Bros., 755 F.2d 1336, 1341 (8th Cir. 1985). The test is whether the things which are to be done after confirmation can be done as a practical matter under the facts. In re Clarkson, 767 F.2d 417, 420 (8th Cir. 1985).

The Eighth Circuit's feasibility test considers whether provisions in a plan are achievable given the unique facts of the case. In re Bowman, 253 B.R. 233, 238-39 (B.A.P. 8th Cir. 2000). This Court will only approve a plan if it has a rational likelihood of success. In re Danny Thomas Prop. II Ltd. P'ship, 241 F.3d 959, 963 (8th Cir. 2001). A plan projecting a marked increase in profitability with no explanation of the cause is not confirmable. In re Euerle Farms, Inc., 861 F.2d 1089, 1091 (8th Cir. 1988).

The debtors' income and expense projections are considered in conjunction with their actual past performance to determine feasibility. Id. at 1090. "Because past behavior and productivity are excellent indicators of future production, courts have frequently rejected plans which are premised on highly optimistic projections of increased production." In re Crowley, 85 B.R. 76, 79 (W.D. Wis. 1988). Courts generally grant debtors every reasonable benefit of the doubt in matters concerning plan feasibility in furtherance of the rehabilitative policies underlying the Code. In re Tofsrud, 230 B.R. 862, 872-73 (Bankr. D.N.D. 1999). They will not, however, blindly confirm a plan which will not cash flow, and which is, therefore, unfeasible. Id.

PROTECTION OF EQUITY CUSHION

The Bank argues that Debtors must maintain its 12.5% equity cushion in the collateral in order to fully protect its secured claim, citing In re Hanna, 912 F.2d 945, 951 (8th Cir. 1990). In Hanna, the court considered confirmation of a Chapter 12 plan for a debtor which ran a livestock operation. It stated that the plan must provide that the value of the livestock herd will be maintained at a sufficient level that the secured creditor will recover on its claim. Id. The court noted, however, without deciding the question, "that the adequate protection element may be satisfied with respect to an oversecured creditor even if the plan does not provide for the maintenance of the entire equity cushion in the herd existing at the time of confirmation." Id. at 951 n.9.

Oversecured creditors are entitled to receive interest on their secured claims to the extent of their equity cushion.

United Savings Ass'n v. Timbers of Inwood Forest Assocs. Ltd., 484 U.S. 364, 374 (1988); 11 U.S.C. § 506(b). The parties have agreed that the Bank will receive six per cent interest on its secured claims. The Bank, however, seeks further protection of its oversecured claim by demanding that its equity cushion be maintained through the term of the Plan. The Bankruptcy Code does not include such a requirement. "[A]n oversecured creditor's interest in property which must be adequately protected encompasses the decline in the value of the collateral only, rather than perpetuating the ratio of the collateral to the debt." In re Delta Resources, Inc., 54 F.3d 722, 730 (11th Cir. 1995). A decline in the amount of an equity cushion is not equivalent to denial of adequate protection of a secured claim. In re Ralar Distribs., Inc., 166 B.R. 3, 8 (Bankr. D. Mass. 1994). Statements made in Timbers of Inwood Forest do not suggest that an oversecured creditor is entitled to adequate protection of the entire equity cushion. In re Senior Care Props., Inc., 137 B.R. 527, 529 (Bankr. N.D. Fla. 1992). A secured creditor's rights are confined to those specified in § 506. Id. Section 506(b) grants the oversecured creditor a claim for postfiling interest and legal fees to the extent of the collateral cushion. Ralar Distribs., 166 B.R. at 8.

"The Court in Timbers emphasized the need for some trimming of usual creditor rights during the reorganizational process." In re Lane, 108 B.R. 6, 9 (Bankr. D. Mass. 1989). The oversecured creditor which, outside bankruptcy, may be able to foreclose prior to erosion of the equity cushion is required to make some sacrifice in a bankruptcy case so that all interests may benefit from a successful reorganization. Id. Through § 506, Congress chose to limit the rights of a secured creditor to protection of its secured claim to the extent it does not fall below the amount of the underlying debt. Id. at 9-10. "A secured creditor's equity cushion is entitled to adequate protection to the extent reasonably necessary to assure that upon default the secured creditor will realize collateral value in the amount of its unpaid secured claim." In re Underwood, 87 B.R. 594, 598 (Bankr. D. Neb. 1988) (discussing Chapter 12 confirmation requirements).

DURATION OF LIVESTOCK AND MISCELLANEOUS DEBT PAYMENTS

The Bank objects to stretching payments over ten years on the debts secured by livestock and the miscellaneous category of collateral. This court in In re Koch, 131 B.R. 128, 132 (Bankr. N.D. Iowa 1991) (Melloy, J.), determined that the term of repayment in a Chapter 12 plan should be supported by some evidence of reasonableness, customary lender practices or market standards. This requires more than a mere mathematical determination of present value of the claim under § 1225(a)(5)(B). Id. at 130. The court reached this holding based on the Chapter 12 dual purpose of giving farmers a fighting chance to reorganize their debts and keep their land while ensuring creditors receive a fair repayment. Id.; In re Fisher, 930 F.2d 1361, 1362 (8th Cir. 1991).

One factor to consider is the length of the original note. Koch, 131 B.R. at 131. Courts also look at the "life expectancy" of the collateral, In re Rice, 171 B.R. 399, 401 (Bankr. N.D. Ala. 1994), the risk of default, In re Patrician St. Joseph Partners Ltd. P'ship, 169 B.R. 669, 681 (D. Ariz. 1994), and the risk that the collateral will lose value, Rice,

171 B.R. at 401. In Koch, the creditor offered evidence regarding its practices in agricultural lending as well as the practices of other lenders. 131 B.R. at 133.

Generally, claims secured by real estate can be stretched out the longest. See In re Mulnix, 54 B.R. 481, 484 (Bankr. N.D. Iowa 1985) (Pelofsky, J.) (finding 20-year term not unreasonable when collateral is real estate); In re SM 104 Ltd., 160 B.R. 202, 231 (Bankr. S.D. Fla. 1993) (collecting cases). The ability to pay secured claims over a number of years is not limited only to long-term installment

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obligations, but also applies to short-term obligations. In re Elk Creek Salers, Ltd., 286 B.R. 387, 390 (Bankr. W.D. Mo. 2002). In In re Bluridg Farms, Inc., 93 B.R. 648, 654 (Bankr. S.D. Iowa 1988), the court approved a 7-year repayment term in a Chapter 12 plan for a claim secured by chattels. In In re Lockard, 234 B.R. 484, 496 (Bankr. W.D. Mo. 1999), the court noted that a Chapter 12 plan repayment period of between 10 and 15 years would be reasonable for an agricultural loan. The Lockard court also gave consideration to the original terms of the note as well as subsequent extensions granted by the creditor. Id. at 495.

CONCLUSIONS

Based on the foregoing, the Court concludes that protection of the Bank's equity cushion is not required for confirmation of Debtors' Chapter 12 plan. The Bank has agreed to receive six per cent interest on its secured claim through the plan. It has also agreed that its attorney fees and costs will be paid after the first three years of the plan. Furthermore, Debtors agree to give the Bank monthly reports and the opportunity to inspect the collateral. The Bank is entitled to retain its liens and receive the present value of its claims under § 506(b). It is not entitled to additional protection of its equity cushion.

In the Bank's proposed findings and conclusions, it quarrels with the language in Debtors' plan which states the Bank's liens on the property securing its claim "shall remain as valid liens and encumbrances to the full extent of the unpaid balance of the allowed secured claims until such time as the allowed secured claims are paid in full." The Bank asserts this fails to retain the Bank's lien on the equity cushion. Debtor is directed to redraft this portion of the Plan, i.e. paragraph 3.04(e), to clarify that all the liens on property which secured the Bank's claims prepetition, will remain liens postpetition until the Bank's entire secured claim paid in full.

Next, the Bank argues that Debtors' Plan improperly stretches out payments on debts secured by livestock and other miscellaneous collateral. Initially, the Court finds that Debtors have agreed to turn over to the Bank the multi-peril insurance check in the amount of \$12,032.00. The Court has reviewed the Bank's Proof of Claim and considered testimony by its vice president and loan officer, Allan Rosendahl, as well

as the entire record as a whole. Mr. Rosendahl testified that the Bank generally limits livestock loans to five years which is the average life of a cow. He also stated that loans secured by crops, feed and other miscellaneous items are limited to three years at the Bank. Contradicting this testimony is the Bank's

Proof of Claim which includes copies of loan documents showing an original term of eight years on a 1998 note with a stated purpose of "refinance debt, buy cows, equipment to build dairy barn." A 2000 note entitled "Change in Terms Agreement" and listing the same loan number and purpose has a 15-year term, to 2015. A January 22, 1999 note has a maturity date of July 25, 2018. The Bank's loan documents also include renewals of notes and refinancings.

Based on the foregoing and the Court's own experience and knowledge of agricultural lending, the Court concludes that the Plan's proposed duration of payments for all categories of the Bank's secured claim is acceptable under § 1225 and § 1222(b)(9). The original notes include terms longer than the three or five years preferred by the Bank. Even if these shorter terms are more common in the agricultural lending community for these types of loans, it is also common that lenders will renew and extend loans at the end of such terms. See, e.g., Lockard, 234 B.R. at 495. The Court finds that the livestock loan need not be limited to the life of a cow.

Debtors propose that their herd will grow through breeding, such that it will constantly be replenished with younger cows. The same is true for collateral such as crops and feed which are cyclically consumed and replenished. Therefore, the Court concludes that the terms of payment on the Bank's entire secured claim as proposed in Debtors' Plan are acceptable.

As to feasibility of the Plan, the Court concludes that Debtors have met their burden to prove by a preponderance of the evidence that the Plan has a rational likelihood of success and they will be able to perform as a practical matter. Of course, there is a certain amount of optimism attached to Debtors' income and expense projections. Debtors' actual past performance, viewed alone, would not support their projections. Debtors, however, have invested significant efforts into making their operation more healthy and profitable, with significant results. The quality of the herd has improved and Debtors have changed their practices and reduced expenses and credit card use in the past year or two.

Debtors' dairy operation has been profitable postpetition and they have made timely adequate protection payments to the Bank as required. Both Debtors are dedicated to making the Plan succeed. Death loss has decreased and Debtors' projection of milking 200 cows before the end of the year is realistic. Milk production has increased, the price of milk has increased, and expenses have decreased. Debtors' Chapter 12 plan is feasible.

SUMMARY

The Bank's objections regarding feasibility of the plan, protection of its equity cushion and the duration of payments on the livestock and miscellaneous collateral debt are overruled. Debtors shall submit a third amended plan incorporating the agreements noted of record at the hearing regarding the Bank's other objections and the objections of Trustee. This final amended plan shall include provision for immediate turnover by Debtors of the \$12,032 multi-peril insurance check to the Bank and appropriate lien retention language as directed above. The Bank shall be granted time to file objections to the final amended plan based solely on whether the plan complies with the parties' agreements and with this ruling.

Debtors filed a Resistance to the Bank's proposed findings of fact. They assert the Bank's request for dismissal is inappropriate. The Bank filed a motion

to strike Debtors' resistance, asserting it was untimely. The Court finds that both these filings are now moot as dismissal is not in prospect. No further ruling will be made on Debtors' resistance or the Bank's motion to strike.

WHEREFORE, the objections of Iowa State Bank regarding feasibility and treatment of its secured claim, as discussed above, are **OVERRULED**.

FURTHER, Debtors are directed to file an Amended Plan incorporating the parties' resolutions and compliance with this Order on or before April 23, 2004.

FURTHER, the Bank and Trustee shall file any objections to the Amended Plan limited solely to whether it complies with the parties' agreements and this ruling on or before May 5, 2004.

FURTHER, Debtors' Resistance to Findings of Fact and the Bank's Motion to Strike Debtors' Resistance are moot.

SO ORDERED this 2nd day of April, 2004.

Paul J. Kilburg
Chief Bankruptcy Judge