

UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF )  
 )  
CLARK & DARLA HUFF, ) CASE NO. BK92-80072  
 )  
DEBTOR ) CH. 12

MEMORANDUM

Hearing was held on May 24, 1995, on a motion filed by Farm Credit Bank of Omaha to approve amortization schedule. Appearances are as follows: Philip Kelly, Attorney for debtors; James Carney for Farm Credit Bank. This memorandum contains findings of fact and conclusions of law required by Fed. Bankr. R. 7052 and Fed. R. Civ. P. 52. This is a core proceeding as defined by 28 U.S.C. § 157(b)(2)(A).

**Background**

The debtors' Third Amended Chapter 12 Plan (the Plan) was confirmed on August 11, 1993. The Plan provided that the balance due to Farm Credit Services (FCS), a secured creditor, would be "amortized over a period of thirty (30) years with interest at 7.5% per annum. Annual payments shall be made on December 31st of each year beginning December 31, 1994."

When the December 31, 1994, payment was due, the debtors tendered a check to FCS for \$3,603.78. This amount was corrected to reflect a total payment of \$3,874.07.<sup>1</sup> FCS disputes this amount and argues that the true amount due and owing on December 31, 1994, was \$4,767.59. The Chapter 12 Plan is silent on the question of how to amortize the loan.

---

<sup>1</sup> The mistake arose because the debtors' first proposed amortization schedule inadvertently began computing the installment payments' first due date as December 31, 1993, instead of December 31, 1994. The debtors replaced the incorrect schedule with the schedule located at Filing no. 167. At the hearing, the debtors represented that the \$200.00 difference would be paid immediately after the hearing, and the Court stated on the record that FCS will not be deemed to have waived the legal issue presently before the Court by accepting this payment.

The disparity between the parties' positions arose because of the different amortization schedules employed by each party and how each amortization schedule dealt with the approximate sixteen and one-half month lapse of time, as opposed to a twelve month lapse, between confirmation of the plan and the December 31, 1994, due date for the first payment to FCS.

The debtors take the position that the amortization of a mortgage should result in equal installment payments throughout the entire repayment period, and therefore, the December 31, 1994, payment should be identical to all of the subsequent annual payments under the confirmed plan. Under the debtors' proposed amortization schedule, the debtors will pay \$3,874.07 each year, so the interest earned on the four and one-half months in excess of the twelve months preceding the December 31, 1994, payment is actually amortized over the life of the mortgage. As a result, the loan is negatively amortized.

FCS objects to the debtors' amortization schedule and takes the position that the first payment should be \$4,767.59 to reflect the interest earned during the entire sixteen and one-half months that passed before the first payment was due, and \$3,792.48 for each year thereafter. FCS disputes the claim of the debtors that amortization requires equal installment payments and takes the position that it is the typical lending practice of FCS to increase the first payment if the time period covered by the payment is greater than twelve months.

Even though the amount at stake is minimal in the present case, FCS is concerned that this case will open the door for other debtors to start using negative amortization in their reorganization plans without specifically informing the affected creditors in the plan. FCS argues that negative amortization is not a sound lending policy for a bank to follow, and FCS would never affirmatively agree to such amortization.

### **Discussion and Decision**

In a case dealing with the issue of "negative amortization" one court has stated:

Negative amortization, which is also described as "deferral of interest" and "accrual of interest," can be defined as a provision wherein part or all of the interest on a secured claim is not paid currently but instead is deferred and allowed to accrue. The accrued interest is added to the principal and paid when income is higher or when the

collateral is sold. The overall rate of interest to be paid on the claim is referred to as the accrual rate. The rate to be actually paid on a monthly basis is referred to as the pay rate. The difference between the two represents the extent of negative amortization.

In re Club Assocs., 107 B.R. 385, 398 (Bankr. N.D. Ga. 1989) (citations omitted). Negative amortization is not per se impermissible under the Bankruptcy Code. In re Fowler, 903 F.2d 694, 699 n. 6 (9th Cir. 1994) ("We note, however, that most courts which have considered the issue outside the Chapter 12 context have refused to place a blanket prohibition on negative amortization."); Federal Sav. & Loan Ins. Corp. v. D & F Constr., Inc. (In re D & F Constr., Inc.), 865 F.2d 673, 676 (5th Cir. 1989) ("We do not hold there can never be an occasion when negative amortization would be fair and equitable"); Club Assocs., 107 at 398.

In a Chapter 12 confirmation proceeding, a bankruptcy court permitted negative amortization after finding that the creditor would ultimately receive the present value of the claim, even though principal and interest were accumulated during the first three years of the Chapter 12 plan. In re Fowler, 83 B.R. 39, 43 (Bankr. D. Mont. 1987), rev'd on other grounds, 903 F.2d 694, 699 n. 6 (9th Cir. 1994) ("[W]e do not consider [the parties'] argument that the district court erred in imposing negative amortization."). The bankruptcy court in Fowler reasoned that by deferring interest and principal during the first three years of the plan, the debtor could devote those funds to income producing activities under the plan. Id. The same bankruptcy court later held in a different case that negative amortization was permissible when a creditor would not receive a principal payment on a debt for four years because the creditor would ultimately receive the present value of its claim as required by 11 U.S.C. § 1225(a)(5). In re Big Hook Land & Cattle Co., 81 B.R. 1001, 1006 (Bankr. D. Mont. 1988). See also In re Hoffmann, 168 B.R. 608, 613 (Bankr. N.D. Ohio 1994) (denying confirmation of Chapter 12 plan and relying upon, as one of several reasons, the fact that the debtor proposed to negatively amortize the loan which would cause the secured creditor to receive less than the value of the claim on the effective date of the plan in violation of 11 U.S.C. § 1225(a)(5)).

In Chapter 11 cases, negative amortization has been rejected as unfair when principal and or interest payments are deferred under the plan so that the level of debt becomes, and remains, greater than the amount due on the confirmation date for several years post confirmation. D & F Constr., 865 F.2d at 676 n. 3 (citing In re Spanish Lake Assocs., 92 B.R. 875, 878-79 (Bankr.

E.D. Mo. 1988); In re Edgewater Motel, 85 B.R. at 998; In re Anderson Oaks Ltd. Partnership, 77 B.R. 108, 110 (Bankr. W.D. Tex. 1987)); In re 222 Liberty Assocs., 108 B.R. 971, 995-96 (Bankr. E.D. Pa. 1990); In re Memphis Partners, L.P., 99 B.R. 385, 388 (Bankr. M.D. Tenn. 1989); but see Club Assocs., 107 B.R. at 398-400 (confirming a plan with negative amortization when the fully secured creditor's loan is extended only five years, plan is otherwise feasible, and secured creditor bargained for negative amortization).

The Chapter 11 cases examine the impact of negative amortization on the creditor's ability to remain adequately protected, that is, whether the amortization schedule provides present value for the claim and whether nonpayment during the early years of the claim places an unfair risk on the creditor. Memphis Partners, 99 B.R. at 388. The analysis employed in the Chapter 11 cases is equally applicable in Chapter 12 when considering the present value requirement of 11 U.S.C. 1225(a)(5)(B)(ii).

Considering the factors discussed in the cases referred to above, the debtors would not have been barred from using a negative amortization schedule at the time of confirmation. FCS concedes that under the debtors' amortization schedule it would receive the present value of its claim under the Plan, and the payments would start to reduce the principal after one year. Thus, the risk to FCS of not being adequately protected in the event of a default by debtors was minimal.

Since the debtors would have been entitled to negatively amortize FCS's debt under the Plan, it must now be determined which amortization schedule should prevail because the Plan failed to refer to an amortization schedule. The Court concludes that the correct amortization schedule is the schedule submitted by FCS.

Based on the evidence received at the hearing, the Court finds as a fact that negative amortization is not the typical financing arrangement utilized by financial institutions. Ex. 1, ¶ 9; Club Assocs., 107 B.R. at 400. A Chapter 12 plan should employ a standard amortization schedule, unless otherwise clearly specified in the plan. In this case, FCS did not expect that the loan would be negatively amortized, and it would not be equitable for this Court to now impose a negative amortization schedule on FCS. FCS's amortization schedule properly requests that the debtors pay the interest accrued during the entire sixteen and one-half months with the December 31, 1994, payment. Amortization is defined as "the reduction of debt by regular payments of interest and principal sufficient to pay off a loan by maturity." John Downes & Jordan Elliot Goodman, DICTIONARY OF FINANCE AND INVESTMENT TERMS 16 (2d ed.

1987). Amortization does not always and absolutely mean that each payment must be equal.

**Conclusion**

The Court finds that the standard amortization schedule employed by FCS is the correct schedule under the Plan. The debtors shall pay the remaining amount due as of the end of 1994, plus accrued interest, if any, by December 1, 1995. Both FCS and the debtors have requested attorney fees to be awarded and both requests are denied.

Separate journal entry to be filed.

DATED: July 20, 1995.

BY THE COURT:

/s/ Timothy J. Mahoney  
Timothy J. Mahoney  
Chief Judge

Copies faxed by the Court to:

KELLY, PHILIP	8-308-635-1387
CARNEY, JAMES	8-308-632-7847
LYDICK, RICHARD	391-8195

Copies mailed by the Court to:

United States Trustee

Movant (\*) is responsible for giving notice of this journal entry to all other parties (that are not listed above) if required by rule or statute.

UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF )  
)  
CLARK & DARLA HUFF, ) CASE NO. BK92-80072  
) A  
\_\_\_\_\_  
DEBTOR(S) )  
)  
) CH. 12  
) Filing No.  
Plaintiff(s) )  
vs. ) JOURNAL ENTRY  
)  
)  
)  
\_\_\_\_\_  
Defendant(s) ) DATE: July 20, 1995  
HEARING DATE: May 24,  
1995

Before a United States Bankruptcy Judge for the District of Nebraska regarding Motion (filed by Farm Credit Bank of Omaha) to Approve Amortization Schedule.

APPEARANCES

Philip Kelly, Attorney for debtors  
James Carney for Farm Credit Bank

IT IS ORDERED:

The Court finds that the standard amortization schedule employed by FCS is the correct schedule under the Plan. The debtors shall pay the remaining amount due as of the end of 1994, plus accrued interest, if any, by December 1, 1995. Both FCS and the debtors have requested attorney fees to be awarded and both requests are denied. See memorandum entered this date.

BY THE COURT:

/s/ Timothy J. Mahoney  
Timothy J. Mahoney  
Chief Judge

Copies faxed by the Court to:

KELLY, PHILIP 8-308-635-1387  
CARNEY, JAMES 8-308-632-7847  
LYDICK, RICHARD 391-8195

Copies mailed by the Court to:

United States Trustee

Movant (\*) is responsible for giving notice of this journal entry to all other parties (that are not listed above) if required by rule or statute.