UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

IN RE:

BRADLEY LEWIS
JEANETTE LEWIS, individually and d/b/a Cedar Hill Farms

CASE NO. 90-00499

Chapter 12

Debtors

APPEARANCES:

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STEPHEN D. GERLING, U.S. Bankruptcy Judge

MEMORANDUM-DECISION, FINDINGS OF FACT,
CONCLUSIONS OF LAW AND ORDER

The Court considers herein confirmation of the Amended Plan of Reorganization filed with the Court on November 21, 1990 ("Amended Plan") by Bradley and Jeanette Lewis, individually and d/b/a Cedar Hill Farms ("Debtors").

The Debtors filed their initial Plan of Reorganization ("Plan") on September 5, l990.

Thereafter, Objections to Plan ("Objections") were filed by the Herkimer County Trust Company ("HCT") as a secured creditor, on November 6, l990.

An evidentiary hearing for the purpose of confirming the Amended Plan and considering the Objections filed by HCT was held at Utica, New York on December 5, l990.

Following the hearing, the parties were provided with opportunity to file memoranda of law and the contested matter was finally submitted on January 2, l99l.

JURISDICTIONAL STATEMENT

The Court has jurisdiction over this contested matter pursuant to 28 U.S.C. §1334(b), §157(a), (b)(l) and (2)(L).

FACTS

Debtors filed their voluntary petition pursuant to Chapter 12 of the Bankruptcy Code (ll U.S.C. §§101-1330) ("Code") on March 2, l990. Debtors did not file the Plan with their petition, and on June ll, l990, Debtors filed a motion seeking an additional l20 days in which to file a plan.

On July l9, l990, the Court entered an Order extending Debtors' time to file a plan for a period of forty-five days from July l7, l990.

As indicated, Debtors filed their Plan on September 5, l990, and a hearing on confirmation of the Plan was scheduled FOR November l3, l990. On November 6, l990, HCT filed their Objections to the Plan and at the confirmation hearing held on November l3, l990, the Court adjourned to December l3, l990 for an evidentiary hearing.

On November 2l, l990, the Debtors, presumably on the authority of Code §1223(a), filed the Amended Plan and obtained an Order from this Court on that same date pursuant to Bankruptcy Rule 9006(c) reducing the time and scheduling an evidentiary confirmation hearing on the Amended Plan for December 5, l990. The Amended Plan purported to alter the Plan only with regard to HCT as a Class III creditor, Farmers Home Administration as a Class VII creditor and the unsecured creditors included in Class XII.

HCT's Objection alleges that the Debtors did not file their Plan in accordance with the Court's Order of July l9, l990, that the Debtors have undervalued the real estate which is subject to HCT's mortgage, that the interest rate and amortization period regarding its mortgage are being impermissibly modified, that HCT's crop loan to Debtors is likewise being impermissibly modified as to interest rate and amortization period, that certain equipment identified as a "mixer" which Debtors allege is subject to a security interest, is in fact leased by HCT to Debtors, that certain equipment identified as a "spreader" alleged by Debtors to be free of HCT's security interest is in fact secured, and finally, that Debtors' Plan is not feasible.

HCT did not file an amended objection to Debtors' Amended Plan, nor were objections filed by any other creditors.

Debtors' Amended Plan in Class III dealing with HCT's real estate mortgage, revalued the real estate at $l45,000, thereby treating HCT's mortgage debt as fully secured. The Amended Plan further decreased the proposed amortization period from thirty to twenty-five years, but did not alter the 9% per annum interest rate proposed in the Plan.

The Amended Plan did not alter the treatment of HCT's crop loan as provided for in the Plan (Class IV), nor did it concede the mixer's status as leased property (Class V) or the spreader's status as being subject to HCT's security interest (Class VI).

At the December 5, l990 confirmation hearing, however, the Debtors and HCT stipulated that the value of Debtors' real property, subject to HCT's mortgage, would be fixed at $l45,000 and that the mortgage would be amortized over twenty-five years, that the mixer, with an agreed value of $2,000 was subject to a security interest held by HCT, that the indebtedness due HCT on the spreader was in fact previously "rolled" into the crop loan, and finally that the crop loan would be amortized at l0.5%.

At the hearing Debtor Bradley Lewis testified that he had operated Cedar Hill Farm since his father's death in l98l, and that in l98l, approximately eighty cows were being milked on the farm. The Debtor testified further that between l984 and l987, he lost approximately one hundred heifers to a disease known as coccidiosis, but that his Amended Plan is based upon a restoration of his dairy herd level to eighty-five cows.

In order to acquire sufficient funds to purchase the approximately forty to forty-five additional cows, which Debtor estimated would cost approximately $800.00 per animal, the Amended Plan provides that Debtors will sell non-essential farm machinery and equipment valued at $40,850 and also obtain post-confirmation financing from "Farmland", the current purchaser of Debtors' milk.

While acknowledging that the machinery and equipment proposed to be sold were subject to a pre-petition lien of Farmers Home Administration ("FmHA"), Debtors' Amended Plan provides for an involuntary "exchange of collateral" whereby FmHA's lien would be transferred from the machinery and equipment to the newly acquired cows.

Debtor Bradley Lewis testified at the confirmation hearing that he is now of the opinion that the machinery and equipment will generate $50,000 to $60,000 in spite of the fact that he believes that he will now have to sell only three tractors as opposed to the four listed in the

Amended Plan.

Debtor Bradley Lewis testified that his projected amended budget for the duration of his plan is based upon an average herd production of l5,000 pounds of milk per cow per year. In support of his contention, Debtor produced records which indicated that in l983, his herd average was l5,724 pounds, l6,l95 pounds in l987 and l4,924 pounds during the month of April l989. (See Debtors' Exhibits 4 and 6). On cross-examination, however, Debtor Bradley Lewis acknowledged that a statement given to HCT indicated that his herd average in l988 was only l3,000 pounds and that he had no current records showing herd average in l990.

Debtor Bradley Lewis also testified that the current milk price was $l3.74 per hundred weight ("cwt."), although his Amended Plan is based on a price of only $l2.50 cwt. He indicated that his current milk check based on forty cows was $6,000 per month, and that Farmland generally loans up to the amount of the monthly milk check. He also noted that Debtor Jeanette Lewis was employed on the farm and off the farm at the Hurd Shoe Company.

On cross-examination, Debtor Bradley Lewis testified that he intends to purchase one used tractor for approximately $4,000 and that his estimate of $800 per additional cow is based on a conversation with a farmer who was proposing to sell his entire herd. He also acknowledged that he had a financial problem purchasing feed for his cows in February and March l990 even though he made no payments to HCT in l989.

HCT offered the testimony of Baldwin S. Hislop ("Hislop"), a vice-president in charge of its farm loan department, who testified that Debtors' Amended Plan fails to consider an annual decline in herd level known as a "cull rate" due to disease, death and cows who no longer give milk. Hislop testified that the cull rate could claim as much as l5% to 20% of the herd annually.

Hislop challenged the Debtors' annual feed estimate of $l4,400 contending that at an eighty-cow herd level, he estimated an annul feed cost of approximately $40,000. Hislop also testified that according to a commonly accepted survey performed by Cornell University, a successful dairy farmer in upstate New York generally carries a debt load of $2,000 to $2,500 per cow, while Debtors' pre-petition debt load per cow, based upon one hundred cows, was estimated at $3,500 to $3,700 per cow. Based upon an actual herd level of forty-six cows, Hislop opined that the Debtors' debt load was $7,000 to $8,000 per cow, making it extremely difficult for Debtors to service their outstanding debt.

Hislop also testified that an equipment sale during the winter months would produce far less than during the spring, and that it was his opinion that a cow's capability of producing the amount of milk being projected by the Debtors could not be purchased at $800 per animal. He pointed out that Debtors' Plan was based upon a monthly milk check of $l3,250, more than double their current check of $6,000.

Finally, Hislop contended that the current interest rate imposed on farm real estate based lending is l2% in upstate New York, but did not dispute the Amended Plan which indicates that HCT's real estate mortgage note currently bears interest at 9%. (See Class III, pg. l3).

On cross-examination, Hislop conceded that a "cull rate" can be offset by raising heifers on the farm rather than purchasing replacement cows, and that feeding cows "high moisture corn" can reduce the annual feed bill. Hislop also conceded that Harris Wilcox, Inc., who performed the appraisal of Debtors' farm, including land, livestock, machinery and equipment, was a reputable farm appraiser. (Harris Wilcox appraisal is attached to the Plan as Exhibit B).

DISCUSSION

Though HCT did not file an objection to the Amended Plan, its Objection to the Plan filed on November 6, l990, except insofar as it was modified by the stipulation entered into at the December 5, l990 confirmation hearing, shall be deemed to be an Objection to the Amended Plan pursuant to Code §1223(c).[1]

It appears that the primary objection which the Court must address is the feasibility of the Amended Plan pursuant to Code §1225(a)(6). HCT also continues to object to the treatment of its secured debt being amortized at an annual interest rate of 9% for the real estate loan, and, since not addressed in the pre-hearing stipulation, presumably to the sixty-month amortization on the crop loan.

It should be noted, however, that HCT offered only a modicum of testimony with regard to interest rate or repayment period. Hislop simply stated that the usual rate on "farm real estate loans" in the upstate New York area is l2%. Debtors allege, apparently without dispute, that the pre-petition interest rate on the real estate loan was 9%, and they do not propose to alter it.[2]

Thus, while interest rate and amortization period were put in issue by both the terms of the Amended Plan and HCT's Objections, there is very little proof by either party from which the Court might reach a conclusion.

With regard to the HCT's real estate loan, the parties have agreed that it will be secured to the extent of $l45,000. Article IV of the Amended Plan at page l3 further provides that

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[1] Paragraph 1 of HCT's Objections is addressed to Debtors' failure to file their Plan until September 5, l990, which was five days beyond the forty-five day extension granted in the Court's Order of July l7, l990. At the commencement of the December 5, l990 hearing, the Court denied that portion of HCT's Objections from the bench.

[2] There appears to be some evidence in the record that the pre-petition interest rate on HCT's real estate estate mortgage was variable.

the Debtors will execute a new mortgage note in that amount to be amortized at 9% per annum over twenty-five years from the date of confirmation. HCT objects that the 9% interest rate is "patently low". (See HCT's Objections to Plan dated November 6, l990 at para. 2).

With regard to HCT's crop loan, while there is apparently no dispute as to the amount due, the Amended Plan in Article IV, at page l4, likewise provides that the Debtors will execute a new note in the undisputed amount of $26,24l.03 payable over sixty months at 9% per annum. Again HCT objects to the amortization period of sixty months, contending that a crop loan, due to the nature of the collateral, must be paid off within one year.

In spite of Debtors' assertion that HCT's secured real estate claim is not impaired, it is clear that Article IV, Class III of the Debtors' Amended Plan seeks to modify re-payment of that claim pursuant to Code §1222(b)(2) and (b)(9) when it proposes to repay HCT $l45,000 at fixed rate of 9% per annum extended over twenty-five years, and, therefore, that modification must meet the requirements of Code §1225(a)(5). See U.S. v. Arnold, 878 F.2d 925, 927 (6th Cir. l989).

Code §1225(b)(5)(B)(ii) contains what is referred to as "present value" language which simply stated requires a secured creditor whose claim is to be paid out over time, to recover money or property having the same value as it would have if the secured creditor's allowed claim was paid in full on the date of confirmation. Typically, where the secured creditor is to receive a stream of monetary payments pursuant to the Chapter 12 plan, a discount or interest rate must be applied to compensate the secured creditor against the ever decreasing time value of money. See In re Shannon, l00 B.R. 9l3 (S.D. Ohio l989).

In calculating a so-called discount rate, case law indicates that there is no hard and fast rule as to how a bankruptcy court should arrive at the rate, though the majority of courts appear to hold that the proper discount rate is an "interest rate for similar loans among regional and local

lenders pursuant to the coerced loan theory". See In re Shannon, supra l00 B.R. at 939.

As is pointed out in In re Shannon, supra, a bankruptcy court is generally assisted in reaching a proper discount rate by testimony provided by bank officials and/or expert witnesses. Unfortunately, in the instant case, the Court has a dearth of testimony or other relevant proof from which to determine a discount rate.

The only testimony to which the Court may refer was Hislop's uncontroverted statement that the current interest rate being charged on farm real estate loans in the area was l2%. Debtors' limited cross-examination of Hislop did not undermine the credibility of his admittedly thin testimony, and Debtors' attempt to establish an applicable discount rate by way of their post-hearing Memorandum of Law, rather than at the evidentiary hearing, is rejected by the Court.

It is to be noted that the majority of courts interpreting Code §1225(a)(5)(B)(ii) have adopted a "market rate" of interest as a proper discount rate. More specifically, market rate is generally defined in those courts as the rate

> which regional lenders of similar loans, here agricultural lenders, would actually charge persons similarly situated to the debtor on the open market, absent the fact of bankruptcy, considering the payout time, the amount and quality of the collateral and other risk factors.

In re Shannon, supra, l00 B.R. at 936. (citing cases).

As indicated, the only competent proof before the Court that would appear to meet the market rate definition is the testimony of Hislop that HCT, as well as other farm lenders in the area, currently make farm real estate loans at a l2% interest rate. Thus, the Court adopts that rate in accordance with Code §1225a)(5)(B)(ii) and rejects the 9% rate proposed in the Amended Plan.[3]

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[3] The Court notes that in its post-hearing "Memorandum" HCT apparently concedes an interest rate of 11% on the real estate loan. The Court, however, does not consider a post-hearing memorandum to constitute a pleading or a stipulation which would be otherwise

The Court also observes that Article IV, Class IV of the Amended Plan at page l4 indicates that Debtors intend to continue HCT's lien on their crops over a five year amortization of the crop loan in a "roll over" fashion, crop cycle to crop cycle. Based upon that treatment of the crop loan, the Court denies HCT's Objection insofar as it rejects the five-years amortization period.

Turning to the central issue of feasibility, the Court initially focuses on the Debtors' proposal found in Article V, Class VII of the Amended Plan which requires an "exchange of collateral" with regard to the secured claim of FmHA. As previously indicated, the exchange of collateral would permit Debtors to sell a significant amount of farm machinery, concededly subject to FmHA's lien, which the Debtor Bradley Lewis contends is no longer necessary to the farm operation, utilize the proceeds to purchase additional cows and subject those cows to the FmHA lien.

Without deciding whether or not the Debtor can force such an exchange of collateral in the face of creditor opposition, the Court concludes that FmHA's failure to object to the Amended Plan subjects FmHA to its terms, including the exchange of collateral, in the event of confirmation. See Code §1227(a); In re Lech, 80 B.R. l00l, l008 (Bankr. D.Neb. l987); In re Grogg Farms, Inc., 9l B.R. 482, 485 (Bankr. N.D.Ind. l988); In re Wickersheim, l07 B.R. l77, l8l (Bankr. E.D.Wis. l989).

Clearly, Debtors Plan contains significant contingencies, i.e. sale of machinery and negotiation of a post-petition loan which will generate sufficient funds to purchase forty to forty-five additional cows with an average production per cow of l5,000 pounds of milk annually, which milk will sell for an average price of $l2.50 cwt., raising a sufficient number of heifers to replace cull

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factually binding upon a party, and, therefore, the Court disregards that portion of the memorandum for purposes of this decision.

cows, growing and feeding "high moisture corn" which may or may not keep Debtors' feed expense in the neighborhood of $l4,400 annually, and preventing a recurrence of coccidiosis.

Clearly, the linchpin of the Debtors' Amended Plan is the doubling of their herd. Without eighty to eighty-five milking cows, the Debtors simply cannot generate sufficient income in the first year of the Plan to meet current expenses. (See Amended Plan, Article VII, pg. 22).

There appears to be no dispute that in past years eighty plus cows have been milked on Cedar Hill Farms in the same facilities as presently exist. It also appears that for the years l983 through l987, Debtors' herd was capable of averaging in excess of l5,000 pounds of milk per cow per year and that as recently as April l989 the herd's indicated average was approximately l5,000 pounds of milk per cow. (See Debtors' exhibit 4 and 6).

It is apparent that the greatest area of uncertainty in the Debtors' Plan, in addition to their ability to double the size of their herd by liquidating certain machinery and obtaining post-confirmation financing, is their projection of annual expenses as set forth on Exhibit D attached to the Amended Plan.

There was very little testimony offered by either the Debtors or HCT with regard to the projected budget other than the dispute over the projected feed expense.

There are items set forth in Exhibit D which appear most significant for which no testimony was offered by either party. Under "Receipts" for each year of the Amended Plan there are significant sources of income identified as "Farmland Premium" and "Cows Sold" for which no explanation was offered by Debtors. Under "Expenses" a payment of $7,200 per year is being made to Kathryn Lewis, the mother of Bradley Lewis who is alleged in the Plan to be a one-third owner of the farm, as well as significantly variable expenses such as Feed $l4,400, Equipment Repair $l4,000, Vet. $l8,000, Fertilizer $4,000, Seed $4,000, Spray $2,000 and Milk House Supplies $l,200.

Debtors offered no historical data from which theses types of variable expenses have been estimated, nor were any operating reports provided which reflect reality since the date of filing. What is clear, is that since Debtors are not presently milking eighty-five cows, Exhibit D, insofar as it projects expenses over the next three years, is clearly speculative.

Farming, be it crop or dairy, is at best a tenuous business subjected as it is to many variables over which even the most efficient farmer has no control. Clearly, the unpredictable nature of farming as a business was at least partially responsible for Congress' enacting Chapter l2 in l986, leading to criticism from some quarters that no particular segment of business or industry should have its own chapter within Title ll.

Courts have recognized the tenuous nature of farming in passing upon the feasibility requirements of Code §1225(a)(6). It has been said that the feasibility standard to be applied in Chapter l2 is not one of "mathematical certainty or guaranteed success." A "debtor need only demonstrate a reasonable assurance of economic viability or a reasonable probability that the plan can be successfully implemented and performed." See Matter of Dues, 98 B.R. 434 (Bankr. N.D.Ind. l989).

Conversely, a Chapter l2 debtor's plan cannot be based upon subjective whims having no factual link to reality. As Bankruptcy Judge James G. Mixon observed in In re Butler, l0l B.R. 566 (Bankr. E.D.Ark. l989), "Farming is an unpredictable business with many variables, including commodity prices, crop yields and weather conditions. If a farmer begins operating in a precarious financial position, any adverse change in the variables can destroy his chances of success. A plan based on unduly optimistic and highly speculative assumptions, with no cushion for adversity, would not survive a negative swing in any variable." Id. at 568

Upon a review of all of the proof before it, and giving due consideration to an

increased payment to HCT, based upon a rate of interest greater than 9%, the Court concludes that Debtors' Amended Plan is feasible, assuming Debtors can increase their herd level to eighty-five cows. Though the more prudent course may be for the Court to withhold confirmation pending the actual machinery sale, loan negotiation, and purchase of additional cows, or condition confirmation on the occurrence of those events within a specified period, the Court believes that that will simply lead to further Court proceedings with an attendant increase in the expenses of the Debtors.

Based upon the foregoing, it is

ORDERED that Debtors' Amended Plan filed with this Court on November 2l, l990, except as modified herein and by Stipulation of the parties, is hereby confirmed.

Dated at Utica, New York

this day of March, l99l

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STEPHEN D. GERLING
U.S. Bankruptcy Judge