

**UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF NORTH CAROLINA
DURHAM DIVISION**

In re)	
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Stanley B. Hughes,)	Case No. 06-80219
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Debtor.)	
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ORDER DENYING CONFIRMATION OF CHAPTER 12 PLAN

This matter came before the court on August 24, 2006, for a hearing on the confirmation of the Debtor's proposed Chapter 12 plan. Appearing before the court was James P. Green, Jr. attorney for the Debtor, John W. Stone, attorney for the Farm Service Agency, United States Department of Agriculture, and Richard M. Hutson, II, Chapter 13 Trustee. For the reasons that follow, the court has concluded that confirmation of the Debtor's plan should be denied.

BACKGROUND

The Debtor filed his petition for relief under Chapter 12 of the Bankruptcy Code on February 27, 2006. The Debtor has been farming since 1975 and currently operates a small farm in Orange County, North Carolina, on which he grows various types of produce, including greens, sweet potatoes, and tobacco. The Debtor co-owns 52 acres of real property (the "Real Property") with eight siblings or their heirs with a total value of \$223,000.00, and he farms approximately 15 acres of that land. The Debtor also leases approximately 250 acres, of which approximately 60 acres is farmland.

In 1979, 1980, and 1981, the Debtor obtained loans from the Farm Service Agency ("FSA") evidenced by four promissory notes with a face amount totaling \$274,570.00 (the "FSA Loans"). As collateral for the FSA Loans, FSA obtained a security interest in the Debtor's farm

machines and equipment, as well as the Real Property.

The Debtor has never been current in his payments on the FSA Loans. The Debtor has not voluntarily made a payment on these loans since approximately 1997, though some payments have been made through FSA's right to offset benefits due the Debtor through various government programs such as the Tobacco Transition Payment Program and the Wheat and Feed Grain Program. In addition, the farm machinery and equipment were liquidated prior to the Chapter 12 filing. All of the loans have now fully matured with an unpaid principal balance owed of \$208,692.44, along with unpaid interest as of the Petition Date in the amount of \$551,147.22 for a total of \$759,839.66, as reflected in FSA's proof of claim filed March 16, 2006.

Prior to the bankruptcy filing, FSA had initiated a foreclosure proceeding in which the Property was sold on January 27, 2006 to the highest bidder and subsequently, a total of four upset bids were placed. On February 27, 2006, when the last upset bid period was set to expire, the Debtor filed this Chapter 12 proceeding. Richard M. Hutson, II is the duly appointed and acting Trustee (the "Trustee").

The Debtor's financial situation is bleak. In addition to the one-eighth interest in Real Property, the Debtor listed only \$7,550.00 in personal property. Even more sobering, however, is the enormous amount of debt that the Debtor has incurred. In addition to the claim filed by FSA in the total amount of \$759,839.66, the Debtor indicates in his Plan that Carolina Farm Credit holds a secured claim in the amount of \$6,154.58, Yeargin Farm Supply holds a secured claim in the amount of \$2,857.34, and Byrd Tractor holds a secured claim in the amount of \$1,414.33. The Orange County Tax Office filed a claim in the amount of \$3,075.99, of which

\$2,954.58 is secured debt, \$67.41 is priority debt, and \$54.00 is unsecured debt. Eastern Carolina Organics filed an informal proof of claim in the amount of \$46,111.40.

The Debtor has incurred significant federal tax liabilities. As of the Petition Date, the Debtor had not filed his tax returns for the years 2003, 2004, and 2005. On April 21, 2006, the Internal Revenue Service (the "IRS") filed a proof of claim listing secured debt in the amount of \$26,533.91, priority debt in the amount of \$101,562.25, and general unsecured debt in the amount of \$198,427.62. A portion of the IRS's claim was estimated since the Debtor had not filed tax returns for three years.

Subsequent to the Petition Date, the Debtor filed his past due returns. His tax returns for the year 2003 reflect that he had gross income from the operation of his farm in the amount of \$93,871.00 and expenses in the amount of \$88,163.00, leaving net farm profit of \$5,708.00. His tax returns for the year 2004 reflect that he had gross income from the operation of his farm in the amount of \$80,651.00 and expenses in the amount of \$75,283.00, leaving net farm profit of \$5,368.00. His tax returns for the year 2005 reflect that he had gross income from the operation of his farm in the amount of \$50,161.00 and expenses in the amount of \$46,740.00, leaving net farm profit of \$3,421.00. On August 15, 2006, the IRS filed an amended claim listing secured debt in the amount of \$22,415.91, priority debt in the amount of \$90,054.64, and general unsecured debt in the amount of \$70,331.46.

The Debtor has filed a Chapter 12 Plan dated July 19, 2006 (the "Plan") under which he proposes to retain the Real Property and fund a five-year plan with income from the operation of the farm. In the Plan, the Debtor indicates that his projected gross farm income will be \$166,500.00 and farm operating expenses will be \$87,375.00. The Plan projects annual living

expenses of \$30,900.00, leaving net farm profit of \$51,966.70 available to fund the Plan. The Debtor's Plan treats FSA's claim as secured in the amount of \$233,000.00 to be paid over a term of 13 years at an interest rate of 9.0%, for an annual installment of \$30,467.52. In addition, the Debtor proposes to pay \$7,991.70 a year to FSA on its \$526,839.66 unsecured claim, \$780.00 a year to the Trustee as adequate protection, and the secured claims of Carolina Farm Credit, Byrd Tractor, Yeargin Farm Supply, the IRS and the Orange County Tax Office in full with interest at 8% over the life of the Plan. The Plan indicates that the IRS has priority and unsecured claims in amounts yet to be determined which shall be paid under the Plan. Thus, without including any payments on the IRS's priority and unsecured claims, the Debtor has obligations under the Plan of approximately \$48,000.00 per year.

FSA, the Trustee, the IRS, and Carolina Farm Credit have all filed objections to the Plan. Both the Trustee and FSA contend the Plan is not feasible, and that it fails to demonstrate that the Debtor's projections are realistic. At the hearing on this matter, all parties present agreed that the issue before the court is one of feasibility.

ANALYSIS

One of the requirements for confirmation of a Chapter 12 plan is that the debtor must "be able to make all payments under the plan and to comply with the plan" 11 U.S.C. § 1225(a)(6). This is commonly referred to as the feasibility test. To find that a plan is feasible, the court must be persuaded that "it is *probable*, not merely possible or hopeful, that the Debtors can actually pay the restructured debt and perform all obligations of the plan." In re Rape, 104 B.R. 741, 749 (W.D.N.C. 1989). See also In re Tate, 217 B.R. 518, 520 (Bankr. E.D. Tex. 1997) (holding that optimism and confidence in the debtor's ability are admirable but without facts to

support optimistic projections, confirmation must be denied); In re Honeyman, 201 B.R. 533, 537 (Bankr. D.N.D.1996) (holding that cash flow projections must be “based upon realistic and objective facts (as opposed to visionary or overly optimistic projections”). While the debtor bears the ultimate burden of proof as to the feasibility of the plan, the court should give the Chapter 12 debtor the benefit of the doubt regarding the issue of feasibility when the debtor’s plan projections use reasonable data in light of the current economic climate. In re Rape, 104 B.R. at 748. The court must also consider the farms’s earning power, capital structure, managerial efficiency, past performance, and whether the same management will continue to operate the farm. Id. at 749; see also In re Torelli, 338 B.R. 390, 397 (Bankr. E.D. Ark. 2006) (“[T]he court should analyze the debtor’s projected income and expenses in relation to actual past performance.”).

In this case, the Plan is premised upon projections for farm income and profit that far exceed the Debtor’s past performance. The highest amount of gross income that the Debtor’s farm has ever generated was \$93,871.00, in 2003. Last year the income was \$50,161.00, yet the Debtor’s Plan projects that the farm’s income in 2006 will be \$166,500.00. In support of this projected income figure, the Debtor testified that in the past year he has become certified to grow organic products and that, as a result, he expects his income to increase due to the higher price of organic produce. Also, the Debtor has joined an organic farming cooperative, which has enhanced his ability to sell his produce in larger markets. The Debtor testified that in the first six months of 2006, he had income of approximately \$52,000.00. This income includes revenue generated from the sale of organic sweet potatoes grown in 2005 and from his spring planting of greens. While the Debtor has demonstrated that the income generated from his farming

operations in 2006 will exceed that of 2005, he has not established that the increase will be over three times that which was generated in 2005.

Of more concern to the court, however, is the fact that the projected expense to income ratio in the Plan is far lower than that which the Debtor has ever been able to achieve in the past. The Debtor's average expense to income ratio for the past five years has been 90.2%, and his lowest expense to income ratio was 74.86%, which was in 2002. The Plan is premised upon an expense to income ratio of 50.1%. The Debtor testified that according to his statement of income and expenses for the first six months of 2006, he had expenses of slightly more than 61.5% of income, or \$32,000.00, leaving approximately \$19,900.00 in profit. The Debtor testified that he calculated his farm expenses using figures from North Carolina State University regarding production as well as his own receipts. The Debtor then testified that he actually only had about \$2,000.00 of the \$19,900.00 in profit, as the rest of his farm income had been used for both farm and living expenses. Thus, the actual condition of the Debtor's finances does not match that which is reflected on paper.

While the Plan is premised upon an expense to income ratio of 50.1%, the Debtor has provided insufficient evidence that he will actually be able to achieve such a result in practice. The Debtor presented evidence that, during the past five years, his average profit has been \$4,026.00 per year. The Debtor's Plan projects that the Debtor will have \$87,117.00 in profit in 2006. The projected expenses as set forth in the Plan are incomplete and unrealistic based upon the Debtor's past performance. The Plan budget includes no amount for rent, small tools, real estate taxes, or insurance. The Debtor has had expenses in all of these categories in past years. The budget includes no amount for the payment of ongoing federal tax obligations. In addition,

the Debtor budgeted \$7,000.00 for fuel costs while such costs have averaged \$11,141.00 over the past three years. The Debtor budgeted \$5,000.00 for utilities while his three year average is \$5,859.00. Given the current economic climate of rising fuel and energy costs, these projections are low. Lastly, even the Debtor's projected Plan obligations are low inasmuch as they do not include any amounts to be paid on the IRS's priority and unsecured claims. Payment of the IRS's \$90,054.64 priority claim will add over \$18,000.00 per year to the Debtor's Plan obligations.

In sum, the court cannot conclude that it is probable that the Debtor will be able to perform his obligations under the Plan. Based upon the foregoing, the Court finds that the Debtor's proposed Chapter 12 plan does not satisfy the requirements of 11 U.S.C. § 1225(a)(6); therefore, confirmation of the Plan is denied.

Stanley B. Hughes

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All parties of record in the case shall be served a copy of the Order Denying Confirmation of Chapter 12 Plan