

**UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF MONTANA**

In re

**JEFFERY PAUL WILSON, and
SHONI LEE CARD,**

Debtors.

Case No. **05-65161-12**

In re

**WILSON SCOTCH MOUNTAIN
ANGUS LLC,**

Debtor.

Case No. **06-60369-12**

MEMORANDUM OF DECISION

At Butte in said District this 7th day of February, 2007.

Pending in the above-captioned jointly administered Chapter 12 bankruptcy cases are Confirmation of the Debtors' Chapter 12 Plans and objections thereto filed by creditors Paul E. Harper Revocable Trust ("Harper Trust") and by Ag Sales, and Debtors' motion for valuation of Ag Sales' security. A hearing on these matters was held after due notice on October 31, 2006, with the parties appearing represented by counsel and offering witness testimony and exhibits, after which the Court granted the parties time to file briefs and took the matter under advisement. After review of the briefs, record and applicable law, this Court sustains Harper Trust's objection to confirmation based upon 11 U.S.C. § 1225(a)(5)(B)(ii), but the Court concludes that Jeffery Paul Wilson and Shoni Lee Card satisfy the income requirement of "family farmer" as defined at

11 U.S.C. § 101(18) and denies Harper Trust's request to dismiss.

Debtors Jeffery Paul Wilson ("Jeffery") and Shoni Lee Card ("Shoni") (together "Debtors") each appeared and testified at the hearing, represented by attorney Gary S. Deschenes ("Deschenes") of Great Falls, Montana. The Harper Trust was represented by attorney Harold V. Dye ("Dye") of Missoula, Montana. Missoula Federal Credit Union ("Missoula FCU") was represented by attorney Richard J. Samson of Missoula. Ag Sales was represented by attorney Christian T. Nygren ("Nygren") of Missoula, and Ag Sales' owner Clyde Hepburn ("Hepburn") testified. Valley Bank of Hot Springs¹ and Valley Bank of Arlee² (together "Valley Bank") both were represented by attorney Dean A. Stensland of Missoula. The Chapter 12 Trustee James Volk ("Volk") appeared in support of confirmation. Counsel for Debtors, Valley Bank and Missoula FCU advised the Court that they had reached stipulations settling those creditors objections, and the Court granted the parties time to file written stipulations. For purposes of the confirmation hearing, Deschenes advised the Court that the parties stipulated the value of Harper Trust's security, Debtors' ranch property, at the amount of \$550,000³.

The Court denied Debtors' motion to continue the confirmation hearing again. Debtors' Exhibit ("Ex.") 1 was admitted, as were Ag Sales Ex. A and B and the Harper Trust's Exhibits H-3, H-4, H-5, H-6, H-7, H-8, H-9, H-10, H-11, H-12, H-13, H-14, H-15, H-16, H-17, H-23, H-24, H-25, H-26, and H-27. In addition to the Debtors, Debtors' expert J. T. Korkow ("Korkow") testified, as did Harper Trust's experts Jack E. Wicks ("Wicks") and Shirlee Walker ("Walker").

¹Valley Bank of Hot Springs has a claim secured by Debtors' cattle and farm equipment.

²Valley Bank of Arlee has a claim secured by mower equipment.

³The parties later increased the stipulated value of Harper Trust's security to \$600,000.

At the conclusion of the parties' cases-in-chief the Court granted the parties time to file simultaneous briefs, which have been filed and reviewed by the Court, together with the record and applicable law. This matter is ready for decision.

This Court has jurisdiction of this Chapter 12 bankruptcy under 28 U.S.C. § 1334(a). This is a core proceeding involving claims and confirmation of a plan under 28 U.S.C. § 157(b)(2)(B) and (b)(2)(L). This Memorandum of Decision includes the Court's findings of fact and conclusions of law.

PROCEDURAL HISTORY

Jeffery Wilson and Shoni Card filed a joint Chapter 13 bankruptcy petition on October 15⁴, 2005, and filed their Schedules and Statements on November 4, 2005. Schedule A lists real property described as a "Ranch/Residence located at 25195 Hwy 200 East Potomac, Missoula County, Montana" valued at \$400,000 encumbered by a secured claim in the amount of \$500,000, which Schedule D identifies as held by creditors "Paul & Linda Harper" dated 1/03 and described as a contract for deed. Ag Sales is listed on Schedule D as a creditor with a claim in the amount of \$28,120.00 secured by a construction lien on "Ranch/Residence (Installed Pivot)", but listed as fully unsecured based upon the existence of superior liens. Schedule D also lists Missoula FCU as a creditor with a \$49,490.00 claim secured by a tractor, dated 2005. Valley Bank is listed on Schedule D with secured claims in the amounts of \$11,000 and \$70,000 secured respectively by a swather and cattle (15 bulls, 85 cows and 65 calves). Their Statement of Financial Affairs at paragraphs 19 and 21 lists "Wilson Scotch Cap Angus, LLC" as a cattle

⁴Jeffery and Shoni's petition date falls before October 17, 2005, the effective date of the amendments to the Bankruptcy Code made by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA").

ranch business beginning in 2002, with Jeffery as 100% owner⁵.

Jeffery and Shoni moved to convert their case from Chapter 13 to Chapter 12, which was granted by Order entered on November 7, 2005.⁶ The Department of Treasury – Internal Revenue Service (“IRS”) filed Proof of Claim No. 3 on November 14, 2005, asserting a priority claim in the amount of \$1,195.25 for heavy vehicle taxes incurred in 2003 and 2004 which are described as unassessed due to no tax return being filed, and an unsecured nonpriority claim in the amount of \$278.57 from 2002. The IRS filed a separate Proof of Claim No. 4 on November 18, 2005 asserting the same \$278.57 unsecured nonpriority claim. The IRS withdrew Proof of Claim No. 3 on November 9, 2006.

Jeffery and Shoni substituted Deschenes as their attorney in March of 2006 and were granted an extension of time to file their Chapter 12 Plan, the first of which they filed on March 27, 2006. Jeffery and Shoni filed amended Plans, the latest their Third Amended Plan on October 11, 2006. Objections to confirmation were filed by Valley Bank of Hot Springs, the Harper Trust, Missoula FCU, and Ag Sales.

Wilson Scotch Mountain filed its Chapter 12 petition and initial Plan in Case No. 06-60369-12 on May 24, 2006⁷, and filed its Schedules and Statements on June 15, 2006. Its Schedules list \$0 personal property, real property described as a “ranch/residence located at 25195 Hwy 200 East Potomac, Missoula, Montana” valued at \$400,000, and the Harper Trust’s

⁵Jeffery and Shoni filed an amended Statement of Financial Affairs on June 22, 2006, providing more detail in paragraphs 18, 19 and 20. Docket No. 79.

⁶Chapter 12 was reauthorized by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”). Pub. L. 109-8, effective October 17, 2005.

⁷After enactment of BAPCPA.

secured claim listed as \$500,000, with \$100,000 unsecured. Wilson and Card are listed as codebtors on Wilson Scotch Mountain's Schedule H to the Harper Trust. The Statement of Financial Affairs states at paragraph 1 that Wilson Scotch Mountain had \$0 annual income in 2004, 2005, and to date in 2006. Paragraph 18 states that Wilson Scotch Mountain began in existence in 2002. Paragraph 21 states that Wilson Scotch Mountain is 100% owned by Jeffery Paul Wilson. Wilson Scotch Mountain did not file Schedules I and J, but filed a "Business Income and Expenses" sheet showing estimated gross monthly income in the amount of \$4,166.00, or \$50,000 per year from lease income, and expenses of \$862.67. Wilson Scotch Mountain amended its Schedule G on June 21, 2006, to list the unexpired cash lease of land to Jeff Wilson and Shoni Card for pasture and haying land, dated 2/1/2005⁸.

The Harper Trust filed a motion to dismiss Case No. 06-60369-12 case on July 7, 2006, on the grounds Wilson Scotch Mountain was never engaged in farming operation and is not eligible for Chapter 12 relief. The Harper Trust withdrew its motion at hearing held on October 31, 2006.

On July 28, 2006, the Harper Trust filed a request for judicial notice that the prime rate of interest is 8.25 percent (8.25%) as of the date of the original confirmation hearing, August 3, 2006, which the Court granted by Order entered on July 28, 2006⁹. The hearing on confirmation and other matters was vacated and held on September 22, 2006, after which the Court entered an

⁸A contract for deed on the original Schedule G with the Harper Trust was deleted from Wilson Scotch Mountain's amended Schedule G.

⁹A simple internet search using any common search engine verifies that the prime rate has not changed. This is a judicially noticeable fact not subject to reasonable dispute, of which a court may take judicial notice under Fed. R. Evid. 201(c).

Order denying confirmation of Jeffery and Shoni's Second Amended Plan, with the agreement of Debtors' counsel, and granting Debtors additional time to amend. Jeffery and Shoni filed their Third Amended Plan on October 11, 2006, the same date Wilson Scotch Mountain filed its Second Amended Plan. Objections to confirmation were filed by Harper Trust in both cases, and by Ag Sales, Valley Bank and Missoula FCU in Case No. 05-65161-12. The objections of Valley Bank of Arlee, Valley Bank of Hot Springs and Missoula FCU were cured by Stipulations with Jeffery and Shoni filed on November 9, 2006¹⁰, leaving only the objections to confirmation of Harper Trust and Ag Sales to be decided.

On October 19, 2006, Debtors filed an objection to Ag Sales Proof of Claim No. 2 and a motion for valuation of Ag Sales' security, Debtors' farm and ranch property, seeking a determination that no equity exists securing Ag Sales claim¹¹. These Chapter 12 cases were consolidated for purposes of joint administration¹² by Order entered on November 1, 2006, after the Harper Trust withdrew its objections.

The Harper Trust filed the only Proofs of Claim in the Wilson Scotch Mountain case No. 06-60369-12. Dye filed Proof of Claim No. 1 on behalf of the Harper Trust on August 8, 2006, asserting a claim in the amount of \$527,174.11, including prepetition attorney fees in the amount of \$11,849.27, and asserting that the value of the Harper Trust's collateral, real estate, is

¹⁰Docket Nos. 166, 167 and 168, each of which was approved by Order entered on November 13, 2006, Docket Nos. 169, 170 and 171, respectively.

¹¹The objection and motion for valuation are based on a valuation of \$550,000. The Debtors later stipulated a value of \$600,000 for their farm and ranch property.

¹²The Order clarified that the consolidation was for joint administration but not for purposes of substantive consolidation.

\$550,000. On October 30, 2006, Harper Trust filed Proof of Claim No. 2, checking the box which states that it amends a previously filed claim, and changing the value of its collateral to “unknown”. Wilson Scotch Mountain filed an objection to Proof of Claim No. 1 on October 30, 2006, on the grounds Harper Trust’s attorney fees have not been approved by the Court, and also filed on the same date a motion for valuation of Harper Trust’s security asserting the same value for Debtor’s real estate, \$550,000. Harper Trust responded to Debtor’s motion for valuation on November 13, 2006, alleging that the value of its real estate collateral is \$700,000. In Case No. 05-65161-12, Harper Trust filed Proof of Claim No. 9, and filed an amended claim on August 9, 2006, asserting an unsecured nonpriority claim in the amount of \$512,730.24 for money loaned. Debtors filed an objection and set the matter for hearing.

At a hearing held on December 7, 2006, on valuation and Debtors’ objections to claims, the parties stipulated that the value of the Harper Trust’s security is \$600,000. The Court’s Order entered on December 8, 2006 (Docket No. 191), found that the Debtors’ objections to Harper Trust’s and Ag Sales’ Proofs of Claim were resolved and directed Ag Sales and Harper Trust to file amended claims. Harper Trust filed Proof of Claim No. 3 in Case No. 06-60369-12 on December 13, 2006, stating the value of its collateral at the agreed \$600,000. Debtors renewed their objection to Harper Trust’s claim on December 20, 2006¹³, because of the lack of accounting for the \$11,849.27 in prepetition attorney fees. Ag Sales filed a fourth amended Proof of Claim on December 11, 2006, asserting a secured claim in the amount of \$27,955.60 plus interest, attorney fees and costs bringing the total to \$41,331.52. Debtors have not filed a

¹³The latest objection was filed in Case No. 06-60369-12 after administrative consolidation, then refiled in Case No. 05-65161-12 (Docket No. 194) on December 21, 2006. A hearing is scheduled to be held on that objection on February 8, 2007.

subsequent objection to Ag Sales' amended claim.

FACTS

Jeffery Wilson and Shoni Lee Card are married and have two sons. Jeffery grew up on a cow/calf ranch operation raising cattle and was educated through graduate school in animal science. Shoni was educated and has 18 years experience as a veterinarian, and is employed as a veterinarian at Pruyne Veterinary clinic in Missoula, where she testified she recently went from part-time to a full time mixed animal veterinary practice.

Jeffery testified that he was injured years ago in a scaffolding accident. He testified that he receives workers' compensation payments in the amount of \$2,088.09 per month with a five percent (5%) annual increase, and a \$5,000 balloon payment from insurance. He admitted that his workers' compensation income is not tied to his present ag operation.

Jeffery grew up working and raising Hereford cattle, but since 1996 he testified he has operated a purebred registered Angus cattle operation, starting with 13 cows in 1997 and growing his herd since by means of embryo transfer, and raising elite Angus bulls. Prior to purchasing land from the Harper Trust at Potomac, Montana, Jeffery rented land for his cattle operation at Florence and Pablo, Montana.

On January 2003 Jeffery, on behalf of Wilson Scotch Cap Angus, LLC, entered into Ex. H-3, a contract for deed with Harper Trust for the sale of 3 parcels of real property in Missoula County, Montana¹⁴. The property consists of 231 acres, of which 190 acres are irrigated. Jeffery

¹⁴The complete legal description of the real property is described in full at pages 1 through 4 of Ex. 1. The property consists of 3 parcels of real property located in portions of Sections 5 and 8, Township 13 North, Range 16 West, P.M.M., including a 30 foot wide private road and utility easement.

testified that uses the land for both pasture and hay. Jeffery testified that when he purchased the property it had been on the market for two and one-half years, and that most of the property lies on a flood plain. The purchase price of the property on Ex. H-3 is \$575,000, payable at an interest rate of 5.75% per annum with a \$50,000 down payment and annual payments until a balloon payment became due on February 15, 2006. Jeffery admitted that he testified at his 2004 examination that Wilson Scotch Mountain's real property purchased from Harper Trust has a value range of from \$400,000 to \$700,000, with the lower value based on a two-week sale.

Jeffery testified that he became the victim of identity theft when a bank employee stole his credit card information and ran up \$84,000 in charges on his credit card. He testified that he lost another \$240,000 when a contractor who owed him money filed for bankruptcy relief, and that these losses prompted him to file for bankruptcy relief.

Jeffery testified that he purchased an irrigation system from Ag Sales in October 2003, purchased a pivot in May of 2004, and that Ag Sales delayed making the pivot operational until the following August causing him to lose more than a full year's hay crop, 126 bales, at a dollar loss of between \$9,000 to \$10,000. Hepburn testified that Ex. A includes Ag Sales' invoices beginning 11-4-03 for Jeffery's purchase of pipe and supplies, with the May invoice showing a center pivot purchased for \$38,900 on 5/10/04. Hepburn testified that Ag Sales installed the pivot but was initially short-handed and hired additional crew, and that Ag Sales last provided supplies and materials to the pivot system in August of 2004, when the balance first became due under their sales agreement.

Shoni testified on cross examination by Nygren that no payment was made to Ag Sales on the pivot by Debtors. But Hepburn gave Jeffery credit for payments, and testified that Jeffery

paid Ag Sales a \$13,000 downpayment shown on the last page of Ex. A on the pivot, plus other payments reflected in the amounts of \$3,000.00, \$750.00, \$12,110.00 and \$3,500, leaving a balance due in the amount of \$28,164.60 as of 9/28/2004¹⁵. Hepburn admitted that when he sold the pivot system to Jeffery he intended that it remain part of the real property.

Under cross examination by Ag Sales' attorney Nygren, Jeffery testified that he had an account at Ag Sales and made prior purchases, and that he tried to obtain financing for the pivot system but the identity theft had affected his credit. Jeffery also had a cost sharing arrangement for the purchase of the pivot system, but he could not get payment from the other party, identified in the record only as "DNRC", before the pivot system was up and running. Hepburn testified that he is familiar with the DNRC contribution payment, but that the DNRC payment goes to the farmer and not to the seller.

Hepburn testified that Ag Sales prepared and filed a construction lien against Wilson Scotch Cap Angus Ranch's real property at Potomac for the center pivot, services and materials described on Ex. B as an irrigation system, dated November 2, 2004. Hepburn testified that the lien includes the pumps, controls, valves and pipe as part of the irrigation system. He testified that Ag Sales has the ability to disassemble and retrieve the pivot system it sold to Jeffery at a cost of \$3,250, calculated at \$2.15 per foot multiplied by 1,300 feet, and that removal would result in no permanent damage to Debtors' property except leaving a concrete pad which could accommodate another irrigation system. Hepburn testified that he could easily resell the used pivot, and that he has sold used pivots before for between \$18,000 to \$24,000.

¹⁵The September invoice entry on Ex. A is a finance charge of \$209 calculated at 12% per annum, which Hepburn testified is the sole finance charge and is the same for new and used systems.

Jeffery testified that he started “Wilson Trucking” in the fall of 2003, when he purchased 1 truck. The previous year, he testified, he had a \$14,000 hauling bill and he felt stupid paying for hauling when he could do it himself.

Ex. H-5 is “Jeffrey¹⁶” and Shoni’s 2003 state and federal tax returns. The paid preparer’s line at the end of Form 1040 shows that it was prepared for Jeffery and Shoni by e Accounting Solutions, Inc., of Missoula. Schedule C of Ex. H-5 shows Jeffery’s income and expenses for his business named “Wilson Trucking”, stating gross receipts and income of \$7,800, and expenses of \$31,587, resulting in a net loss in the sum of \$23,787. The repairs and maintenance expense listed for Wilson Trucking on Schedule C is \$8,076, and supplies are listed in the sum of \$4,746. Jeffery testified that he has owned only one flatbed trailer in his life, and that in 2003 he used his truck and trailer to hauled extra hay for one other person who earlier had hauled hay for him, but that it was too hard to keep a driver, who he paid by cash or check¹⁷ for each load. Jeffery testified that his accountant identified only as “Scott” determined that the trucks and income therefrom should be listed on Schedule C. He admitted that he signed his tax returns under penalty of perjury.

By 2004, Jeffery testified, he had cut back on his trucking business because of a drought which prevented him from earning income from trucking, and thereafter he used his truck and trailer exclusively for his ranch to haul his own hay and straw and to haul his own cattle to market. Jeffery decided to sell his semi truck and trailers because he had reduced his cattle herd

¹⁶The record does not show whether the correct spelling is “Jeffery” as on the petition or “Jeffrey” as on his tax returns. Ex. H-5.

¹⁷Jeffery testified that he used his farm account for his Wilson Trucking business.

by sales from 380 head to 70 or 80 head, and did not need to move as much hay for the smaller herd.

Ex. H-6 is Jeffery and Shoni's 2004 federal and state individual income tax returns. Schedule C shows a net loss for Wilson Trucking in the amount of \$22,544, from depreciation (\$8,224), repairs and maintenance (\$10,494) and supplies (\$3,826). Schedule F of Ex. H-6 shows a \$26,887 loss from Jeffrey's farming on sales of \$66,855 and other income. Form 4797 of Ex. H-6 shows a gain in the amount of \$3,387, which the continuation sheet shows is from the sale of a house, cattle, a semi truck, semi trailer, step deck trailer, and flatbed trailer. Jeffery testified that he sold his truck and trailer and considered the proceeds all to be ag income, all of which went to Valley Bank. But the depreciation schedule for Wilson Trucking, Schedule C, at Form 4562, in Ex. H-6, also lists depreciation from Wilson Trucking's semi truck, semi trailer, step deck trailer, and flatbed trailer in the total 2004 amount of \$8,224.

After Jeffery and Shoni filed their bankruptcy petition, in February 2006 Harper Trust was paid about \$18,000 by the Debtors, Shoni testified. Jeffery testified at a deposition held in May of 2006 that he had 29 bulls, 84 cows and 33 heifers. Jeffery testified that he sold 5 bulls since, leaving 24 bulls and that he has 44 calves, only a few of which he intends to cull for quality purposes.

Jeffery and Shoni's Third Amended Plan's attachments include a budget for operation for 2007 and typical, admitted as Ex. 1, showing total annual "crop income" of \$111,950 and off farm income of \$95,000. Jeffery testified that in 2005 he sold bulls at private treaty sales for an average price range of between \$2,500 to \$2,600 per bull, and that he has 64 head of cattle ready for sale this coming March. He testified that the carcass ratios for his Angus bulls are

exceptional and bring a premium price.

Although Jeffery had been selling bulls at private sales, at Korkow's suggestion about 7 or 8 weeks before the confirmation hearing Jeffery agreed to begin advertising production sales of bulls with another producer beginning in March of 2007 and again in the Fall, which Korkow believes will help the Debtors in projecting their income and expenses and result in better cash flow from production sales. Jeffery testified the production sale is set for March 24, 2007, at Great Falls.

Debtors' Third Amended Plan projects a sale price for bulls at \$2,000, which he testified is the national average sale price, but he testified that he expects that his bulls will sell for \$2,500 at an advertised production sale. Jeffery testified that he can produce Angus bulls in accordance with his production estimates, which he described as conservative. On cross examination Jeffery testified that he did not sell as many bulls at private sale as he had contemplated because he did not have enough time to conduct private sales, and he wanted to have enough bulls to sell at the production sale in March 2007 when he estimated he will have 22 two year old bulls and 44 yearling bulls, as well as female cows to sell at the production sale. He testified that he will have between 112 to 115 bulls for sale at the following Spring production sale. Shoni agreed that their herd will increase for a couple of years.

Korkow testified that the Debtors' cattle income has not changed, but that Debtors' off-farm income increased from \$85,000 to \$95,000 to conform with Debtors' actual performance. He specified that Debtors received tax refunds and revenues from puppy sales in their off-farm income, and further testified that Jeffery's workers' compensation increases by 5% in February 2007 to \$2,193 per month. Shoni confirmed Korkow's estimate of Debtors' off-farm income,

and testified on rebuttal that they can earn \$95,000 in income. She testified that Jeffery's off-farm income is about \$30,000 per year, and that her take home pay as a veterinarian and miscellaneous income is about \$65,000¹⁸.

Jeffery and Shoni's annual living expenses were set at \$25,000 in their Third Amended Plan, Ex. 1. Shoni testified that she prepares the Debtors' monthly operating reports, and that their projections are based on their historical expenses and tax returns, arrived at after discussing their expenses with Korkow. Korkow testified that the increase in expenses reflects additional child care expenses and a life insurance premium which is closer to their actual expenses. Shoni later testified that their child care expenses have recently been significantly reduced even though she is back to full time work. Their living expenses include no payment for housing or utilities, because those are included in the farm operating expenses in addition to heating fuel and expenses. Shoni testified that most of their personal utilities are paid by the farm.

Ex. 1 includes lists total farm operating expenses. Korkow testified that he determined Debtors' operating costs from their tax returns, operating reports and interviews. Operating expenses on Ex. 1 total \$144,200, of which Korkow testified that approximately \$30,000 is attributable to family living expenses paid for by Jeffery's ranch operations.

Other operating expenses include land rent in the amount of \$85,000, \$20,000 for feed supplements, \$2,500 for repairs, \$2,900 for veterinary care, \$2,500 for auto and advertising¹⁹, \$4,000 for utilities, \$3,500 for "other" and \$4,000 for supplies which Korkow explained were

¹⁸Shoni testified that her take home pay from her veterinary practice is \$56,000. The other \$9,000 is from miscellaneous income.

¹⁹Jeffery testified that his advertising cost works out to \$35 per bull for sale.

catch-all amounts including some artificial insemination, embryo transplant and barter. Shoni testified that her being a veterinarian keeps Jeffery's vet costs down. Korkow testified that the \$20,000 expense for feed is for supplements because Jeffery can grow his own hay, but that if his land produced no hay he would have to pay between \$50 to \$65 per ton for two tons per head of cattle.

Korkow testified that Jeffery's repair costs in 2005 totaled \$2,600, and his 2006 repair costs exceeded \$2,500 but he did not know by how much. Jeffery testified that his recent repair costs have been higher because he bought a used baler and put \$2,000 into it for repairs, but that he does not anticipate the need to purchase any other machinery and the condition of his equipment is good enough that Jeffery expects to pay no more than the projected \$2,500 for repairs. Jeffery and Shoni both testified that they can live and operate within their budget projections. Ex. 1 states Jeffery and Shoni's cash carryforward in the sum of \$52,150. Korkow testified that he could not verify the cash on hand because some cash receipts from some private bull sales had not been received yet.

Wilson Scotch Mountain's Second Amended Plan proposes payments in the amounts of \$55,055.75 on December 31, 2007; \$48,176.65 on December 31, 2008; and \$48,176.65 on December 31, 2009, all from annual lease income of \$64,000. It treats the Harper Trust's claim as secured by collateral valued at \$550,000.00²⁰, payable over a term of 30 years at seven percent (7%) interest per annum and annual payments in the amount of \$44,323.00, in addition to which

²⁰Based upon the stipulation that the value of the Debtor's real estate is \$600,000, the proposed treatment of the Harper Trust's claim may not satisfy the requirement of 11 U.S.C. § 1225(a)(5)(B)(ii), depending on the determination of the allowed amount of Harper Trust's claim.

in the first year the Harper Trust would be paid interest in the amount of \$6,329. Wilson Scotch Mountain's Plan provides for no distribution to unsecured claims, as the Debtor foresees all income will be needed for operating expenses.

Jeffery and Shoni's Third Amended Plan provides for payments in the amounts of \$50,693.68 on December 31, 2007, \$23,062.16 on December 31, 2008, and \$23,062.16 on December 31, 2009. Valley Bank's treatment in the Third Amended Plan includes payment on two secured claims secured by a mower²¹ (\$10,114.00) over 7 years at an interest rate of 8.25% and annual payments of \$1,959.00; and a claim secured by cattle²² (\$80,000) over 15 years at 8.25% and annual payments of \$9,490.00 with a 7 year balloon. Missoula FCU is treated as a secured creditor secured by collateral with a value of \$50,000 payable over 7 years at 8.5% and annual payments of \$9,768.00. The Stipulations between the Jeffrey and Shoni, Valley Bank and Missoula FCU, Docket Nos. 166, 167 and 168, which were approved by the Court and incorporated into any Chapter 12 Plan proposed by the Debtors, modified treatment of each of their claims.

Korkow's Expert Testimony.

J. T. Korkow of Powder River Ag Consulting, LLC, is an agricultural consultant who was employed by the Debtors in March of 2006 to consult on their reorganization and testify at confirmation. Korkow testified that he is experienced in and familiar with agricultural lending, and that the proposed 7% interest rate and 30 year repayment terms provided in Wilson Scotch

²¹Valley Bank of Arlee is secured by the mower. Docket No. 168.

²²Valley Bank of Hot Springs is secured by cattle and farm equipment by Stipulation, Docket No. 167.

Mountain's Second Amended Plan for the Harper Trust's secured claim are appropriate.

Korkow testified that Jeffery and Shoni's Third Amended Plan has room for Ag Sales' claim, although no payments to Ag Sales are currently disclosed. Korkow testified that Jeffery is improving his crop base and the pivot irrigation system is essential.

At present, Korkow testified, Jeffery and Shoni's non-farm income subsidizes their operating income. Korkow explained that Jeffery and Shoni's non-farm income will cover the Debtors' expenses until the March 2007 sales of 2-year old bulls. Under cross examination Korkow admitted that Jeffery and Shoni's bull operations will continue to lose money, but that he includes their off-farm income in his analysis. Korkow admitted that their farm expenses from Ex. 1 of \$144,200 exceed their typical crop income of \$111,950 resulting in a loss of \$32,250. But Korkow testified that the figures include the payment to Harper Trust, and that the farm expenses necessarily include some of Jeffery and Shoni's living expenses such as housing, heating fuel and insurance. Korkow testified that Debtors' off-farm income increased from \$85,000 to \$95,000 on Ex. 1, consisting of workers compensation payments and the bonus to Jeffery and Shoni's income as a veterinarian, which can cover the losses and plan payments, and also that Jeffery intends to increase the size of his herd in order to produce more revenue from bull sales.

Regarding Debtors' operating expenses, Korkow testified that, after reviewing Debtors' operating reports and interviews, in his opinion, Debtors' near future repair expenses will not exceed the projected \$2,500. He admitted that their prior years' repair expense exceeded \$2,500 but testified that Debtors' equipment is in good working order.

Korkow testified that in his expert opinion Debtors' Plans both are feasible, even with a

provision added for treatment of Ag Sales' claim and increased payments to Valley Bank and Missoula FCU, and cash flow when taking their farm and personal incomes together.

Wicks' Expert Testimony.

Jack Wicks is an experienced agricultural expert in Montana, former county extension agent and economist, real estate appraiser, and experienced in farm and ranch management who has testified in numerous Montana bankruptcy cases as an expert witness over several years. Wicks testified that he reviewed Debtors' Plans, and he prepared an analysis admitted as Ex. H-24²³. In preparation of Ex. H-24, Wicks testified that he relied on Jeffery's beginning cattle inventory of 84 cows from his May 2006 Rule 2004 examination.

Wicks made several assumptions in preparation of his analysis and testimony, including: 90% weaning rate for breeding cows and 2% death loss; retention of 2 herd bulls from 2006 yearling bulls, 12% cull rate of breeding females; sale of 75% of male calves as registered breeding bulls; 10 breeding bulls from each calf crop sold as 2 year olds (which Wicks testified has since changed); and 80% of female calves sold as replacement heifers or retained. Ex. H-24.

On cross examination Wicks testified that he has never been on the Wilson Scotch Mountain real property at Potomac, and that he does not know what type of producer Jeffery is. Wicks admitted that he would accept a higher weaning rate for Jeffery if he had a higher proven history, and that his numbers would change if Jeffery's actual calving rate was 95%. On the other hand, Wicks refused to concede during cross examination that his estimate of culled cows and heifers was incorrect, because he testified that the Debtors failed to take into account a 2%

²³ Ex. H-24 is dated 10/16/06, but at Ex. 3 refers to "2nd Amended Plan". It is unclear whether Wicks' analysis covered Jeffery and Shoni's Third Amended Plan.

death loss.

Wicks testified that the cattle prices currently are at the top of the market cycle, which typically reflects a 5 year upswing in prices followed by a 5 year decline. In 2007 and subsequent years Wicks predicts a decline in the number of bulls Jeffery will have available for sale, and predicts a drop in the price per pound Jeffery will realize for his male and female culls. Wicks agreed that the price for registered heifers is higher, but he testified that Jeffery's Plan does not show retention of an adequate number of heifers to maintain his herd, and that if Jeffery intends to increase his herd he will incur additional expenses for additional land.

On rebuttal Jeffery and Korkow both disagreed with several of Wicks' assumptions and conclusions. Jeffery testified that he does not intend to keep his herd the same number, and claimed that he can double his production without having to lease additional land by fertilizing, which he has not been doing to date. Jeffery asserted that his practice of embryo transfer produces better quality beef, reduces his culling rate²⁴ and enables him to grow his herd. Jeffery testified that his cull rate for the current year 2006²⁵ was 3% compared with Wicks' assumed 12%, and that his calving rate is in the high-90 percent range compared with Wicks' assumption of 90%. Korkow testified that the Debtors' educational background in animal science and production experience are above average, and therefore the local averages upon which Wicks' relied for his assumptions do not apply to these Debtors.

On cross examination Wicks testified that he has developed Chapter 12 Plans, and that

²⁴Jeffery claimed his bulls last longer, that he has 6 head over 8 years old and that most of his bulls last until age 12 or 13.

²⁵Jeffery testified that the previous year he culled heavier to get rid of bad blood.

they are generally “extremely tight if they work at all”. On Ex. 2 of Ex. H-4 Wicks estimates Debtors’ combined 2006 total farm income in the amount of \$68,897.50 compared with \$111,950 on Debtors’ Ex. 1; and \$63,230 in 2007 compared with \$111,950 on Ex. 1.

Ex. 3 to Ex. H-24 is Wicks’ projected cash flow of the Debtors’ combined operations, and it shows a loss in cash carryover in the amount of \$29,902 after 2007, with increasing losses in each succeeding year²⁶. Wicks testified that the Debtors underestimate their repairs and machinery replacement expense, and that the \$2,500 which Debtors budgeted for repair expense is “very little”. Wicks added a \$15,000 annual expense for machinery replacement beginning in 2007, based upon 10%, and he added a yearly \$4,240 expense for freight and trucking because he testified that sellers of bulls at private treaty sales must deliver bulls. Ex. 3 to Ex. H-24. On cross examination Wicks acknowledged that \$100,000 would be sufficient to replace Jeffery’s machinery, although Wicks did not agree with the net cash projections on Ex. 1²⁷ after five years.

Walker’s Expert Testimony.

Shirlee Walker is a certified public accountant (“CPA”) and fraud examiner with 25 years experience in cash flow analysis, and has a MBA in tax. Walker testified that she performed a cash flow analysis of the Debtors’ Plans.

Ex. H-26 is Walker’s summary of the Debtors’ monthly operating reports for the period from January through August of 2006, but not including September, including Jeffrey and Shoni’s incomes, personal expenses and farm activity. The last page of Ex. H-26 compares 8

²⁶Ex. 3 to Ex. H-24 projects negative cash carryovers after plan payments in 2008 in the amount of \$35,855, \$41,509 in 2009, and \$42,064 in 2010. Wicks’ projections include \$0 payments to Ag Sales each year.

²⁷Ex. 1 shows net cash after 2011 in the amount of \$101,648.

months of Debtors' actual income and expenses which Walker testified she compiled from the monthly operating reports and income and expenses from Debtors' Plan, Ex. 1. The expense line of the last page of Ex. H-26 includes an entry of \$8,954.69 under the column "Seman [sic] cost" with no corresponding expense in the Plans. On cross examination Deschenes asked Walker about the February farm expense on Ex. H-26, 1C, at the bottom of the page showing a \$8,464.69 charge under the column marked "Seman cost" on the bottom line marked "Seaan ? Pre-pay". Deschenes asked Walker whether that entry would not be a semen expense if it was part of an \$18,000 payment to the Harper Trust, and Walker agreed but repeated that the entry is under the "Seman cost" column. On rebuttal Shoni testified that the \$8,469.69 charge from the February 2006 operating report was a payment to insured title, and represents a semi-annual payment to Harper Trust of the \$18,000 paid.

Ex H-9 is Jeffery and Shoni's February operating report, and it shows on the sixth page under "Farm Expenses" a payment to Insured title dated 2-2 in the amount of \$8,464.69. Shoni testified that the memo for that \$8,464.69 line entry is supposed to read "semi annual payment" to Harper Trust. She admitted, however, that the memo is hard to read and the Court agrees²⁸. Walker's interpretation of the memo for the \$8,464.69 line entry on Ex. H-9 as "Seaan ? Pre-pay" on Ex. H-26, 1C, is reasonable, as is her alternate reading the entry as "Seman cost". The illegibility of that line entry is not Walker's fault and the error does not in the least undermine her credibility or the weight afforded to her testimony.

Walker testified that even without the mislabeled seman expense the Debtors' expenses

²⁸The "l" at the end of "annual" is cut off on the copy of Ex. H-9, sixth page, for the \$8,464.69 line entry memo which was submitted to the Court. In addition the "i" at the end of "semi" is not dotted and the last letter looks as much like a capital "N" as an "i".

still far exceed their income. The 8-month repair expense of \$4,536.58 on the last page of Ex. H-26 exceeds the Plan's budget of \$2,500. The 8-month feed expense of \$21,358.74 exceeds the Plan's budgeted \$20,000. The 8-month legal, accounting and other expense is stated as \$5,275, which Walker testified she took from 2006, compared with the Plans' projection of \$1,000, which Walker agreed would require less in plan payments. Total farm expenses on the last page of Ex. H-26 are \$93,549.51 for the 8-month period, which Walker testified does not include loan payments. Personal expenses for the 8-month period on Ex. H-26, 1B, include \$2,473.03 in child care, which Walker testified she obtained from the operating reports.

Walker testified that Debtors' farm expenses are much higher in the months of January, February and March, while their personal incomes are more consistent, with the exception of a January income for Jeffery in the amount of \$7,089.49, which is a workers' compensation payment. Ex. H-26, 1A. Walker concluded from Ex. H-26 that the Debtors lack adequate income and cash on hand to pay their expenses incurred from January through March of 2007. On cross examination Walker explained that Debtors' personal income averages about \$7,500 per month while their expenses average \$12,000 per month and their expenses do not decline to \$4,500 per month until near the end of the year.

Wilson also prepared Ex. H-27, which compares the cash flow under Debtors' revised Plans in 2007 with their cash flow if the interest rates on the secured claims are set at the prime rate, prime plus 1, prime plus 2, and prime plus 3. Ex. H-27, 2A, states Debtors' non-ag income of \$86,510 instead of \$95,000 from Ex. 1. Walker testified the \$86,510 in non-ag receipts is derived from Shoni's \$4,700 monthly income multiplied by 12 and added Jeffery's disability income of \$30,074 from their operating reports. When asked about the \$9,500 reduction in non-

ag income on Ex. H-27, 2A, Walker testified that the miscellaneous income such as tax refunds might not be realized in a given year, for example if a tax liability occurs instead of a refund.

Walker revised the farm disbursements before payments from \$144,200 to \$175,550 on Ex. H-27, 2A. She testified that the increase is based on Debtors' actual 2006 expenses, although on cross examination Walker agreed that the Debtors' projections of farm expenses "roughly" corresponded with their projections. Ex. H-27, 2A, includes an entry for income to Wilson Scotch Mountain in the sum of \$64,000 under each column. Walker testified that \$64,000 entry was rent paid by Jeffery and Shoni to Jeffery's wholly owned entity Wilson Scotch Mountain to be used to pay Harper Trust. Walker subtracted that \$64,000 from Debtors' projected \$144,200 in projected farm expense and divided the remaining \$80,200 by 12 for an average projected farm expense in the sum of \$6,683.33, which she testified was about \$5,000 less than their average actual farm expenses from their operating reports.

The result on Ex. H-27, 2A, is that at the prime rate the Harper Trust payment increases from \$44,323 to \$50,012 and net cash goes from the combined Plans' positive \$39,250 to a \$7,068 loss. Ex. H-27, 2A, shows that an interest rate of prime plus 1 more than doubles the 2007 loss to \$14,616, and further increases in the interest rate increase the losses. Walker testified that any payment to Ag Sales would simple increase the magnitude of the losses. On rebuttal Korkow testified that Walker's testimony did not change his opinion that Debtors' Plans are feasible, because their non-farm income is high enough to subsidize Jeffery's ag operations.

Walker also prepared and testified regarding Ex. H-23, an analysis of Jeffery and Shoni's 2004 income tax returns, Ex. H-6. Walker included Jeffery's livestock sales and grain sales from Ex. H-6 in his 2004 ag income at a total of \$97,348 on Ex. H-23. Proceeds from the sale of

Jeffery's trucking assets totaling \$27,459 were included in Jeffery and Shoni's non-ag income which totaled \$140,288. Walker concluded on Ex. H023 that Jeffery and Shoni's ag income was 40.97% of their total 2004 income, while their non-ag income totaled \$140,288 or 59.05%.

Deschenes cross examined Walker on the tax treatment of Jeffery's trucking assets sold. Walker testified that she assumed the proceeds from the sale of Wilson Trucking assets were not farm-related because trucking expenses and depreciation were listed on Schedule C, and that if the trucking assets were used on Jeffery's farm then his 2004 tax return, Ex. H-6, is incorrect.

After Jeffery testified that he used his truck and trailers solely to haul his own hay and cattle in 2004 before selling them, Walker was recalled and testified regarding proper tax accounting of business income on Schedule C versus profit or loss from farming on Schedule F. Walker testified that under the tax code expenses generally are reported in the same business as income is earned²⁹, and that it is not proper to report depreciation for a vehicle used in agriculture on Schedule C. Walker testified that the depreciation schedule for Wilson Trucking on Ex. H-6, Schedule C, Form 4562, lists depreciation for Wilson Trucking's semi truck, semi trailer, step deck trailer, and the flatbed trailer which Jeffery argued he used exclusively on his farm. Under cross examination, Walker testified that the depreciation for the flatbed trailer is in two places on Ex. H-6, Schedule C and Schedule F. Walker was asked whether the flatbed trailer on Form 4562– Schedule C is the same flatbed trailer listed on the depreciation schedule for Schedule F, and she responded by noting that both were acquired 5/15/02. Similarly, the acquisition dates for the semi truck, semi trailer and step deck trailer on Form 4797 of Ex. H-26 correspond with the

²⁹The "matching principle".

acquisition dates on Form 4562³⁰.

Walker testified that depreciation for vehicles on Form 4562 were charged to Schedule C, although she later admitted that the flatbed trailer was used exclusively on Jeffery's farm. In the event vehicles are used both in the business and farm, Walker testified, then income, depreciation and expenses would properly be allocated between the two businesses. Based upon that testimony, which the Court finds credible and entitled to conclusive weight, the Court accepts and adopts Walker's findings on Ex. H-23 that the proceeds from the sale of trucking assets in 2004 are non-ag income for purposes of determining Jeffery and Shoni's eligibility as family farmers, except for the \$6,821 in proceeds from the sale of the flatbed trailer, \$13,412 gross sales price for the semi truck and \$4,723 for the semi trailer. The Court finds those proceeds, totaling \$24,956, are ag proceeds because Walker testified that they should be allocated between the business and farm according to their use³¹, and because Walker conceded Jeffery's uncontroverted testimony that the flatbed trailer was used exclusively on the farm. Since Jeffery testified that he used the semi truck and semi trailer exclusively to haul his own hay and cattle in 2004, those proceeds must also be allocated to ag income based on Walker's testimony, while the proceeds from the remaining step deck trailer in the amount of \$2,503 remain non-ag income.

³⁰The acquisition dates for the semi truck on both forms is 9/7/2000, the semi trailer was acquired 9/7/2000, and the step deck trailer 4/1/2001. Ex. H-26, Forms 4797 (continuation sheet) and 4562.

³¹Walker's testimony regarding allocation overcomes the negative implication from Jeffery and Shoni's inclusion of depreciation for Jeffery's trucking assets on their Schedule C depreciation schedule for Wilson Trucking business expenses. While that treatment may run afoul of the tax code, and suggest that amended returns may be in order, in light of Walker's admission regarding allocation according to use the Court does not deem the errors on their tax returns sufficient to deny them eligibility for Chapter 12 relief under § 101(18) when the question is so close.

Applying those adjustments to Ex. H-23, the Court finds that the ag income must be increased by trucking asset proceeds in the amount of \$6,821 (flatbed trailer), \$13,421 (semi truck) and \$4,723 (semi trailer) to a total of \$122,304, or 51.47% of the total 2004 income of \$237,636; and the non-ag income is reduced to \$115,332 or 48.53%.

DISCUSSION

I. Contentions of the Parties.

The Harper Trust objects to confirmation of the Debtors' Chapter 12 Plans because they do not provide interest to its claim based upon the prime rate plus a risk factor, and because the Plans are visionary and not feasible for several reasons, including late amendments. Further, Harper Trust argues that Jeffrey and Shoni are not eligible for Chapter 12 relief because only 40.97% of their income was from agricultural sources rather than the more than 50% required to qualify as a family farmer under 11 U.S.C. § 101(18), according to Shirlee Walker's analysis of their 2004 tax return, Ex. H-23. Harper Trust contends that Jeffery's capital gain from the sale of Wilson Trucking assets, his worker's compensation income and Shoni's income from sale of property make them ineligible under § 101(18) under the "mechanical" or tax return test, and that Debtors should be prohibited from impeaching their tax return under an "economic reality" test, even though Harper Trust contends they do not pass that test either.

On the issue of feasibility the Harper Trust argues that Debtors have always lost money on their agricultural operations and continue to "lose" \$32,250 throughout the term of their proposed Plan. Harper Trust cites its experts Wicks' and Walker's testimony criticizing the number of Debtors' animals to be sold, their insufficient budgeting for operating expenses and equipment repairs, inability to pay accruing interest. Harper Trust argues that Debtors' expert

Korkow is a “hired gun” who will testify to “just about anything in support of the preordained conclusion that the Plans are feasible” and is of suspect credibility, and that even Korkow admitted that the Plans are “tight”. Harper Trust objects to granting Debtors leave to further amend because of delay and seeks dismissal.

At the confirmation hearing Ag Sales’ attorney Nygren stated that Ag Sales withdrew its claim above \$550,000, and prefers removal of the pivot system for resale³². Ag Sales filed a brief arguing that its claim is secured by a construction lien on the center pivot and other materials installed upon the Wilson Scotch Mountain land. Ag Sales objects to confirmation because Debtors’ Plans pay Ag Sales nothing, and Ag Sales contends that it is secured by the value of the center pivot which is a real estate improvement that can be removed without harm to the real estate, not personal property or a fixture, and to the extent the irrigation system is severable Ag Sales has priority over the Harper Trust. Therefore, Ag Sales argues, its secured claim must be provided for in the Debtors’ Plan or it must be allowed to remove the irrigation system.

Debtors contend that their Plan is feasible and that Harper Trust’s experts committed errors even while utilizing Korkow’s projected expense figures for the Debtors which exceed their actual expenses. Debtors argue that Walker made errors including overstating semen expense and failing to include Shoni’s miscellaneous income, and that Wicks erred in adding expenses for machinery replacement and repairs not in Debtors’ projections. Debtors attack Wicks’ assumptions regarding death loss of calves and cull rate, which are not in line with Debtor’s actual production and projections that their cattle herd will increase as a result of the

³²This request for removal of the irrigation system is not before the Court in a procedurally proper manner for such relief to be even considered at the present time.

Debtors' combined experience, education and expertise. Debtors admit that all Chapter 12 Plans are tight, but contend that their additional income ensures the Plans' feasibility.

Debtors argue that Korkow was the sole witness regarding interest rate and term, and that therefore the 7% rate and 30 year term, which he testified are appropriate for treatment of the Harper Trust's claim, are undisputed. With respect to eligibility, Debtors argue that the truck and trailer sold in 2004 by Jeffery were used in 2004 exclusively on his own farm, and his 2004 tax returns and undisputed testimony show no income from his trucking business in 2004. Finally, Debtors argue that only the capital gain from the sale of the truck, not the gross sales price, can be considered in determining gross income, and that Debtors' agricultural income exceeds their nonagricultural income regardless of whether the capital gain is counted is considered "ag or non-ag". Debtors argue that Jeffery's testimony regarding the truck and trailer is not disputed by any evidence before the Court, and that the definition of gross farm income is not determined by what is stated on Schedule C of his tax return. Debtors request the Court declare their Plan feasible and that they are eligible for Chapter 12 relief.

The Chapter 12 Trustee advised the Court at the confirmation hearing that in his opinion the Debtors' bull raising operation is a viable operation, that the Debtors are working hard, and that they have a good chance of success.

II. Confirmation – § 1225(a)

A. Cramdown Interest Rate – § 1225(a)(5)(B)(ii).

Harper Trust objects to confirmation based upon § 1225(a)(5), which requires that:

(5) with respect to each allowed secured claim provided for by the plan –

(A) the holder of such claim has accepted the plan;

(B)(i) the plan provides that the holder of such claim retain the lien securing such claim; and

(ii) 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; or

(C) the debtor surrenders the property securing such claim to such holder[.]

Subsections (A) and (C) do not apply in the instant case because neither Harper Trust nor Ag Sales have accepted Debtors' Plans, and Debtors' Plans do not surrender any property which secures their claims. Korkow admitted in his testimony that Debtors' Plan(s) will have to be amended to provide for Ag Sales' secured claim³³. Wilson Scotch Mountain's Plan provides that Harper Trust retains its lien, and thus the only subsection of § 1225(a)(5) at issue is § 1225(a)(5)(B)(ii).

A leading commentator notes that the present value requirement of § 1225(a)(5)(B)(ii) is identical to the present value requirements of § 1129(a)(9), § 1129(b)(2)(A)(i)(II) and 1325(a)(5)(B)(ii), and therefore case law interpreting those provisions is equally applicable to determining present value under § 1225(a)(5)(B)(ii). 8 COLLIER ON BANKRUPTCY, ¶ 1225.03[4][c] (15th ed. 2005); *see also In re Hungerford*, 19 Mont. B.R. 103, 113-14 (Bankr. D. Mont. 2001) (cases construing cramdown statutes under Chapters 11 and 12 provide valuable interpretation of Chapter 13).

In Chapter 12 cases this Court has long employed a "market approach" to determine the

³³From Korkow's testimony and the stipulation reached between the parties valuing Debtors' ranch property at the sum of \$600,000, the Court infers that Debtors have withdrawn their motion for valuation of Ag Sales security (Docket No. 148), which seeks to value the same real property at \$550,000. Alternatively, given that \$600,000 valuation Debtors' motion to value Ag Sales security at \$550,000 is moot.

cramdown interest rate using a formula, starting with a base rate (either the prime rate or the rate on treasury obligation) and adding a “risk factor” based on the risk of default and the nature of the security. See *In re Fowler*, 903 F.2d 694, 697-98 (9th Cir. 1990); *In re Schaak*, 17 Mont. B.R. 349, 355-57 (Bankr. D. Mont. 1999); *In re Janssen Charolais Ranch, Inc.*, 73 B.R. 125, 127-28 (Bankr. D. Mont. 1987); *Hungerford*, 19 Mont. B.R. at 112-13 (quoting *Janssen Charolais Ranch*). The Ninth Circuit in *Fowler* approved this Court’s use of the formula approach in a Chapter 12 case, but remanded the case for findings regarding the risk of default and nature of the security when it was unable to determine the basis for the bankruptcy court’s 0.75 % risk factor or the district court’s slightly higher factor. *Fowler*, 903 F.2d at 698-99.

The United States Supreme Court in a Chapter 13 case, *Till v. SCS Credit Corp.*, 541 U.S. 465, 478-80, 124 S.Ct. 1951, 1961, 158 L.Ed.2d 787 (2004) (plurality opinion), adopted the formula approach over other approaches to establish a cramdown rate. Together with *Till* and the Ninth Circuit precedent in *Fowler*, this Court considers its longstanding formula approach still good law.

Case law exists interpreting *Till*’s footnote 14 observation that a market of lenders advertises financing for Chapter 11 debtors in possession, so it is not necessary to apply the formula approach from *Till* in a Chapter 11 context. *In re American Homepatient, Inc.*, 420 F.3d 559, 567 (6th Cir. 2005) (affirming cramdown interest rate determined under coerced loan theory); *Till*, 541 U.S. at 476 n.14. That reasoning and case law, however, do not apply in the instant Chapter 12 case to depart from the formula approach. No willing market of cramdown lenders is shown to exist by the evidence in the instant Chapter 12 case equivalent to that described in *Till*’s footnote 14 for Chapter 11 cases. Harper Trust is not shown by the evidence

to be a commercial or agricultural lender.

In the instant case, Case No. 06-60369-12, Debtors' proposed cramdown interest rate provided for the Harper Trust's secured claim in Wilson Scotch Mountain's Second Amended Plan is 7%, a full 1.25% below the prime rate, rather than prime plus an appropriate risk factor. Korkow testified that the 7% interest rate is appropriate, but it appears rather that, as in *Janssen Charolais Ranch*, he merely pulled the 7% interest rate out of a hat. *Janssen*, 73 B.R. at 128. Korkow offered no testimony regarding the nature of the security as required by the Ninth Circuit in *Fowler*, and he admitted that the Debtors' Plans are "tight" which was in line with Wicks' opinion and indicates that a risk of default must be factored into the cramdown rate. In light of the longstanding formula approach in effect in this Court for Chapter 12 cases, Korkow's unsupported "expert" opinion that a below-prime cramdown rate is appropriate makes no sense, and rather than satisfy the Debtors' burden under § 1225(a)(5)(B)(ii) it simply undermines Korkow's overall credibility and is unworthy of any probative weight.³⁴ The proposed 30 year term for Harper Trust is likewise unsupported by credible evidence, especially considering that the original term of the contract for deed was just over 2 years with a balloon payment.

Risk is heightened to an extent based on the unpredictable nature of the agricultural economy. *Fowler*, 903 F.2d at 697, citing *United States v. Doud*, 869 F.2d 1144, 1145 (8th Cir. 1989). *Fowler* further requires consideration of risk of default and the nature of the security. COLLIER adds that the risk adjustment depends also on the duration of the payment stream and should be high enough to compensate creditor for risk, but not so high as to doom the plan. 8

³⁴If Korkow was willing to extend financing to the Debtors at 7% over 30 years to pay off Harper Trust's claim his testimony might be worthy of weight, but then we would not be contemplating cramdown.

COLLIER ON BANKRUPTCY, ¶ 1225.03[4][c] (discussing *Till*, 541 U.S. at 480). COLLIER also discusses cases discussing a range of risk factors at ¶ 1225.03[4][c] n.28, and states that although the parties can present evidence of risk factors at a hearing, the evidentiary burden is placed on the creditor to substantiate any risk adjustment over a moderate level. COLLIER, ¶ 1225.03[4][c]; *Till*, 541 U.S. at 484-85. At the confirmation hearing neither Harper Trust nor Ag Sales offered any evidence regarding risk factors, and thus failed their evidentiary burden under *Till*.

The Court concludes that Debtors' Plans failed to satisfy the requirements of § 1225(a)(5)(B)(ii) for an appropriate cramdown rate for the Harper Trust's secured claim under the formula approach, and failed to satisfy the same requirement for Ag Sales' claim which Debtors now concede must be provided for in their Plan. Harper Trust's objection to confirmation based on § 1225(a)(5)(B)(ii) is sustained.

B. Feasibility – § 1225(a)(6)

Harper Trust objects to confirmation on the grounds the Debtors' Plans are not feasible because they underestimate their expenses and operate at a loss. Debtors respond that Harper Trust's experts made errors in their analyses and that their Plans are feasible. Because of the determination above regarding cramdown rates, the issue of feasibility is in a sense moot because the present Plans before the Court cannot be confirmed. Wilson Scotch Mountain's Second Amended Plan's treatment of Harper Trust's secured claim at a cramdown rate of 7% and a term of 30 years fails to satisfy § 1225(a)(5)(B)(ii) and Debtors admit they must pay Ag Sales something on its secured claim. Furthermore, Jeffery and Shoni's Third Amended Plan's treatment of Valley Bank and Missoula FCU are not in accordance with their stipulations with those creditors filed on November 9, 2006 (Docket Nos. 166, 167 & 168), and those stipulations

increasing claims, interest rates and/or payments must be incorporated into a further amended plan not yet filed.

The feasibility requirement is set forth at 11 U.S.C. § 1225(a)(6), which requires for confirmation that “(6) the debtor will be able to make all payments under the plan and to comply with the plan.” Debtors have the burden of proving that their Plans have a reasonable chance of success. *Schaak*, 17 Mont. B.R. at 357, citing *In re Martin*, 66 B.R. 921, 926 (Bankr. D. Mont. 1986). This Court observed in *Schaak*:

While economic certainty is not a necessary element of feasibility, courts cannot confirm plans that are purely “visionary,” *Pizza of Hawaii, Inc. v. Shakey’s, Inc. (Matter of Pizza of Hawaii, Inc.)*, 761 F.2d 1374, 1382 (9th Cir. 1985). This Court fashioned the test for feasibility under Chapter 12 on a prior occasion as thus:

[T]he benefit of the doubt in Chapter 12 cases will be given to farmers, if it appears that a reasonable chance of meeting their payments as projected under a plan [sic].

In re Rugg, 8 Mont. B.R. 457 (Bankr. D. Mont. 1990) (quoting *In re Hansen*, 77 B.R. 722 (Bankr. N.D. 1987).

Korkow admitted that Debtors’ Plans and budget are “tight”, but Wicks’ expert opinion is that all Chapter 12 plans are tight. The necessity of increasing the interest rate provided for the Harper Trust’s claim from 7% to over the prime rate of 8.25%³⁵ necessarily makes the prospect for feasibility of any further amended plans even tighter. The Court set forth above the conflicting expert testimony regarding Wicks’ assumptions of Jeffery’s cull rate, death rate and production, and budget, Walker’s and Korkow’s analyses, and Debtors’ rebuttal. On the other hand the Court finds considerable persuasive evidence that Jeffery and Shoni are highly educated and experienced at animal science, they earn income on and off the farm, and Jeffery in particular

³⁵A simple Google search reveals that the prime rate is unchanged from 8.25%.

is expert at breeding and raising breeding Angus bulls and cattle, using cutting edge technology, during a period when the cattle prices are at the top of a market cycle. The Court notes the Chapter 12 Trustee voiced support for Debtors' Chapter 12 Plans and advised the Court that they are cooperating, working hard and have a good chance of success. In this Court's view Debtors are entitled to the benefit of the doubt and a last chance.

At present the Court concludes that Debtors have not satisfied their burden of proving that their Plans have a reasonable chance of success under § 1225(a)(6), but only because the issue is premature. The Court deems it an appropriate exercise of its discretion to grant the Debtors a final opportunity to amend their Plans, and a hearing to propose an appropriate cramdown rate to Harper Trust and provide for Ag Sales' claim.

C. Family Farmer – 11 U.S.C. § 101(18).

Harper Trust seeks dismissal because it contends Jeffery and Shoni do not meet the definition of "family farmer" under § 101(18). "Only a family farmer³⁶ with regular annual income may be a debtor under chapter 12" 11 U.S.C. § 109(f). "[F]amily farmer" is defined at 11 U.S.C. § 101(18), which requires in pertinent part that Debtors "receive from such farming operation more than 50 percent of such individual's or such individual and spouse's gross income for the taxable year preceding the taxable year in which the case concerning such individual's or such individual and spouse was filed". The 50% gross income requirement in § 101(18) was added to restrict Chapter 12's use as a tax shelter. *In re Pratt*, 78 B.R. 277, 278 (Bankr. D. Mont. 1987) (quoting legislative history of P.L. 99-554 (H.R. 5316)). The taxable year preceding 2005 when Jeffery and Shoni filed their petition in Case No. 05-65161 is 2004,

³⁶BAPCPA added the phrase "or family fisherman" to § 109(f)

which is the applicable period for determining eligibility under § 101(18). Their 2004 tax returns were admitted as Ex. H-6.

This Court has long applied the IRS Code definition of gross income and careful review of a debtor's tax and financial records as a "mechanical", "easily applicable" test for determining eligibility as a family farmer. *Pratt*, 78 B.R. at 278-280, quoting *Matter of Wagner*, 808 F.2d 542, 544-49 (7th Cir. 1986). Shirlee Walker provided expert testimony and prepared Ex. H-23 showing Jeffery and Shoni's ag and non-ag income for 2004. Walker concluded based on the matching principle that Jeffery's trucking assets sold in 2004 constituted non-ag income because the depreciation of those assets was included on his 2004 return on the depreciation schedule for Schedule C, Form 4562. Her conclusion shown on Ex. H-23 is that Jeffery and Shoni's ag income was 40.97% of their gross income.

However, based on Jeffery's testimony that he used his semi truck and trailer to haul only his own hay, straw and cattle in 2004, and used his flatbed trailer exclusively on his farm, and Walker's testimony that income should be allocated if used both in the business and farm, the Court recalculated and moved the proceeds for the sale of the semi truck, semi trailer and flatbed trailer from the non-ag column to the ag column on Ex. H-23 bringing the ag income to a total of \$122,304, or 51.47% of the total 2004 income of \$237,636, and the non-ag income to \$115,332 or 48.53%.

Income from the sale of farm machinery has long been considered as derived from a farming operation. *In re Martin*, 78 B.R. 593, 596 (Bankr. D. Mont. 1987), quoting *Matter of Armstrong*, 812 F.2d 1024, 1026-27 (7th Cir. 1987); *see also* 2 COLLIER ON BANKRUPTCY, ¶ 101.18[6] & n.27 (2005) . This Court in *Martin* also held that share cropping and custom

cutting³⁷ are typical farming activities because they were essential to the success of the debtors' whole farming operation. In the instant case Jeffery's uncontroverted testimony is that he used his trucking assets exclusively on his farm in 2004, during a time of drought, to haul his own straw, hay and cattle. This Court deems these activities just as essential to the success of Jeffery's cattle operation as the share cropping and custom cutting in *Martin*.

The Court acknowledges Walker's testimony that Debtors' tax returns were prepared incorrectly because of the inclusion of depreciation of the trucking assets on Schedule C of their 2004 tax return, Ex. H-6. However, the Court notes that the Schedule C for Wilson Trucking lists no income for 2004, which corroborates Jeffery's testimony that he used the assets only for his farming operation. Moreover, while the depreciation for the trucking assets is found on the depreciation schedule for Wilson Trucking Schedule C, Form 4562 on Ex. H-6, the same trucking assets are listed on the depreciation schedule for Schedule F, Form 4797 including the continuation sheet. Walker testified that the trucking assets were depreciated on both Schedule C and Schedule F.

While that treatment may run afoul of the tax code, and suggest that amended returns may be in order, in light of Walker's admission regarding an allocation according to use, the Court does not deem the errors on their tax returns sufficient to deny them eligibility for Chapter 12 relief under § 101(18) when the question is so close. The fact is Jeffery used the trucking assets solely on his farm in 2004, so their proceeds should properly be allocated to his farming operation that year according to Harper Trust's expert Walker.

In sum, Debtors received from their farming operation 51.47% of their gross income in

³⁷The custom cutting holding was in dicta. *Martin*, 78 B.R. at 597.

the year 2004, and therefore are family farmer as defined at § 101(18) and eligible for Chapter 12 relief under § 109(f).

CONCLUSIONS OF LAW

1. This Court has jurisdiction of this Chapter 12 bankruptcy under 28 U.S.C. § 1334(a).
2. This is a core proceeding involving claims and confirmation of a plan under 28 U.S.C. § 157(b)(2)(B) and (b)(2)(L).
3. Debtors failed their burden of proof under 11 U.S.C. § 1225(a)(5)(B)(ii) to establish an appropriate cramdown interest rate for the Harper Trust's secured claim in accordance with the Court's long-standing formula approach.
4. Debtors did not satisfy their burden of proof under 11 U.S.C. § 1225(a)(6) to show their Plans are feasible.
5. Debtors received more than 50% of their gross income in the year 2004 from their farming operation, and therefore are family farmers as defined at § 101(18) and eligible for Chapter 12 relief under § 109(f).

IT IS ORDERED a separate Order will be entered in conformity with the above sustaining Harper Trust's objection to confirmation based on 11 U.S.C. § 1225(a)(5)(B)(ii) and denying confirmation of Wilson Scotch Mountain's Second Amended Chapter 12 Plan and Jeffery and Shoni's Third Amended Chapter 12 Plan, both dated October 11, 2006; Debtors will be granted a period of twenty (20) days to file a further amended Chapter 12 Plan or Plans satisfying all requirements for confirmation under § 1225(a); and that the final hearing on confirmation in these jointly administered Chapter 12 cases will be scheduled to be held at Missoula on Friday, March 30, 2007, at 9:00 o'clock a.m.

IT IS FURTHER ORDERED a separate Order will be entered denying Debtors' motion for valuation of Ag Sales' security, filed October 19, 2006 (Docket No. 148) without prejudice and with leave to refile.

BY THE COURT

A handwritten signature in cursive script that reads "Ralph B. Kirscher". The signature is written in black ink and is positioned above a horizontal line.

HON. RALPH B. KIRSCHER
U.S. Bankruptcy Judge
United States Bankruptcy Court
District of Montana