In the United States Bankruptcy Court

for the Northern District of Iowa

GLENN H. FREESE and
DONNA B. FREESE
Debtor(s).

Bankruptcy No. X89-01328S

Chapter 12

ORDER RE: CONFIRMATION OF PROPOSED PLAN

Debtors seek confirmation of their "Amended Chapter 12 Plan" filed June 4, 1990 and amended July 5, 1990. Hearing on confirmation took place August 17, 1990 in Sioux City, Iowa. The court now issues its ruling which includes findings of fact and conclusions of law as required by Bankr. R. 7052. This is a core proceeding under 28 U.S.C. § 157(b)(2)(L).

I.

Procedural Background

Glenn H. Freese and Donna B. Freese, husband and wife, filed their joint voluntary petition under chapter 12 on September 6, 1989. They filed their initial plan in December, 1989 (Docket no. 40). It drew an objection from Farm Credit Bank of Omaha (FCBO).[(1)] Following an initial confirmation hearing in January, 1990, the court issued its findings with regard to the value of debtors' real property mortgaged to FCBO. That property is described as:

> The Northwest Quarter (NW1/4) of Section Sixteen (16) and the Northeast Quarter (NEl/4) of Section Seventeen (17), all in Township 84 North, Range 37 West of the P.M., Crawford County, Iowa.

The real estate contains 320 acres and includes a building site. Valuation of the 320 acres required a breakdown of the property into a ten-acre building site and 310 acres of bare land. As part of its initial confirmation order, the court valued the 310 acres of bare ground at $394,250.00. The ten-acre building site was valued at $60,000.00.[(2)]

The initial plan proposed to sell the building site to a family member and to pay the proceeds of sale to FCBO. The remaining 310 acres were to be retained by the Freeses with FCBO being paid their value over 30 years.

The Freeses filed an amended chapter 12 plan in March, 1990 (docket no. 85). The amended plan drew new and renewed objections from FCBO. Westside State Savings Bank (WESTSIDE) , whose prior treatment was changed by the amended plan, filed objections to confirmation. Final hearing on confirmation was scheduled for April 24, 1990. One day prior, Freeses filed a further amended plan (Docket no. 104).

At the confirmation hearing on April 24, the court stated that the proposed plan was not confirmable on its face because it violated 11 U.S.C. § 1225(a)(4). The proceeding memo which issued from that hearing gave debtors additional time to file an amended plan. The debtors' amended chapter 12 plan was filed June 4, 1990 (Docket no. 115) and was amended on July 5, 1990 (Docket no. 137). Again, objections were filed by FCBO and Westside. The objections were numerous.

It is surprising, given the number of plans filed, the detail of the objections and the time which has been available to the parties for negotiation, that so many objections to the plan still existed at the time of trial. The court has determined not to deal with all of the objections; its failure to reach them is in no way an indication as to whether the objections are valid or invalid. Certain major objections have merit, and because the court concludes that the plan is not confirmable, it declines to discuss each specific objection raised by the creditors.

III.

The Plan Fails to Meet the Requirements of

11 U.S.C. S 1225(a)(5)

A.

The chapter 12 plan cannot be confirmed in its treatment of an allowed secured claim unless the holder of that claim has accepted the plan, or the plan provides that the holder of the secured claim retain the lien which secures the claim and "the value, as of the effective date of the plan, of property to be distributed by the trustee or the debtor under the plan on account of such claim is not less than the allowed amount of such claim. . . . " 11 U.S.C. § 1225(a)(5)(B)(I) and (II).

Debtors have a home in Vail, Iowa legally described as Lot 2 and the West 671 feet of Block 3, Block 4, Town of Vail, Crawford County, Iowa. The parties stipulated at the initial confirmation hearing that its fair market value is $40,000.00 "net of liquidation costs." Debtors are purchasing the home on contract from Helen Rehbein. According to debtors' presentation, the contract vendor is owed $10,300.00 (Chapter 12 plan, Schedule A; Amendment to Plan filed July 5, 1990).

FCBO objected to debtors' claim of exemption in this homestead. Debtors and FCBO settled this dispute by a consent order presented to the court. By this order, it was determined that the debtors' homestead was not exempt from the claims of FCBO (Order, June 22, 1990, Docket no. 125). Debtors concede that FCBO has a judgment lien against the homestead (debtors' brief, September 4, 1990, Docket no. 164, p. 11). The value of FCBO's lien is approximately $29,000.00.

During its mortgage foreclosure proceedings against the debtors' farmland, FCBO obtained the appointment of a receiver. It is undisputed that the receiver has in his possession approximately $30,000.00 in receivership proceeds. Debtors concede that FCBO has a lien on such proceeds by virtue of the provision in its mortgage giving it a primary security interest in rents and profits of the mortgaged premises. Debtors' recognition is stated as follows: "[T]he funds in the hands of the state court receiver are part of the security of Farm Credit Bank of Omaha and the net proceeds being somewhat in excess of $30,000.00 are to be deducted from the unsecured claim of Farm Credit Bank of Omaha." (Debtors' post-trial brief, p. 11).

Debtors' plan proposes that the funds in the hands of the receiver be paid to FCBO, and that FCBO release its judgment lien on the homestead. FCBO objects, arguing that such treatment does not

provide it with the value of its secured claim. The court agrees. FCBO has security interests in the funds in the hands of the receiver and in the homestead. The plan which requires it to give up one of those security interests in return for the other cannot be confirmed unless the security interest being released without compensation has no value. That is not the case. Because the plan requires FCBO to release its judgment lien without adequate compensation, the plan fails to meet the requirements of 11 U.S.C. § 1225(a)(5).

B.

In their amended plan, debtors propose to sell a lo-acre building site to their son for $62,500.00. The proceeds are to be paid to FCBO. There is nothing inherently objectionable about this proposal.[(3)] The treatment of the remaining 310 acres represents a change from the Freeses' original plan. Debtors originally intended to keep the 310 acres by paying FCBO their value over 30 years. Now debtors propose to convey 160 acres to FCBO for a reduction in debt of $203,483.20. Debtors would retain 150 acres, paying FCBO their value over 30 years at 10-1/2% interest per annum. Debtors value these 150 acres at $190,765.50.

As part of the initial confirmation hearing, the court valued the 310 acres as $394,250.00. At the time of that confirmation hearing, the only proposal was to retain 310 acres. Therefore, the court in its initial confirmation order did not, in its findings, break down the 310 acres into tracts which had varying prices per acre. However, the court's determination that the 310 acres were worth $394,250.00 was based on its calculations that the 150 acres were worth $1,375.00 per acre and the 160 acres were worth $1,175.00 per acre.

Debtors now propose to keep 150 acres and return 160 acres to FCBO. They value these acres by dividing $394,250.00 by 310 acres. Because the debtors propose to keep the more valuable acres, such treatment is detrimental to FCBO and violates § 1225 (a)(5) of the Code. The 160 acres which the debtors propose to return are valued by the court at $188,000.00. However, debtors seek a credit of $203,483.20. Debtors propose to keep 150 acres which the court determines to have a value of $206,250.00. Debtors propose to pay FCBO $190,765.50 plus interest over 30 years.

IV.

Best Interest Test, 11 U.S.C. A 1225(a)(4)

FCBO argues that it is not receiving what it would receive if the debtors' estate were liquidated in chapter 7 because the debtors have failed to list certain assets as part of its liquidation analysis. These include cash, the debtors' 1990 crop, and the debtors' interest in a trust. Debtors acknowledge that the 1990 crop is not valued for the purposes of its liquidation analysis. They argue, however, that because the farmer's business changes over time, it is unreasonable to require a debtor to continually value his assets for the purpose of the liquidation test. They contend that the liquidation analysis was made on the basis of property existing on March 1, 1990, and that the value of the property existing at the time of the confirmation was not substantially different in value. Particularly, they indicate that values of feed and inventory existing in March, 1990 would have decreased, and the decrease would more than offset the value of the 1990 crop.

The court cannot agree that the debtors have no obligation to revalue property when confirmation proceedings extend over a long period of time. The court agrees that some reasonable leeway should be allowed to debtors in general as there is always a period of delay after inventory and valuation and

before the final confirmation hearing. However, the identity of the debtors' assets in this case has changed substantially since March, 1990, with no attempt by the debtors to update their analysis.

Debtors are beneficiaries of the "Glenn H. and Donna B. Freese Trust" which was established by them in February, 1986. They transferred 80 acres to the trust. The 80 acres were encumbered by mortgages to FCBO and Westside. Under the terms of the trust, the debtors are to receive the net income from the trust during their lives. Debtors' son has been renting the trust property, paying the trust $65.00 per acre annually. The trust income is used to pay real estate taxes and mortgage debt. Any additional income from the land, however, goes to Freeses.

FCBO has taken the position that the debtors' transfer of the land to the trust was a fraudulent conveyance. There is evidence that the trust paid no consideration for the 80 acres.

There is also evidence that the debtors were insolvent shortly after the transfer. The transfer of the real estate to the trust took place on or about February 3, 1986. On March 7, 1986, debtors provided FCBO with a balance sheet showing a negative net worth (Exhibit BB). The balance sheet did not include the 80 acres. FCBO claims that the transfers was fraudulent under state law. However, the court need not determine that issue. It is unnecessary because the debtors have even failed to value their interest in the trust. Debtors have the right to the income from their 80 acres for life. Glenn Freese testified that he receives income from property. This beneficial interest presumably has value. Debtors' failure to value it leads the court to conclude that they have not met their burden of proof to show that the plan complies with § 1225 (a) (5) of the Code.

Debtors have failed to prove that they are distributing to unsecured creditors not less than each would receive if the estate were liquidated in chapter 7.

V.

Interest Rate Paid on Unsecured Claims

Debtors' plan proposes to pay a minimum dividend to unsecured creditors. They propose to pay this amount over five years at 7% interest per annum.

In order to meet the requirements of 11 U.S.C. § 1225(a)(4) the debtors must distribute to each unsecured creditor "the value, as of the effective date of the plan, of property" which is not less than the amount such creditors would receive if the estate were liquidated. Because of the value requirement as of the plan's effective date, payment of interest is required if the dividend is to be paid over time. Debtors say this is satisfied by the payment of 7% per annum, and assert that this interest factor is satisfactory because it is the amount which these creditors would receive if they deposited the money in a bank. Debtors contend that the unsecured creditors are not entitled to an interest rate based on a "secured loan." (Debtors' brief, page 9.) FCBO argues that it is entitled to a commercial loan rate. Creditors holding secured claims have been held to be entitled to market rate interest. In re Konzak, 78 B.R. 990, 992 (Bankr. N.D. 1987) citing In re Monnier Brothers, 755 F.2d 1336 (8th Cir. 1985).

Debtors' argument that the discount rate should be based upon the interest rate obtainable for deposit in a bank is rejected. If the court were to accept that argument, it would be changing the positions of the parties. Debtors borrowed money from the creditors which are in the unsecured class--at least two of which are commercial lenders. Time payments of the dividend to unsecured creditors is essentially a continuation of a portion of the loans. A discount factor or interest rate, should be based upon the market rate of interest at which debtors could borrow. It should not be based upon the rates which

bank depositors receive from their deposits. If the court approved debtors' theory, it would be treating them as commercial lenders. They are not. It is not the business of Freeses to take deposits, pay interest on those deposits, lend out money and charge interest. Freeses would remain borrowers under their plan. Therefore, the interest rate for their payments over time cannot be based on the rates obtained by Freeses when they deposit money in a savings account or purchase certificates of deposit. Therefore, Freeses' proposal to pay 7% interest on the plan payments to unsecured creditors does not meet the requirements of 11 U.S.C. § 1225(a)(4).

VI.

Trustee's Fee

One of the case trustee's untimely objections was that the debtors failed to propose payment of a trustee's fee on impaired, secured claims. Although confirmation is not denied on this ground, because the objection was not timely raised, the court points out that the objection is meritorious.

The claims of the unsecured class are impaired. so also are the claims of the following classes of creditors: Class III (Crawford County Treasurer); Class IX (Helen Rehbein) ; Class XI (FCBO) and Class XII (Westside) . Debtors do not propose to pay a percentage fee to the case trustee on the payments to these impaired claimants.

The case trustee is entitled to her percentage fee from all payments made under the plan to impaired claimants. 28 U.S.C. § 586(e)(1)(B)(ii) ; In re Hagensick, 73 B.R. 710 (Bankr. N.D. Iowa 1987) ; see also Matter of Logemann, 88 B.R. 938 (Bankr. S.D. Iowa 1988).

CONCLUSIONS OF LAW

Debtors' proposed plan cannot be confirmed because it violates 11 U.S.C. § 1225(a)(4) and (5).

ORDER

IT IS ORDERED that confirmation of the debtors' proposed plan of reorganization filed June 4, 1990 and modified July 5, 1990 is denied. Judgment shall enter accordingly.

SO ORDERED ON THIS 1st DAY OF OCTOBER, 1990.

William L. Edmonds
Chief Bankruptcy Judge

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1. The deadline for filing of objections to the plan was January 17, 1990. The case trustee, Carol Dunbar, filed objections to the plan on January 24, 1990. These were untimely. The case trustee did not attend the initial confirmation hearing on January 24, 1990. Although amended plans have been filed, the case trustee has never filed renewed or new objections to the amended plans. The case trustee did attend the final confirmation hearing and has filed a brief arguing against confirmation of the plan. However, because the objections have not been timely raised, they will not be considered.

2. During the course of the bankruptcy case, debtors applied for the court's permission to make a $2,500.00 capital improvement to the ten-acre building site and agreed as part of the application to

add $2,500.00 to the valuation of the property. Therefore, the plan proposes to sell the ten-acre building site for $62,500.00.

3. FCBO objects to the vagueness of the proposal. It argues that there has been no showing of the ability of Kevin Freese to buy the property nor any showing as to when such sale would be accomplished. FCBO is correct that the plan is vague as to when it will receive the proceeds of sale. There has also been little if any showing that Kevin Freese will be able to pay the purchase price. The objection has merit, but the court will ignore it, as other, more substantial, defects prevent confirmation.