

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF)	
)	
JOHN & IRENE PARIS,)	CASE NO. BK88-40180
)	
DEBTOR)	CH. 12
)	Fil. No. 177

MEMORANDUM

Hearing was held on May 20, 1993, on Motion to Determine Net Disposable Income. Appearing on behalf of debtor was Frederick Allan, Jr., of Bauer, Galter, O'Brien & Allan, Lincoln, Nebraska. Appearing on behalf of Crawford State Bank (Bank) was David Pederson of Murphy, Pederson, Waite & Williams, North Platte, Nebraska. Appearing on behalf of Trustee was Ruth Hamilton of Omaha, Nebraska. 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

In August of 1989, a fire caused by a Burlington Northern train caused damage to pasture and crop land owned or operated by the debtors. In addition, the fire destroyed cattle that were on the ranch, although owned by parties other than the debtors, and destroyed hay and damaged equipment.

Prior to the fire, the debtors had settled with their creditors with regard to treatment in a Chapter 12 plan. Confirmation of the plan occurred after the debtor negotiated a settlement with the Burlington Northern railroad in which they received \$145,000.00 for the damages incurred as a result of the fire.

The Chapter 12 plan was basically a plan to liquidate the personal property, including livestock, machinery and equipment. The debtors turned over most of such property to the Crawford State Bank (Bank) and repurchased some of the equipment to continue their farming and ranching operation.

The Bank had a claim secured by real property which is not involved in this dispute. It also had both a secured claim with

regard to equipment and an unsecured claim. The secured claim was dealt with in the plan by a seven-year payoff and the unsecured claim was to receive a proportionate share of disposable income over the three years of the plan.

The debtors' plan acknowledged that the debtors owned no livestock and would be taking care of livestock on a share-calf basis, which along with government program payments, revenue from crops and timber sales would generate sufficient income to satisfy the creditors under the plan. At the time the plan was confirmed, it did not appear from the projections that there would be disposable income to distribute to the unsecured claims.

After the debtors received payment from the Burlington Northern Railroad, they paid numerous expenses of operations, paid an attorney for negotiating with the railroad, purchased replacement hay, purchased some equipment, paid off the secured claim of the Crawford State Bank, purchased cattle and paid the Internal Revenue Service approximately \$11,000.00 in taxes based upon the taxes accruing from the settlement.

In the summer of 1990, the Bank received a copy of an operating report from the debtors showing the \$145,000.00 fire settlement. The Bank requested information on the disposition of the settlement proceeds. The Bank was not satisfied with the information received and filed this motion to determine net disposable income. After much discussion and various exchanges of information and pleadings, the parties were unable to agree on the issue of whether or not some or all of the \$145,000.00 settlement should be considered disposable income under 11 U.S.C. § 1225(b)(2). A trial on this issue was eventually held in May of 1993.

Trial Matters

At the trial, Mr. Paris testified that he had spent far more than \$145,000.00 to pay for the damages caused by the fire. He claimed that he paid a variety of expenses for cleanup of the property, replaced some damaged equipment, replaced hay which had been harvested and then destroyed by the fire, and replaced hay which was not able to grow as a result of the destruction of the land surface by the fire. He also testified that he purchased cattle to replace the share-calf cattle which had either been destroyed or removed from his property after the fire because he was unable to properly care for such share-calf cattle. In his opinion, in order to have sufficient revenue to make the appropriate payments under the Chapter 12 plan, he had to have cows on the premises which would provide an annual calf crop, the

sale of which was the main revenue source for the ranching operation.

The Bank presented evidence that the Chapter 12 plan did not propose that the debtor would purchase cattle or that the debtor would need new machinery. From the Bank's point of view, no machinery was destroyed, although some may have needed repairs resulting from the fire. In addition, the evidence presented by the Bank showed that most, if not all, of the share-calf cows were returned to the ranch in the spring of 1990 and so the calf production from those cows, although interrupted by the fire, was not terminated. The Bank officer testified that it was the position of the Bank that an increase in debtor-owned cattle was not anticipated by the plan and was simply a capital expenditure which increased the assets of the debtor to the detriment of unsecured creditors.

One of the problems that became apparent at the trial was that the debtors have not kept consistent records of losses resulting from the fire and expenditures resulting from the fire. The operating reports to the Chapter 12 Trustee, the reports given to the Bank and the tax returns for 1989, 1990 and 1991, differ as to the purpose of the expenditure of the settlement proceeds.

The tax preparer of the debtor testified, by deposition, that he was made aware of the settlement proceeds and attempted, without any records from the debtor other than a farm record book, to determine the appropriate manner in which to record the settlement and determine the tax consequences of the settlement. After the Bank filed the motion for determination of disposable income, the debtors, without any records, informed the tax preparer that certain treatment of the expenditures was incorrect and that amended tax returns needed to be filed. Those tax returns were filed which reflected expenditures for labor and other items that the debtors now claim were legitimate operating expenses. The tax preparer, on examination by counsel for the Bank, admitted that the tax return for the appropriate year failed to account for approximately \$54,000.00 in income which, when added to other changes that needed to be made to the tax returns, would result in a net tax obligation to the debtors of \$20,000.00 to \$30,000.00 additional taxes, interest and penalties to be paid.

The Bank presented an expert witness concerning the tax matters and the testimony of the expert witness agreed with the testimony of the tax preparer concerning the net result from various changes that needed to be made. In other words, he agreed that approximately \$30,000.00 in taxes, penalties and

interest was probably due from the debtors to the taxing authorities.

The Plan

The debtors' plan provides that all of the debtors' projected disposable income to be received in the three-year period of the plan will be applied to make payments under the plan. The Code defines "disposable income" as: income which is received by the debtor and which is not reasonably necessary to be expended for maintenance or support of the debtor or a dependent of the debtor; or for the payment of expenditures necessary for the continuation, preservation, and operation of the debtors' business. 11 U.S.C. § 1225(b)(2).

Findings of Fact, Conclusion of Law, Discussion

When there is a dispute about the existence of disposable income in a Chapter 12 case, it is the duty of either the trustee or the interested creditor to calculate an estimated amount of disposable income available and make a satisfactory showing that the debtor has failed to comply with the plan by not making appropriate payments of disposable income. Once the initial burden is met, the Court shall require the debtor to show that all disposable income payments have been timely made. In re Kuhlman, 118 B.R. 731 (Bankr. D.S.D. 1990). The Court will look at the totality of the circumstances to determine whether the debtors' expenses were reasonably necessary for family support and continuation, preservation, and operation of the farm and such review will include the amount of and reason for any variance in the debtors' actual income and expenses from those projected in the plan, the debtors' past borrowing practices, the availability of credit, and the necessity of any capital improvement. Kuhlman at 739.

With the above standard in mind, the Court finds that the Bank has presented sufficient evidence for the Court to determine that the \$145,000.00 settlement, which was not anticipated in the plan, could have resulted in net disposable income after being used for replacement items that were destroyed and repair of items that were damaged in the fire. The Bank presented Exhibit 11 which is a list of items that the Bank believes the funds were spent on which would not qualify as replacement or repair and would not qualify as maintenance or support of the debtor or necessary for the continuation, preservation and operation of the debtors' business. The Bank requests the Court to consider the debtors' business as that business which is described in the plan. The plan deals with no purchase of new equipment, no

purchase of livestock and the operation of a share-calf arrangement.

The Court has considered the Bank's objection and the items that it contests as shown on Exhibit 11, as well as the detail of the items contained in Exhibit 8. The Court has further considered the testimony of Mr. Paris concerning his reason for purchasing new equipment and cattle. The Court concludes from a review of all of the evidence that over the life of the plan and considering the operation of the debtors' business as it was proposed in the plan, and further considering the problems resulting from the fire, the debtors should have had net disposable income for distribution to unsecured creditors in the amount of \$38,940.00.

The disposable income figure is determined by adding together the payment to Crawford State Bank of \$18,455.20, which is shown as No. 26 on Exhibit 11; the payment to Torrington Livestock for the purchase of forty-eight head of cattle, shown on Exhibit 8 and 11 at Line 27 in the amount of \$32,295.00; the payment to Torrington Livestock of \$14,400.00 for cattle, less the \$9,360.00 value of cattle paid to others for in kind labor services, for a net additional amount of \$5,040.00, from Line 33 of Exhibit 8 and Exhibit 11; the payment of \$11,050.00 to Gary's Implement for a tractor and disc shown at Line 32 on each exhibit; the purchase of livestock by Mark Paris in the amount of \$9,570.00, shown at Line 61 on each exhibit; the purchase of livestock in the amount of \$810.00 by Lance Paris shown at Line 63 on each exhibit. From that total of \$68,940.00 is deducted \$30,000.00, the estimated income tax obligation due as a result of a failure to include certain income in the tax returns presently filed. The net result is \$38,940.00 of disposable income.

The payment of \$18,455.20 to the Crawford State Bank on its secured claim is included in this calculation because the Bank was to receive that amount through the regular operation of the plan over several years. Had the plan been successful, the Bank would have received such amount from ordinary operating revenue results. Instead, the Bank was paid from the lump-sum settlement. By using the lump-sum settlement in this manner, the debtors, although making full payment on a secured claim, deprived the unsecured claim of a proportionate share of disposable income.

The purchase of forty-eight head of cattle from the Torrington Livestock is included in this calculation because the plan did not propose cattle ownership. The share-calf arrangement which the debtor had prior to confirmation and which

was anticipated to be the revenue producer during the plan, was simply interrupted, not terminated, by the fire. The evidence is that many of the share-calf cows were replaced on the premises in the spring of 1990. There is not sufficient evidence to show the amount of loss of operating income directly attributable to the removal of the share-calf cows in the fall of 1989 and their return in 1990. Therefore, the Court cannot determine whether or not it was consistent with the plan to purchase the number of cows purchased. There is also no evidence before this Court that other share-calf arrangements consistent with the plan were unavailable to the debtor instead of the purchase of cattle.

The net purchase of cattle in the amount of \$5,040.00 from Line 33 is included because of the same analysis made above. There is nothing in the plan that shows or anticipates cattle to be purchased. There is nothing in the evidence to show that there was a significant necessity for the purchase of this cattle in the spring of 1990 instead of entering into further share-calf arrangements. The \$9,360.00 which has been deducted from the purchase price on Line 33 represents a payment to the two sons of the debtors for labor during and after the fire. That amount appears to have been a legitimate expense for the preservation and continuation of the business, and the fact that it was paid in kind, that is, with cattle, instead of in cash, should make no difference. In addition, the evidence is that the animals purchased for the sons became part of a share-calf arrangement that benefitted the operation of the business.

The purchase of the tractor and disc shown on Line 32 of Exhibit 8 and Exhibit 11 was not anticipated by the plan and the plan was confirmed on the basis that there were sufficient pieces of equipment to maintain the operation. Mr. Paris testified that after confirmation, the Bank insisted on taking more equipment than was anticipated prior to confirmation. However, the testimony is not convincing with regard to the need for this additional equipment to be purchased, not from operating income, but from the lump-sum settlement. The feasibility of the plan had to have been determined by all of the parties and the Court based upon the equipment that was on the premises at the time of confirmation, after the fire. This purchase is a capital improvement, that, if the plan was feasible, could have and should have been purchased from operational revenue, rather than from the lump-sum settlement.

The last two purchases of livestock by Mark and Lance Paris are not justified. Mr. Paris testified that Lance and Mark have access to the debtors' checking account and that they purchased the animals in February and March of 1991 with his authority. They used funds in the debtor account and, the purchase was

allegedly pursuant to an agreement the debtors had with the sons for cleanup of burned debris. Since these purchases were made more than a year after the cleanup of the ranch and were made after or at approximately the time the motion for determination of disposable income was filed, the debtors had the burden of proof on the issue of whether such a purchase or purchases were legitimate operating expenses resulting from the fire or were something else. The testimony of Mr. Paris concerning his agreement with his sons is not corroborated. It is not consistent with the manner in which the plan describes the business. It is not consistent with the manner in which the tax returns were prepared and filed, until eventually amended. It is not consistent with the fiduciary duty of a debtor-in-possession to manage the affairs of the debtor for the benefit of the creditors. In other words, to permit the sons of the debtors to use the debtor checking account and purchase livestock for their own benefit, more than a year after any alleged labor services had been rendered, with no written agreement, simply does not meet the requirement that the debtors convince this Court that the expenditures were not from disposable income.

The deduction for the anticipated tax obligation is based upon the theory that had the debtors properly filed their tax returns with all of the appropriate entries, they would owe \$30,000.00 in taxes. There is a dispute between the tax preparer of the debtors and the expert witness of the Bank with regard to how various items should have been dealt with on the tax returns. Nonetheless, both parties agree that under the circumstances of this case as it exists now, there is a high probability that the debtors owe \$30,000.00 in taxes. If they had paid such taxes, such taxes would be appropriately deducted from revenue for determining a three-year disposable income amount.

In conclusion, the Court finds that the debtors have had, over the life of the plan, \$38,940.00 in disposable income which should have been distributed either during the case or prior to discharge, to the unsecured creditors.

A separate journal shall be filed.

DATED: August 31, 1993.

BY THE COURT:

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

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

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JOHN & IRENE PARIS,)	CASE NO. BK88-40180
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<u>DEBTOR(S)</u>)	
)	CH. 12
)	Filing No. 177
Plaintiff(s))	
vs.)	<u>JOURNAL ENTRY</u>
)	
)	
)	DATE: August 31, 1993
<u>Defendant(s)</u>)	HEARING DATE: May 20,
)	1993

Before a United States Bankruptcy Judge for the District of
Nebraska regarding Motion to Determine Net Disposable Income.

APPEARANCES

Frederick Allan, Jr., Attorney for debtor
David Pederson, Attorney for Bank
Ruth Hamilton, Attorney for Trustee

IT IS ORDERED:

The Court finds that the debtors have had, over the life of
the plan, \$38,940.00 in disposable income which should have been
distributed either during the case or prior to discharge, to the
unsecured creditors. See memorandum entered this day.

BY THE COURT:

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