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An Agricultural Law Research Article

Bankruptcy Reform and Family Farmers: Correcting the Disposable Income Problem

by

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September 2006

Originally published in the Texas Tech Law Review
38 TEX. TECH. L. REV. 309 (2006)

A National AgLaw Center Research Publication

BANKRUPTCY REFORM AND FAMILY FARMERS: CORRECTING THE DISPOSABLE INCOME PROBLEM

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I. Introduction

When Congress signed the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 into law on April 20, 2005,[1] it marked the conclusion of years of contentious debate.[2] Much of the new law is directed toward consumer bankruptcy reform, and Congress debated the most controversial aspects of it at length, while the media reported it widely in the news.[3] Buried within this massive law,[4] however, are important changes that will significantly benefit family farmers who seek relief under Chapter 12 of the Bankruptcy Code.[5] The new law eliminates the temporary authorization for Chapter 12, making it a permanent part of the

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1. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (to be codified in scattered sections of 11 U.S.C.) [hereinafter 2005 Bankruptcy Act].

2. *See, e.g.*, *Bankruptcy Amendments Passed: Bankruptcy Will Be a More Hostile Place for Consumer Debtors*, 15 No. 10 CONSUMER BANKR. NEWS 1 (2005) ("After more than eight years of trying, Congress has gotten a bankruptcy reform bill to the desk of a President eager to receive it."); Stephen Labaton, *House Passes Bankruptcy Bill; Overhaul Now Awaits President's Signature*, N.Y. TIMES, Apr. 15, 2005, at C5. Steve Pfister, National Retail Federation's senior vice president for government relations stated that "[i]t feels like we've been waiting as long to pass bankruptcy reform as Washington spent trying to get baseball back in town." *Id*.

3. Labaton, *supra* note 2, at C5

> The legislation had been opposed by many bankruptcy law professors and judges who testified in recent months that it was unnecessary and would create more problems than it would solve. They said that it would impose new obstacles on many middle-income families seeking desperately needed protection from creditors, and that it would take far longer for those families to start over after suffering serious illnesses, unemployment and other calamities."

Id.

4. H.R. REP. NO. 109-31, pt. 1 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88. The official version of the bill is 512 pages in length. *See id*.

5. 2005 Bankruptcy Act, §§ 1001-1007, 119 Stat. 23. Congress included these "farmer friendly" provisions in the overall bankruptcy reform bill in order to obtain farm state votes, and proponents of reform prevented their separate passage. 148 CONG. REC. H6849 (daily ed. Oct. 1, 2002) ("For 5 years now, family farmers have been held hostage by the contentious debate surrounding the larger bankruptcy issue."); *see also* Susan A. Schneider, *Congress Extends Chapter 12 Bankruptcy*, AGRIC. L. UPDATE, Aug. 2002, at 1 (reporting debate on and extension of Chapter 12).

Bankruptcy Code.[6] Amendments expand Chapter 12 eligibility by broadening four different criteria.[7] Congress eliminated the priority formerly given to certain capital gains taxes.[8] The new law also prohibits the "retroactive assessment of disposable income."[9]

This Article focuses on the last amendment—the assessment of disposable income.[10] It is an amendment that has not been widely reported, nor does it appear to have been the subject of significant congressional debate.[11] It is set forth in one very short section of the bill,[12] but it reverses over a decade of misinterpretation of the plain language of the original Chapter 12 disposable income requirement.[13] It is a significant change that promises to enhance the likelihood of successful family farm reorganizations throughout the country.[14]

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6. § 1001, 119 Stat. at 185-86. When Congress first enacted Chapter 12 in 1986, it was a temporary provision of the Bankruptcy Code. Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, § 255, 100 Stat. 3088, 3105-13 (codified at 11 U.S.C. §§ 1201-1231). It had a sunset provision that provided for repeal on October 1, 1993. § 302(f), 100 Stat. at 3124. Congress renewed it numerous times, each time as a temporary extension. *See* Susan A. Schneider, *History of Chapter 12 Bankruptcy: On Again, Off Again*, AGRIC. L. UPDATE, Aug. 2002, at 1-2. Renewals, however, sometimes came months after Chapter 12 had sunset, creating frustrating gaps in its availability. *Id*.

7. §§ 1002, 1004-05, 1007, 119 Stat. at 186-87. First, the statutory maximum for debts is increased from $1,500,000 to $3,237,000. § 1004, 119 Stat. at 186. This maximum amount will now increase with the Consumer Price Index. *See* § 1002, 119 Stat. at 186. Second, the requirement that at least eighty percent of debt come from farming is amended, allowing farmers to be eligible if just fifty percent of their debt arises out of the farming operation. § 1004, 119 Stat. at 186. Third, the income requirement that provided that fifty percent of income from the preceding taxable year must come from farming is expanded to allow for a consideration of either the taxable year preceding the bankruptcy "or [] each of the [second] and [third] taxable years preceding" the bankruptcy. § 1005, 119 Stat. at 186-87. Fourth, eligibility is extended to "family fisherman," although they will be subject to the pre-reform income and debt standards, such as $1,500,000 maximum debts and eighty percent debt from farming. § 1007, 119 Stat. at 187-88. The maximum aggregate debt ceiling will be indexed. § 1202, 119 Stat. at 193. These changes took effect 180 days from the date of enactment. § 1501, 119 Stat. at 216.

8. § 1003, 119 Stat. at 186. Under the new law, claims owed to any government unit as a result of the disposition of a farm asset may no longer be afforded § 507 priority. *Id*. Provided that the debtor receives a discharge, these claims can be treated as unsecured debt. *Id*.; *see* Neil E. Harl et al., *Major Developments in Chapter 12 Bankruptcy*, 16 AGRIC. L. DIG. 57 (2005). This provision took effect on the date of the enactment but will not apply with respect to cases commenced before that date. § 1003(c), 119 Stat. at 186.

9. § 1006, 119 Stat. at 187.

10. *Id*.

11. *See* discussion *infra* Part VI.

12. § 1006, 119 Stat. at 187.

13. *See* Susan A. Schneider, *Recent Developments in Agricultural Bankruptcy: Judicial Conflict and Legislative Indifference*, 25 U. MEM. L. REV. 1233, 1249-63 (1995) (challenging the prevailing judicial interpretation of the disposable income requirement in Chapter 12).

14. *See* discussion *infra* Part VII.

This Article first presents the statutory framework and history of the original disposable income requirement contained in both Chapter 12 and Chapter 13.[15] It then explains how the courts misinterpreted this requirement in two key respects: first, in requiring a review of all actual income and expenses at the discharge hearing of the Chapter 12 debtor; second, in computing disposable income to include key farm assets necessary for the continuation of the farming operation.[16] These harsh interpretations placed significant and sometimes insurmountable burdens on family farm reorganization.[17] In this context, this Article presents the importance of the new provisions contained in the 2005 Bankruptcy Act.[18] This Article introduces these provisions and explains how they correct the disposable income problem in Chapter 12 and how they enhance the likelihood of a successful restructuring.[19]

II. Disposable Income Requirement Prior to 2005 Bankruptcy Act

Congress designed Chapter 12 to provide a quick and predictable process for reorganizing the debt obligations of family farmers.[20] In this regard, Congress chose not to model it after Chapter 11 reorganization, but instead used Chapter 13 as its model.[21] Although Chapter 12 provides several additional reorganization powers to the family farm debtor,[22] the overall structure and content of most of the specific Chapter 12 provisions are identical to those contained in Chapter 13.[23]

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15. *See* discussion *infra* Parts II-III.
16. *See* discussion *infra* Part IV.A-B.
17. *See* discussion *infra* Part V.
18. *See* discussion *infra* Part VI.
19. *See* discussion *infra* Part II.
20. H.R. REP. NO. 99-958, at 48 (1986) (Conf. Rep.), *reprinted in* 1986 U.S.C.C.A.N. 5246, 5249 (noting that most family farmers have too much debt to be eligible for Chapter 13 and that Chapter 11 is often too complicated, expensive, and unworkable).
21. 132 CONG. REC. H8986-02 (daily ed. Oct. 2, 1986), *available at* 1986 WL 788079 (stating that the new Chapter 12 "is closely modeled after existing Chapter 13").
22. *Id*. *Compare* 11 U.S.C. § 1222(b)(2) (2000) (allowing the modification of all secured claims), *with* 11 U.S.C. § 1322(b)(2) (2000) (allowing the modification of secured claims, except for claims secured only by real estate that is the debtor's primary residence), *and* 11 U.S.C. § 1222(b)(9) (2000) (allowing for the payment of secured claims beyond the plan term, where no such allowance is made under Chapter 13).
23. RANDY ROGERS & LAWRENCE P. KING, THE COLLIER FARM BANKRUPTCY GUIDE 4-6 (1999) (observing that authority for interpreting Chapter 12 provisions can be found in the judicial interpretation of identical Chapter 13 provisions).

Congress based its decision to use Chapter 13 as its model on the realization that the basic framework for Chapter 11 reorganization did not provide a viable alternative for family farm debtors.[24] Aside from the complexity of the process under Chapter 11, creditors have numerous tools with which to block a debtor's plan from being confirmed.[25] For example, Chapter 11 confirmation requirements provide that either the creditors must vote to approve the debtor's plan, or the plan must comply with the "absolute priority rule" in § 1129(b).[26] The absolute priority rule prevents debtors from retaining an ownership interest in their property over the objection of unsecured creditors unless the debtors will pay the unsecured creditors in full.[27] Thus, in almost all cases, creditors can block the confirmation of a plan that allows the debtor to keep the farm unless the farmer is able to pay unsecured creditors one hundred percent of their claim.[28]

In contrast, under Chapter 12 and Chapter 13, creditors can object to confirmation of a debtor's plan, but they cannot vote down the debtor's plan.[29] Creditors base approval on adherence to specific standards set forth in the Code, and creditors do not impose the absolute priority rule.[30] In Chapter 12, § 1225 lists specific plan confirmation requirements and provides that the court "shall confirm" the debtor's plan if these requirements are met.[31] Congress establishes different requirements for secured[32] and unsecured claims.[33] Congress also replaced the absolute priority rule for unsecured claims with the disposable income requirement.[34]

The disposable income requirement appears as one of two independent protections afforded to unsecured claimholders.[35] The

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24. H.R. REP. NO. 99-958, at 48 (referring to Chapter 11 as "needlessly complicated, unduly-time consuming, inordinately expensive and, in too many cases, unworkable").

25. 11 U.S.C. § 1129.

26. *Id*. § 1129(b).

27. *Id*. § 1129.

28. *See id*. § 1129(a)(8), (b). In Chapter 11, either the creditors must vote to approve the debtor's plan pursuant to § 1129(a)(8), or the plan must comply with the absolute priority rule in § 1129(b), which prevents debtors from retaining an interest in their property over the objection of unsecured creditors unless the debtor pays them in full. *Id*. § 1129. In *Norwest Bank Worthington v. Ahlers*, the Supreme Court reversed the Eighth Circuit decision that found an exception to the absolute priority rule for farmers. Norwest Bank Worthington v. Ahlers (*In re* Ahlers), 485 U.S. 197, 203 (1988).

29. *See id*. §§ 1225, 1325.

30. *See id*. §§ 1225, 1325.

31. *Id*. §§ 1225, 1325.

32. *Id*. § 1225(a)(5).

33. *Id*. § 1225(a)(4), (b).

34. ROGERS & KING, *supra* note 23, at 3-71 (noting that Chapter 12 eliminates the absolute priority rule in favor of the disposable income rule).

35. 11 U.S.C. §§ 1225(b), 1325. Unsecured claims are also protected by the

relevant portion of § 1225, in effect prior to the 2005 bankruptcy law amendments, provides as follows:

> (b)(1) If the trustee or the holder of an allowed unsecured claim objects to the confirmation of the plan, then the court may not approve the plan unless, as of the effective date of the plan—
>
> (A) the value of the property to be distributed under the plan on account of such claim is not less than the amount of such claim; or
>
> (B) the plan provides that all of the debtor's projected disposable income to be received in the three-year period, or such longer period as the court may approve under section 1222(c), beginning on the date that the first payment is due under the plan will be applied to make payments under the plan.[36]

Similarly, Chapter 13 confirmation requirements are found in § 1325.[37] Clearly, the Chapter 12 disposable income requirement was based on that found in Chapter 13—the language is identical but for the reference to the possibility that a Chapter 12 plan may be for longer than three years.[38]

In either Chapter 12 or Chapter 13, it is unlikely that a debtor will be able to meet the first alternative presented in the disposable income requirement (i.e., to provide the unsecured claimholder with value that is "not less than the amount" of the claim).[39] Most debtors are not financially able to pay one hundred percent of their unsecured debt, even if they were to pay over an extended period of time.[40] Therefore, in almost all cases, when a trustee or unsecured

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liquidation test. *Id* §§ 1225(a)(4), 1325. An unsecured claimholder can be either an unsecured creditor or a secured creditor whose security is of less value than the amount of the debt owed to that creditor. *Id*. § 506.

36. *Id*. § 1225(b)(1).

37. *Id*. § 1325.

38. *Id*. § 1325(b)(1). Section 1325(b)(1) provided as follows:

> If the trustee or the holder of an allowed unsecured claim objects to the confirmation of the plan, then the court may not approve the plan unless, as of the effective date of the plan—(A) the value of the property to be distributed under the plan on account of such claim is not less than the amount of such claim; or (B) the plan provides that all of the debtor's projected disposable income to be received in the three-year period beginning on the date that the first payment is due under the plan will be applied to make payments under the plan.

Id.

39. 11 U.S.C. § 1225(b)(1)(A); *see* H.R. REP. NO. 99-958, at 50 (1986) (Conf. Rep.) *reprinted in* 1986 U.S.C.C.A.N. 5246, 5251.

40. 11 U.S.C. §§ 1222(b)(2), 1322(b)(1). If a plan proposed to pay an objecting creditor one hundred percent of their unsecured claim, it would also have to pay one hundred percent of all other unsecured claims in order to avoid discriminating among like creditors. *Id.*

claimholder objects, the debtor's plan must include a provision that commits all "projected disposable income" over the term of the plan to unsecured claims.[41]

Chapter 12 provides that:

> "[D]isposable income" means income which is received by the debtor and which is not reasonably necessary to be expended—
>
> (A) for the maintenance or support of the debtor or a dependent of the debtor; or
>
> (B) for the payment of expenditures necessary for the continuation, preservation, and operation of the debtor's business.[42]

This definition again mirrors the Chapter 13 definition that was in place at that time.[43]

As protection against inaccurate assessments of projected disposable income at confirmation, Chapter 12 includes a provision that allows "the debtor, the trustee, or the holder of an allowed unsecured claim" to request modification of the terms of the plan to increase or reduce plan payments, extend or reduce the time for such payments, or alter the distribution to a creditor to take account of any payment made other than under the plan.[44]

The disposable income requirement raises a number of significant questions for interpretation.[45] The most obvious questions involve the definition of disposable income, including what expenses are "reasonably necessary" and what "expenditures [are] necessary for the continuation, preservation, and operation of the debtor's business."[46]

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41. *Id*.
42. *Id*. § 1225(b)(2).
43. *Id*. § 1325(b)(2). Section 1325(b)(2) provided as follows:

> "[D]isposable income" means income which is received by the debtor and which is not reasonably necessary to be expended—(A) for the maintenance or support of the debtor or a dependent of the debtor, and (B) if the debtor is engaged in business, for the payment of expenditures necessary for the continuation, preservation, and operation of such business.

11 U.S.C. § 1325(b)(2) (1994). In 1996, Congress amended this Chapter 13 definition of disposable income to allow charitable contributions not to exceed fifteen percent of the debtor's gross income to be included in the maintenance and support calculations. Religious Liberty and Charitable Donation Protection Act of 1998, Pub. L. No. 105-183, § 4, 112 Stat. 517, 518 (1998) (codified at 11 U.S.C. § 1325(b) (2000)). This change was never incorporated in the Chapter 12 definition of disposable income, so it is uncertain how charitable contributions should be addressed.

44. 11 U.S.C. § 1229(a) (2000).
45. *See* discussion *infra* notes 48-50.
46. *See* discussion *infra* Part V.

But, a more fundamental and surprising question must first be addressed—a question that has produced a sharp split in authority.[47] While two circuit courts interpreted the disposable income issue in Chapter 13 to be one that is resolved at confirmation based on projections presented to the court and debated by interested parties,[48] another circuit court held that under Chapter 12 the parties can litigate the issue of disposable income again at the discharge hearing.[49] According to that court, the debtor must defend the payment of all actual disposable income over the term of the plan in order to receive a discharge, even if the debtor has paid all amounts projected for disposable income at confirmation and provided for in the confirmed plan.[50] These radically different interpretations of identical language are troubling and set the stage for further congressional action.

III. The Legislative History of the Disposable Income Requirement

The disposable income requirement can best be understood by reference to the history of its initial adoption within Chapter 13. Congress added the requirement to Chapter 13 by the Bankruptcy Amendments and Federal Judgeship Act of 1984.[51] The history underlying this amendment, both legislative and judicial, is instructive.

Although consumer bankruptcy reorganization provisions have existed in bankruptcy law since the 1930s, they were burdensome and not widely used until the adoption of the new Bankruptcy Code in 1978.[52] Most consumers in need of bankruptcy relief opted for a straight discharge of their debts.[53] The 1978 Code included a more flexible Chapter 13 that Congress specifically designed to encourage debtors to reorganize their obligations, as opposed to seeking immediate liquidation and discharge under Chapter 7.[54]

The protection provided to unsecured claimholders under the Chapter 13 provisions of the 1978 Code was the "best

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47. *See* discussion *infra* notes 48-50.

48. *See infra* Part IV.A. (discussing *In re* Anderson, 21 F.3d 355 (9th Cir. 1994) and *In re* Killough, 900 F.2d 61 (5th Cir. 1990)).

49. *See infra* Part IV.B. (discussing Rowley v. Yarnall, 22 F.3d 190 (8th Cir. 1994)).

50. *See infra* Part IV.B. (discussing *Rowley*, 22 F.3d 190).

51. Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 317, 98 Stat. 333.

52. *See Personal Bankruptcy: Oversight Hearings Before the Subcomm. on Monopolies and Commercial Law of the H. Comm. on the Judiciary*, 97th Cong. 6 (1981) (statement of Chairman Rodino) [hereinafter *Personal Bankruptcy Hearings*].

53. *Id*.

54. *Id.; see also* Paul M. Black & Michael J. Herbert, *Bankcard's Revenge: A Critique of the 1984 Consumer Credit Amendments to the Bankruptcy Code*, 19 U. RICH. L. REV. 845, 861 (1985).

interests of creditors test."[55] This was a liquidation value test that required the debtor to pay unsecured creditors as much as they would have received had the debtor filed Chapter 7 bankruptcy instead.[56] Thus, unsecured claimholders were guaranteed to receive as much as they would have received in a liquidation.[57]

Because this was the only statutory confirmation requirement that expressly applied to unsecured claims, some courts ruled that meeting this requirement was all that a debtor's plan needed to provide with respect to these claims.[58] Courts also ruled that a "zero-payment" or "nominal-payment" Chapter 13 plan that provided little or nothing above liquidation value to unsecured creditors was permissible.[59]

Other courts, responding to objections from unsecured creditors, imposed an additional test on Chapter 13 debtors that was loosely based on the "good faith" requirement contained within Chapter 13 confirmation standards.[60] These courts were concerned that debtors who could afford to pay their unsecured creditors more than liquidation value should be forced to do so.[61] Moreover, because Chapter 13 afforded debtors a broader discharge than that available under Chapter 7, courts were

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55. *See* Hardy v. Cinco Fed. Credit Union (*In re* Hardy), 755 F.2d 75,76 (6th Cir. 1985).

56. 11 U.S.C. § 1325(a)(4) (2000). This required the debtor's plan to provide that the value, as of the effective date of the plan, of property to be distributed under the plan on account of each allowed unsecured claim is not less than the amount that would be paid on such claim if the estate of the debtor was liquidated under Chapter 7 of this title on such date.

Id.

57. *Id*.

58. H.R. REP. NO. 95-595, at 123-24 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6084-85 ("The bill requires only that creditors receive under the plan more than they would if the debtor went into straight bankruptcy.").

59. *See, e.g.*, *In re* Cloutier, 3 B.R. 584, 586 (Bankr. D. Colo. 1980) (confirming a Chapter 13 plan that provided no payments to unsecured creditors and rejecting argument that the plan violated the good-faith requirement); *see also* Joseph P. Corish & Michael J. Herbert, *The Debtor's Dilemma: Disposable Income as the Cost of Chapter 13 Discharge in Consumer Bankruptcy*, 47 LA. L. REV. 47, 49 (1986) (stating that some courts allowed zero payment plans and citing 5 COLLIER ON BANKRUPTCY ¶ 1325.04[2] (L. King 15th ed. rev. 1986)).

60. This requirement provides that the plan must have been "proposed in good faith and not by any means forbidden by law." *In re* Hobday, 4 B.R. 417, 421 (Bankr. N.D. Ohio 1980) (describing Chapter 13 as "devised principally as a vehicle for the repayment of unsecured debts" and rejecting confirmation of a zero-payment plan as a per se violation of good faith); *see, e.g.*, Tenney v. Terry (*In re* Terry), 630 F.2d 634, 635-36 (8th Cir. 1980) (reversing an order of confirmation of a zero-payment plan and stating that a Chapter 13 plan that proposes to pay nothing to unsecured creditors cannot be found to be in good faith); *see also* 11 U.S.C. § 1325(a)(3); Black & Hebert, *supra* note 54, at 863-64 (discussing cases that found zero-payment plans to violate good faith and citing 5 COLLIER ON BANKRUPTCY ¶ 1325.01[2][C] (L. King 15th ed. 1984)).

61. *In re Hobday*, 4 B.R. at 420*; see In re Terry*, 630 F.2d at 635-36.

concerned that they should impose additional requirements on the debtor.[62] Some courts interpreted good faith to require that the debtor pay as much to unsecured claimholders as was reasonably possible.

Arguably, this interpretation of good faith was inconsistent with congressional intent, and it clearly was not in keeping with traditional notions of good faith.[63] Even though Congress had good intentions, it had the practical effect of judicially imposing a financial requirement on debtors that was not found in the statutory language.[64] Moreover, as different courts imposed different standards in defining good faith with respect to the payment of unsecured debts, there was a considerable amount of confusion as to what Congress required under Chapter 13.[65]

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62. *Compare* 11 U.S.C. § 727 (listing the exceptions to Chapter 7 discharge), *with* 11 U.S.C. § 1328 (providing a much reduced listing of exceptions to Chapter 13 discharge). As one scholar explained the "super discharge" afforded to Chapter 13 debtors,

> "[s]ection 727 provides for a discharge of all debts unless the debtor acts in a fraudulent manner or in a manner specified by Section 523. Debts excepted from discharge under Section 523 include: taxes; debts incurred through obtaining money through false pretenses, fraud, embezzlement and larceny; alimony and child support; and debts incurred by willful and malicious injury of another person. The more lenient Section 1328 allows for a discharge of all debts except any amount owed for alimony and child support."

Richard S. Bell, *The Effect of the Disposable Income Test of Section 1325(b)(1)(B) upon the Good Faith Inquiry of Section 1325(a)(3)*, 5 BANKR. DEV. J. 267, 272-73 (1987). As Bell notes, the good-faith requirement has been used to limit discharge in Chapter 13 cases where the debtors "'motivations and intentions hardly comport with the true spirit and purpose of Chapter 13.'" *Id*. at 273 (quoting *In re* Chase, 43 B.R. 739, 743 (Bankr. D. Md. 1984)).

63. *See Personal Bankruptcy Hearings*, *supra* note 52, at 32-34 (statement of Professor Vern Countryman, Harvard Law School, Vice Chairman, National Bankruptcy Conference) (describing the "traditional construction" of the good-faith test as "requiring only that the plan be consistent with the spirit and general purposes of Chapter 13 and not as a basis for determining the quantum of payments or dividends to creditors"); *see* Black & Hebert, *supra* note 54, at 864 (observing that such an interpretation conveniently ignored Congress's refusal to enact an express best efforts standard); *see also* Corish & Herbert, *supra* note 59, at 50 & n.18 (describing the approach of these bankruptcy courts to the good-faith standard as "ingenious, if perhaps dubious" and noting that "[m]ost of the better reasoned cases held that this requirement was limited to an investigation of the fairness of the plan creation process rather than a measure of the plan payments").

64. *See* Black & Herbert, *supra* note 54, at 864 (characterizing this broad reading of good faith as "clearly incorrect from a historical standpoint," and arguing that it "ignored Congress'[s] refusal to enact an express best efforts standard").

65. *See* Bell, *supra* note 62, at 268 (addressing the "substantial payment" test used by the courts to determine whether the good-faith test had been met and observing that "[o]bviously the term 'substantial' had many different interpretations among the courts"). For example, after rejecting zero-payment plans in *In re Terry*, two years later, without overruling *Terry*, the Eighth Circuit held that "good faith does not impose a rigid and unyielding requirement of substantial payment to unsecured creditors. A per se minimum payment requirement to unsecured creditors as an element of good faith would infringe on the desired flexibility of Chapter 13 and is

Two years after Congress enacted the 1978 Code, Congress began a series of oversight hearings on the operation of the new Chapter 13.[66] Changes had already been proposed in Congress and as the chairman of the subcommittee noted at the onset, the subcommittee was "particularly interested in examining some confusion that has apparently arisen among the courts concerning the proper standard of confirmation to be applied to such plans."[67]

The first witness before the committee was Vern Countryman, Professor of Law, Harvard Law School, and Vice Chairman of the National Bankruptcy Conference.[68] Professor Countryman defended many of the central features of Chapter 13 but offered several amendments to address the concerns of creditors and the inconsistent use of the good-faith standard.[69]

Professor Countryman proposed that Congress amend § 1325 to incorporate a new requirement that would address the concerns of those courts that were imposing their own "best efforts" test but that would provide certainty and consistency to confirmation standards.[70] This new requirement would rely on the debtor's income and expense projections.[71]

Based on these projections, courts could evaluate what income was likely to be available during the plan term and confirm a plan that was fair to unsecured creditors.[72] Professor Countryman's proposed amendment provided as follows:

> [T]he court may not confirm a plan over a timely objection by the holder of an allowed unsecured claim, unless the payments to be made under the plan total at least (1) an amount equal to 100 percent of allowed claims; or (2) the debtor's total projected

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unwarranted." United States v. Estus (*In re* Estus), 695 F.2d 311, 316 (8th Cir. 1982).

66. The hearings were held before the Subcommittee on Monopolies and Commercial Law of the House Committee on the Judiciary on October 22, 1981; March 23, 1982; March 25, 1982; April 28, 1982; May 20, 1982; and June 16, 1982. *See Personal Bankruptcy Hearings*, *supra* note 52.

67. *Id.* at 1.

68. Professor Countryman, recognized as one of the most influential progressive bankruptcy scholars, was a determined advocate of consumer protections in bankruptcy. David A. Skeel, Jr., *Vern Countryman and the Path of Progressive (and Populist) Bankruptcy Scholarship*, 113 HARV. L. REV. 1075, 1077 (2000) (describing Countryman as having a passion "to protect the little guy, the individual debtor who had run into financial trouble and filed for bankruptcy" and noting that he "advocated reforms that would assure greater protection for individual debtors," "fought tirelessly for the interests of debtors in organizations . . . and was a founding trustee of the National Consumer Law Center").

69. *Personal Bankruptcy Hearings*, *supra* note 52, at 21.

70. *Id.* at 21-22.

71. *Id*. at 22.

72. *Id*. at 22-23.

> disposable income during the three-year period commencing on the date the debtor's first payment under the plan is due.[73]

Recognizing that projections could prove inaccurate, Professor Countryman also proposed an amendment to the Chapter 13 modification provision to allow it to be used to modify a confirmed plan if there were significant changes in the debtor's disposable income that rendered the projection in the confirmed plan erroneous.[74]

Professor Countryman explained how the proposed amendments would work:

> Under our proposed new § 1325(c), any unsecured creditor can invoke an additional standard for confirmation of a plan not proposing full payment: that it provides for payment of the debtor's total projected "disposable income" for the three-year period. The term "disposable income" would be defined in new § 1320 to include all income not reasonably necessary for the support of the debtor and his dependents and, if the debtor is engaged in business . . . not reasonably necessary for payment of actual business expenses. In new § 1325(d) we would also add a provision to make clear that the "good faith" requirement of § 1325(a)(3) is no longer to be construed to impose any other quantitative requirements on the amounts payable under a plan. . . .
>
> Since plans are confirmed on the basis of projections of future income of the debtor, any subsequent change in the debtor's income, either an increase or a reduction, during the term of the plan will result in an excessive or an inadequate commitment of his disposable income under the plan. Because we believe that, in exchange for the advantages of Chapter 13 over Chapter 7, the debtor should commit his disposable income for the term of the plan, we propose a new § 1329(d) to deal with that problem. While this provision will permit the debtor to seek a modification of the plan in the event of a reduction in income, it will also permit an unsecured creditor, in the event of an improvement in the debtor's income position at any time during the period of the plan, to seek a modification so that the full amount of the debtor's disposable income remains committed to payments under the plan.[75]

These amendments, referred to by Professor Countryman as the "ability-to-pay test," formed the basis for what later became the "disposable income test."[76] Congress adopted this test for

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73. *Id*. at 29 (written statement of Professor Vern Countryman).
74. *Id*. at 31.
75. *Id*. at 22-23.
76. *Id*. at 29.

Chapter 13 bankruptcy in the Bankruptcy Amendments and Federal Judgeship Act of 1984.[77] This Act added the following confirmation requirement to Chapter 13:

> If the trustee or the holder of an allowed unsecured claim objects to the confirmation of the plan, then the court may not approve the plan unless, as of the effective date of the plan—
>
> (A) the value of the property to be distributed under the plan on account of such claim is not less than the amount of such claim; or
>
> (B) the plan provides that all of the debtor's projected disposable income to be received in the three-year period beginning on the date that the first payment is due under the plan will be applied to make payments under the plan.
>
> (2) For purposes of this subsection, 'disposable income' means income which is received by the debtor and which is not reasonably necessary to be expended—
>
> (A) for the maintenance or support of the debtor or a dependent of the debtor; or
>
> (B) if the debtor is engaged in business, for the payment of expenditures necessary for the continuation, preservation, and operation of such business.[78]

Although the adopted language was not identical to that proposed by Professor Countryman, the substance was essentially the same—if a party raised an objection to confirmation, the debtor would be required to include a plan provision that would commit an additional amount of payment to their unsecured claimholders.[79] The amount of this payment would be based on projections of the parties' income and expenses during the plan term.[80] This would provide a fixed obligation that became part of the confirmed plan.[81]

Also following Professor Countryman's design, the 1984 Act amended the Chapter 13 plan modification provision to allow the debtor to modify plans "[a]t any time after confirmation but before the completion of payments under a plan, . . . upon request of the debtor, the trustee, or the holder of an allowed unsecured claim."[82]

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77. Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 317, 98 Stat. 333 (codified as 11 U.S.C. § 1325).

78. § 317, 98 Stat. at 356-57 (quotations omitted).

79. *Personal Bankruptcy Hearings*, *supra* note 52 (written statement of Vern Professor Countryman).

80. *See id*.

81. *See id*.

82. § 319, 98 Stat. at 357 (quotations omitted).

Two years later, Congress adopted the disposable income test and the plan modification provision as part of the new Chapter 12, Adjustment of Debts of a Family Farmer.[83]

IV. Contrasting Judicial Interpretations of the Disposable Income Test

Despite the nearly identical language, conflicting interpretations developed in the circuit courts regarding the proper application of the disposable income test to reorganizations in Chapter 12 as opposed to Chapter 13.[84] Chapter 13 case law remained close to the literal language of the statutory provision by treating the disposable income requirement as a confirmation issue,[85] but Chapter 12 case law rejected that approach with little discussion, developing a different mechanism for applying the test retroactively at discharge.[86]

A. The Disposable Income Test in Chapter 13

A review of published Chapter 13 case law reveals general adherence to the implementation suggestions provided by Professor Countryman.[87] Either the trustee or a creditor can trigger the projected disposable income requirement.[88] Courts determine projected disposable income at plan confirmation based on evidence of income and expenses provided by the debtor to the satisfaction of the court.[89] In most cases, debtors establish current income and expenses, and then these values are extended over the three-year plan term.[90] As the Fifth Circuit explained:

> Following the dictates of the relevant statutory language . . . [t]he bankruptcy court must take two steps in relation to this process. Initially, it must project the income of the debtor "over the next three years." For practical purposes, this task is usually accomplished by multiplying the debtor's monthly income by 36. Next, the

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83. Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, § 255, 100 Stat. 3088, 3105-13 (codified at 11 U.S.C. §§ 1201-1231).

84. *See id*.

85. *See id*.

86. *See id*.

87. *Id*.

88. *See* Educ. Assistance Corp. v. Zellner, 827 F.2d 1222, 1226 (8th Cir. 1987) (affirming the bankruptcy court's dismissal of the creditor's objection to confirmation of the debtor's plan and noting that the creditor had challenged the determination of projected disposable income).

89. *See id*.

90. 2 KEITH M. LUNDIN, CHAPTER 13 BANKRUPTCY § 164.1 (3d ed. 2000 & Supp. 2004).

> bankruptcy court must assess the amount of the debtor's income that is "disposable." [91]

In accordance with another case involving an objection to confirmation, the Fourth Circuit Court of Appeals ruled that "[p]rojected disposable income typically is calculated by multiplying a debtor's monthly income at the time of confirmation by 36 months, the normal duration of a Chapter 13 plan, then determining the portion of that income which is 'disposable' according to the statutory definition."[92]

Obviously, this process is easiest to apply in cases where the debtor's monthly prebankruptcy income has been stable.[93] But, fluctuations in income have not deterred Chapter 13 courts from evaluating plan projections for statutory compliance.[94] Courts have used income averaging for the past three years to project future income when there was significant annual income fluctuation.[95] Wide variations in income for self-employed debtors have been averaged in order to achieve a reasonable projection.[96] Courts have considered speculative increases in regular income such as future overtime pay and salary increases, attempting to determine whether they are too speculative to be projected.[97]

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91. Commercial Credit Corp. v. Killough (*In re* Killough), 900 F.2d 61, 64 (5th Cir. 1990) (citation omitted). At issue in *Killough* was whether potential overtime wages should be included in the calculation of the debtor's disposable income. *Id*. at 61. The lower courts had said that overtime need not be included if, as under the facts of the case, it was not definite enough that the debtor would be receiving overtime pay. *Id*. The Fifth Circuit affirmed, recognizing that "there may be instances where income obtained through working overtime can and should appropriately be included in a debtor's projected and disposable income for the purposes of a Chapter 13 plan" but holding that "[t]his is not such a case." *Id*. at 66 (citing COLLIER ON BANKRUPTCY ¶ 1325.08[4][a] (L. King 15th ed. rev. 1985) for support of its approach to the determination of projected disposable income).

92. Solomon v. Cosby (*In re* Solomon), 67 F.3d 1128, 1132 (4th Cir. 1995) (holding that projected disposable income does not include funds in Individual Retirement Accounts (IRAs) that will not be received by the debtor during the plan term).

93. *See id*.

94. *See, e.g.*, *In re* Weiss, 251 B.R. 453, 461-62 (Bankr. E.D. Pa. 2000) (utilizing an average net annual income figure for computing disposable income).

95. *See id*.

96. *See, e.g.*, *In re* Goodrich, 257 B.R. 101, 104-05 (Bankr. M.D. Fla. 2000) (confirming a Chapter 13 plan based on a projection of $25,000 annual income derived from the past three years' incomes ranging from $15,421.62 to $32,123.54 and an income of $15,110.75 in the year of filing, and stating that the debtor's projection seemed "optimistic" and denying a creditor's objection).

97. *See, e.g.*, Commercial Credit Corp. v. Killough (*In re* Killough), 900 F.2d 61, 65 (5th Cir. 1990) (stating that while future overtime might be included in some circumstances, it need not be included when its availability and the debtor's ability to undertake it is speculative); *In re* Schyma, 68 B.R. 52, 63 (Bankr. D. Minn. 1985) (holding that future salary increases that are not guaranteed need not be included in projected disposable income calculation). *But see In re* Smith, 222 B.R. 846, 858

Although some scholars argue that the amount and duration of disposable income payments are not the proper subject of the good-faith analysis, good faith remains an independent confirmation requirement, and some courts still merge the two requirements.[98] Generally, this only occurs in cases in which the debtor seeks to use Chapter 13 to discharge debts that are not dischargeable under Chapter 7.[99] Nominal payments to unsecured creditors do not, in and of themselves, constitute bad faith.[100]

Regardless of the nature of the challenge, any objection to the plan's initial treatment of disposable income is raised at confirmation.[101] The possibility that the projections made at confirmation might be in error underlies the postconfirmation plan modification provision of § 1329.[102] This allows the debtor, trustee, or unsecured claimholder the opportunity to seek modification of the plan to, among other things, increase or decrease the payments under the plan.[103] Under this provision, the projection contained in a confirmed plan can be modified if there is a "substantial change in [the debtor's] ability to pay."[104]

The Ninth Circuit Court of Appeals addressed the projected disposable income requirement in the context of a trustee's attempt

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(Bankr. N.D. Ind. 1998) (holding that future overtime pay should be included in projected disposable income based on the finding that the debtor had earned significant amounts of overtime pay in the past and was likely to do so in the future). Note that in some situations a debtor may wish to include future overtime pay as a means of meeting the feasibility requirement for plan confirmation. *See In re* Smith, 43 B.R. 319, 321 (Bankr. E.D.N.C. 1984) (including husband's overtime pay in considering whether the plan was feasible). Presumably, if it is included for one confirmation requirement, it must be included for the others. *See id*.

98. Villanueva v. Dowell (*In re* Villanueva), 274 B.R. 836, 841 (B.A.P. 9th Cir. 2002) ("[T]he debtor's proposed plan term and percentage payment to unsecured creditors are factors the court may consider in determining good faith.") (citing Fid. & Cas. Co. of N.Y. v. Warren (*In re* Warren), 89 B.R. 87, 93 (B.A.P. 9th Cir. 1988)). In contrast, the court noted that a leading Chapter 13 bankruptcy treatise disagrees with that approach. *Id*. at 841-42 n.6 (citing 3 KEITH M. LUNDIN, CHAPTER 13 BANKRUPTCY § 194.1 (3d ed. 2000)).

99. *See, e.g.*, *In re Warren*, 89 B.R. at 93-94 (reversing confirmation of plan with nominal payment to unsecured creditor with claim based on debtor's embezzlement); Oregon v. Selden (*In re* Selden), 121 B.R. 59, 61 (Bankr. D. Or. 1990) (confirming Chapter 13 plan over objection on good-faith grounds because of nominal payment on student-loan debt that could not be discharged in Chapter 7). For a discussion of this issue, see Bell, *supra* note 62.

100. *See, e.g,*, *In re Villanueva*, 274 B.R. at 841 (citing *In re Warren*, 89 B.R. at 92) ("Nominal payment by the debtor does not necessarily constitute bad faith."); *In re Warren*, 89 B.R. at 92 ("[I]t is now established that nominal payment by the debtor to creditors does not necessarily constitute bad faith.") (citing Kitchens v. Ga. R.R. Bank & Trust Co., 702 F.2d 885, 888 (11th Cir. 1983)).

101. 11 U.S.C. § 1224 (2000).

102. *See id*. § 1329.

103. *Id*.

104. Educ. Assistance Corp. v. Zellner, 827 F.2d 1222, 1226 (8th Cir. 1987).

to incorporate an automatic modification provision in the case of In re Anderson.[105] At issue in In re Anderson was the trustee's insistence that the debtors sign a "Best Efforts Certification" before plan confirmation.[106] This certification would have bound them to pay whatever their actual disposable income might be, not the amount that they projected.[107] When they refused to sign, the trustee objected to confirmation of their plan.[108] The debtors maintained that their plan included an accurate projection of their disposable income and that the court should have confirmed on that basis.[109]

The Ninth Circuit found the statutory language in § 1325 to be "clear" in requiring only an examination of projected disposable income, not actual disposable income computed during the plan.[110] The court noted that to "project" means "to plan, figure or estimate for the future"[111] and held that the debtor's plan need only provide for a reasonable projection of disposable income and promise to pay that amount.[112] The court adopted the two-part process for determining projected disposable income originally introduced by the Fifth Circuit in In re Killough, holding that the Killough interpretation "fully accords with the plain language of the statute."[113]

As to the trustee's request that the court impose a requirement that the debtors adjust their projections in the event that their projected income differed from their actual income, the court stated that "the Trustee's efforts to force the Andersons to agree to a periodic adjustment of their payments without a court order is inconsistent with the procedures established for modifying a debtor's plan."[114] The court held that the proper approach is for the trustee to seek modification of the plan if it needs adjustments.[115] The court stated:

> In essence, the Trustee asks us to ignore § 1329 and sanction the use of the Certification requirement as a means of vesting the Trustee with the authority to unilaterally adjust the Andersons' payments without a court order. . . . By providing in § 1329 a

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105. Anderson v. Satterlee (*In re* Anderson), 21 F.3d 355 (9th Cir. 1994).
106. *Id*. at 356-57.
107. *Id*. at 356.
108. *Id*. at 357.
109. *Id*.
110. *Id*.
111. *Id*. at 357 n.5 (citing WEBSTER'S NINTH NEW COLLEGIATE DICTIONARY 940 (9th 1984)).
112. *Id*. at 358.
113. *Id*. at 357; *see In re* Killough, 900 F.2d 61 (5th Cir. 1990).
114. *In re Anderson*, 21 F.3d at 358 (citing 11 U.S.C. § 1329).
115. *Id*.

> mechanism to modify a confirmed plan, Congress plainly did not intend to vest trustees with such unfettered authority.[116]

Thus, in the context of Chapter 13, courts have interpreted the disposable income requirement along the lines proposed by Professor Countryman, allowing litigation over the issue to occur at confirmation when projections are established or as part of a plan modification when projections prove inaccurate.[117]

B. The Disposable Income Test in Chapter 12

Congress enacted Chapter 12, the Adjustment of Debts of a Family Farmer with Regular Annual Income, in 1986 in response to an extensive financial crisis that affected farmers throughout the country.[118] Following on the heels of an agricultural boom in the 1970s, the "agricultural depression" that marked the 1980s has been said to "rival[] that of the 1930's [sic] in terms of its impacts on farmers."[119] Farmers saw their net worth decline by more than half as land values, machinery values, and crop prices all declined dramatically.[120] Economic forces outside of the agricultural sector caused a similarly dramatic rise in credit costs as interest rates soared.[121] Farmers with adjustable rate mortgages soon found themselves unable to meet interest payments.[122]

The new chapter limited eligibility to "family farmer[s] with regular annual income."[123] Family farmers were restrictively defined according to the amount of their farm income, the amount of their farm debt, and their maximum overall debt.[124] It was a powerful new

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116. *Id*. (citing United States v. Mehrmanesh, 689 F.2d 822, 829 (9th Cir. 1982)). "'We may not construe a statute so as to make any part of it mere surplusage.'" *Id*. (quoting *Mehrmanesh*, 689 F.2d at 829). Some lower courts have required a debtor to provide monthly statements to the trustee to verify that income has not increased, and when overtime pay is anticipated at confirmation, required the debtor to increase their disposable income plan payments accordingly. *See, e.g.*, *In re* Smith, 222 B.R. 846, 858 (Bankr. N.D. Ind. 1998). The Ninth Circuit would likely disagree with this approach insofar as it required the automatic increase in payment. *See supra* note 105 and accompanying text. Based on the information provided, however, the trustee should be free to seek modification. *See supra* note 102 and accompanying text.

117. *See supra* notes 63-65 and accompanying text.

118. Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, § 255, 100 Stat. 3088, 3105-13 (codified at 11 U.S.C. §§ 1201 -1231).

119. *Id*.

120. *Personal Bankruptcy Hearings*, *supra* note 52, at 21.

121. *Id*. at 22.

122. NEIL E. HARL, THE FARM DEBT CRISIS OF THE 1980S 13-17 (1990).

123. § 253, 100 Stat. at 3105.

124. *Id*. § 251 (codified at 11 U.S.C. § 101(17)).

chapter of the Bankruptcy Code designed for a narrow category of debtors.[125]

Based on Chapter 13, Chapter 12 provided family farmers an opportunity to restructure their debt while retaining their farm property.[126] The new Chapter 12 included the disposable income requirement, coupled with a modification provision that allowed the debtor, the trustee, or any unsecured creditor to request modification.[127] Both provisions contained language virtually identical to that found in Chapter 13.[128] The Conference Report provided only the instruction that farmers can include expenses associated with minor nonfarm businesses in their deductions from disposable income, arguably indicating that the rest of the language was clear.[129]

Creditors often reacted aggressively to farm debtors' new authority to file for relief under Chapter 12.[130] Creditors frequently challenged eligibility, and a significant body of case law developed around the specific Chapter 12 eligibility requirements.[131] Similarly, efforts to write down secured debt pursuant to the cramdown provisions produced a wide range of published decisions on interest rates, valuation, and other aspects of the treatment of secured claims.[132]

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125. *See id*.

126. Chapter 12 provides reorganization powers that exceed that of Chapter 11 or 13 in that home mortgages can be written down in Chapter 12, while they cannot be under either Chapters 11 or 13. *Compare* 11 U.S.C. § 1222(b)(2) (2000), *with* 11 U.S.C. § 1322(b)(2) *and* 11 U.S.C. § 1123(b)(5).

127. § 255, 100 Stat. at 3113.

128. *See supra* notes 35-37 and accompanying text.

129. 132 CONG. REC. H8986-02 (daily ed. Oct. 2, 1986) (noting this as the Conference Report of H.R. 5316, *Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986*, H. R. No. 99-958 (1986)), *available at* 1986 WL 788079. This Report provides only the following with regard to disposable income:

> Section 1225 defines "disposable income" as income which is not reasonably necessary to be expended for the maintenance or support of the debtor or a dependent of the debtor or for the payment of expenditures necessary for the continuation, preservation, and operation of the debtor's business.
>
> The Conferees recognize that family farmers who are eligible for Chapter 12 may be involved in minor businesses not directly related to the farming operation. The Conferees intend that the term "debtor's business" in section 1225 include such businesses.

Id.

130. *See* cases cited *infra* notes 131-32.

131. *In re* Cross Timbers Ranch, Inc., 151 B.R. 923, 924 (Bankr. W.D. Mo. 1993); *see, e.g.*, Watford v. Fed. Land Bank of Columbia (*In re* Watford), 898 F.2d 1525, 1526 (11th Cir. 1990); Otoe County Nat'l Bank v. Easton (*In re* Easton), 883 F.2d 630, 631-32 (8th Cir. 1989); *see also* ROGERS & KING, *supra* note 23, at 4.03 (stating that Chapter 12 eligibility "has been one of the most frequently litigated issues in chapter 12 cases").

132. *See, e.g.*, First Brandon Nat'l Bank v. Kerwin (*In re* Kerwin), 996 F.2d 552, 560-61 (2d Cir. 1993) (allowing judicially determined value of surrendered property to

The nature of farm debt, coupled with the state of the farm economy when Congress enacted Chapter 12, created a situation that was different from that in typical consumer Chapter 13 cases.[133] In Chapter 13, many of the unsecured claimholders were true unsecured creditors (i.e., creditors with no security associated with their debt).[134] In contrast, under Chapter 12, institutional lenders who were secured creditors with security insufficient to support their claims represented many of the largest unsecured claimholders.[135] Their interests were bifurcated into a secured claim and an unsecured claim.[136] The protections afforded secured creditors under their secured claims,[137] and both the liquidation test[138] and the disposable income test protected their unsecured claims.[139]

Published case law contains little that indicates that a secured creditor or any unsecured claimholder challenged a Chapter 12 debtor's computation of projected disposable income at confirmation.[140] Unlike in Chapter 13 where there are numerous reported decisions of creditors seeking additional disposable income payments,[141] Chapter 12 creditors seemed more likely to argue that

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be used to eliminate secured claim); U.S. Dep't of Agric. v. Fisher (*In re* Fisher), 930 F.2d 1361, 1363-64 (8th Cir. 1991) (addressing appropriate interest rate to be charged in order to provide secured creditor with the present value of its interest); Farm Credit Bank of Spokane v. Fowler (*In re* Fowler), 903 F.2d 694, 696-99 (9th Cir. 1990) (addressing appropriate interest rate to be charged in order to provide secured creditor with the present value of its interest); Hardzog v. Fed. Land Bank of Wichita (*In re* Hardzog), 901 F.2d 858, 860 (10th Cir. 1990) (addressing appropriate interest rate to be charged in order to provide secured creditor with the present value of its interest).

133. *See* HENRY J. SOMMER, ET AL., CONSUMER BANKRUPTCY LAW AND PRACTICE § 16.1.1 (1988).

134. *See supra* note 131 and accompanying text. Many consumer debts are unsecured obligations (e.g., medical bills, most credit card bills, and utility bills).

135. *See, e.g.*, Fobian v. W. Farm Credit Bank (*In re* Fobian), 951 F.2d 1149, 1150 (9th Cir. 1991) (concerning undersecured interest of Farm Credit System lender); *In re Fisher*, 930 F.2d at 1362 (concerning undersecured interest of USDA lender, Farmers Home Administration); *see* cases cited *supra* note 131.

136. 11 U.S.C. § 506 (2000); *see also In re Fobian*, 951 F.2d at 1151 (holding that bifurcation of undersecured claim is required to determine compliance with § 1225 requirements for treatment of both secured and unsecured claims).

137. 11 U.S.C. § 1225(a)(5).

138. *Id.* § 1225(a)(4).

139. *Id.* § 1225(b)(1).

140. *See, e.g.*, *In re* Edwards, No. 03-10018, 2004 WL 316418 (Bankr. D. Vt. Feb. 13, 2004). As further evidence of the conflicting interpretation of the virtually identical Chapter 12 and Chapter 13 provisions on disposable income, the Farm Service Agency objected to confirmation on the basis of the disposable income requirement in the recent case of *In re Edwards*. *Id.* at *1.

141. *See, e.g.*, Commercial Credit Corp. v. Killough (*In re* Killough), 900 F.2d 61, 64-65 (5th Cir. 1990) (ruling on objection to confirmation based on the disposable income requirement in Chapter 13 and holding that overtime pay should not be included in projected income); Educ. Assistance Corp. v. Zellner, 827 F.2d 1222, 1226 (8th Cir. 1987).

there would be insufficient income to fund the plan itself.[142] While this approach undercuts any argument that the creditor might make for increased disposable income payments, it allowed the creditor to seek immediate dismissal of the case.[143] In particular, undersecured creditors with significant security likely preferred liquidation.[144]

As such, the early reported decisions are replete with analysis of the Chapter 12 "feasibility requirement."[145] This confirmation requirement calls for debtors to establish that they "will be able to make all payments under the plan and to comply with the plan."[146] Failure to show feasibility is grounds for denial of confirmation and ultimately dismissal of the bankruptcy.[147] In order to show feasibility, the debtor must show evidence of the debtor's ability to meet the financial obligations of the plan.[148] Creditors have the right to object and challenge the debtor's ability to perform.[149] Creditor objections based on the feasibility requirement led bankruptcy courts to deny confirmation of many Chapter 12 plans.[150]

Thus, the feasability requirement is the inverse of the disposable income requirement.[151] While both require an analysis of income and expense projections for the term of the plan, a challenge to the former requires an allegation that income is insufficient to

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142. *See, e.g.*, *In re* Novak, 252 B.R. 487, 490-91 (Bankr. D. N.D. 2000).

143. *See infra* Part V.

144. *See* First Brandon Nat'l Bank v. Kerwin (*In re* Kerwin), 996 F.2d 552, 557 (2d Cir. 1993) (stating that undersecured creditor, after receipt of collateral, becomes entitled to pro rata share of payments made to all unsecured creditors upon liquidation of estate).

145. ROGERS & KING, *supra* note 23, at 4-88 to 4-89, nn.26-27 (discussing the Chapter 12 feasibility requirement and citing to numerous reported decisions on that issue).

146. 11 U.S.C. § 1225(a)(6) (2000); *see In re Novak*, 252 B.R. at 492 (stating that while this does not provide a "guarantee of performance, it does require reasonable assurance that the plan terms can be carried out," rejecting the debtors' proposed plan as not feasible).

147. *See* § 1225(a)(6); *In re Novak*, 252 B.R. at 492.

148. 5 COLLIER ON BANKRUPTCY ¶ 1225.02, 1225.12 (L. King 15th ed. rev. 1996).

149. *See* 11 U.S.C. § 1224.

150. *See, e.g.*, Euerle Farms, Inc. v. State Bank in Eden Valley (*In re* Euerle Farms, Inc.), 861 F.2d 1089, 1091-92 (8th Cir. 1988) (denying confirmation based on the finding that the debtor's income projections were too high and that the debtor would be unable to make a required balloon payment); *In re* Crowley, 85 B.R. 76, 79-80 (Bankr. W.D. Wis. 1988) (denying confirmation of the debtor's Chapter 12 plan because it did not meet the feasibility test when the debtor projected increased milk production without indicating how he would obtain the increase); *In re* Konzak, 78 B.R. 990, 994 (Bankr. D. N.D. 1987) (denying confirmation of the debtor's Chapter 12 plan because it did not meet the feasibility test when the debtor projected yields and market prices that were higher than that shown historically); *see also* ROGERS & KING, *supra* note 23, at 4-89 n.26 (listing additional cases in which confirmation was denied for failure to meet the feasibility requirement).

151. *See* Susan A. Schneider, *Chapter 12 Bankruptcy: Family Farmer Reorganizations*, *in* HENRY J. SOMMER ET AL., CONSUMER BANKRUPTCY LAW AND PRACTICE 433, 498 (7th ed. 2004).

make the regularly scheduled plan payments.[152] A challenge based on disposable income is an allegation that income projections are too low and that extra income is available.[153] Given the strict feasibility requirements, it is not surprising that the early Chapter 12 plans were rarely subject to disposable income challenges, even when the plan promised little or no disposable income for unsecured creditors.[154]

Although disposable income does not often appear in reported Chapter 12 cases as a confirmation issue, it frequently resurfaces as an objection to discharge.[155] Chapter 12 creditors have successfully argued that while the statute uses the term projected disposable income, this usage imposes a general confirmation standard that requires the ultimate turnover of all actual disposable income as determined as of discharge.[156] In some cases, this resulted in creditor objection to discharge and intense litigation.[157] Courts have denied discharge for debtors who are found not to have paid all actual disposable income for failure to complete all payments under the plan.[158] The leading case that supports this approach is the Eighth Circuit case of *Rowley v. Yarnall*.[159]

In *Rowley*, the debtors' confirmed Chapter 12 plan contained the requisite promise that all "projected disposable income" would be applied to payments under the plan.[160] But, the plan also projected that there would be no disposable income, stating that "[n]o dividend or distribution of any kind is projected for the members of this [unsecured claims] class."[161] At the end of the three-year plan period, having made all of their payments, the debtors filed a motion for discharge alleging that they had complied with all of the requirements of their plan.[162] The Chapter 12 trustee and two undersecured creditors objected, arguing that the debtors failed to pay the actual or net disposable income realized during the plan years to their unsecured creditors.[163]

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152. *See id*. at 497.
153. *See id*. at 498.
154. *Id*. (referring to the disposable income requirement as the "flip side to the feasibility question").
155. *See, e.g.*, *In re* Wood, 122 B.R. 107, 112 (Bankr. D. Idaho 1990).
156. *See, e.g.*, *id*. at 115.
157. *See id*. at 111 (reasoning that creditors may seek denial of discharge if all disposable income has not been paid).
158. Rowley v. Yarnall, 22 F.3d 190, 191 (8th Cir. 1994).
159. *Id*. at 190.
160. *Id*.
161. Yarnall v. Rowley (*In re* Rowley), 143 B.R. 547, 550 (Bankr. D. S.D. 1992).
162. *Rowley*, 22 F.3d at 191.
163. *Id*. The objecting creditors were institutional lenders with a leading role in farm finance, Production Credit Association of the Midlands, a Farm Credit System lender, and Farmers Home Administration, a USDA lender. *Id*. Each creditor had their secured claim written down by the confirmed plan and sought additional compensation

The Eighth Circuit examined the statutory language of § 1225(b).[164] The court noted that

> [a] plain reading of the language of the statute might appear to support the position advanced by the Rowleys. "Projected net disposable income" seems to indicate that the statute only requires that the Chapter 12 debtor pay that amount which the plan projects will be available as disposable income over the plan period.[165]

Nevertheless, the court found that a literal reading of the "projected disposable income" requirement would yield "an absurd result" that would "reduce § 1225(b) to a nullity."[166] The court explained that requiring only the payment of projected disposable income, as stated in the confirmed plan,

> would essentially direct farmers to put forth a reorganization plan, which, if objected to by unsecured creditors, would be confirmed over such objections if they simply "predict" that disposable income will be zero. Section 1225(b) would serve no purpose other than a mechanical one. This interpretation of the statute violates the very important and well-settled canon of statutory construction that the legislature is presumed not to have done a vain thing, inserting language for no purposes.[167]

The court did not understand that the parties could litigate the projected disposable income at confirmation, as has been done in numerous Chapter 13 cases.[168] Moreover, the court did not consider that the same income and expense projections that are the basis for feasibility determinations would serve as a basis for rational projected disposable income rulings.[169] Quoting a U.S. Supreme Court opinion, the court held that "since 'interpretations of a statute which would produce absurd results are to be avoided if alternative interpretations consistent with the legislative purpose are available,' we must look to the legislative purpose behind [the] statute."[170]

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for the resulting unsecured portion of their claim. *Id.*

164. *Id*. at 192.

165. *Id*.

166. *Id*.

167. *Id*.

168. *See generally id*. at 190-94 (failing to consider litigation of projected disposable income at confirmation).

169. *See generally id*. (failing to consider the bases for feasibility and projected disposable income determinations).

170. *Id*. at 192 (citations omitted) (second alteration in original) (quoting Griffin v. Oceanic Contractors, Inc., 458 U.S. 564, 575 (1982)).

Unfortunately, the court did not look to the legislative history of the disposable income requirement.[171] Nor did it consult Chapter 13 case law interpreting the identical requirement.[172] Instead, the court cited general legislative history regarding the purpose of Chapter 12 and made broad statements about congressional intent in creating it.[173] It concluded that Congress designed Chapter 12 "primarily to provide family farmers with a faster, simpler, and cheaper alternative to Chapter 11 and Chapter 13 procedures, while preserving the fair treatment of creditors under those chapters."[174]

In determining what the fair treatment of creditors should be, the court inexplicably discussed Chapter 11 protections, noting the proper "balancing of power" between creditors and the debtor in Chapter 11.[175] The court then stated that it could not "assume that Congress intended to depart from these general purposes of bankruptcy law when creating an expeditious avenue for farm reorganizations."[176]

The court's reference to Chapter 11 with respect to the rights of unsecured creditors is puzzling because the power afforded unsecured creditors in Chapter 11 is often cited as one of the most significant reasons that Chapter 12 was needed.[177] Farmer-debtors were unable to comply with Chapter 11's absolute priority rule, a rule that prohibits debtors from retaining ownership of their property unless their unsecured creditors receive one hundred percent of their claim.[178] When Congress enacted Chapter 12, it chose the Chapter 13 model for the protection of unsecured claims, rejecting the absolute priority rule found in Chapter 11.[179]

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171. *See generally id*. at 190-94 (lacking discussion on the legislative history of the disposable income requirement).

172. *See generally id*. (lacking discussion of Chapter 13 case law).

173. *Id*. at 192-93.

174. *Id*. at 193.

175. *Id*.

176. *Id*.

177. *See* ROGERS & KING, *supra* note 23, at 3-70 to 3-71 ("The farmer-debtor's perceived inability to overcome the absolute priority rule was one of the prime reasons for enactment of chapter 12.").

178. *See id*. The farmers' have difficulty complying with the absolute priority rule in Chapter 11 and

> [m]ost farmers in chapter 11 lack the ability to pay unsecured creditors in full and thus do not have the means to effect a cramdown if the unsecured class rejects the plan. The result is that the unsecured creditor class holds an effective veto power over the farmer's ability to confirm a chapter 11 plan. If the farmer cannot convince the class to accept the plan, the farmer faces liquidation of the farm.

Id.; *see also* Norwest Bank Worthington v. Ahlers (*In re* Ahlers), 485 U.S. 197 (1988) (reversing the Eighth Circuit decision finding an exception to the absolute priority rule for farmers).

179. *See In re* Coffman, 90 B.R. 878, 882 (Bankr. W.D. Tenn. 1988) (rejecting the creditor's argument that Congress intended the disposable income requirement to serve

Similarly, it is puzzling why the Rowley court did not discuss the issue of plan modification .[180] A review of the § 1229 modification provision reveals its particular applicability to changes in disposable income.[181] While secured creditors cannot seek to modify the debtor's confirmed plan, § 1229 allows "the debtor, the trustee, or the holder of an allowed unsecured claim" to seek the increase or the reduction of payment provided to a particular class under the plan.[182]

Despite the weakness of the analysis in the Rowley case, there is little within published Chapter 12 case law to challenge this analysis.[183] Moreover, it appears that some standing Chapter 12 trustees have strongly encouraged Chapter 12 debtors to include an actual disposable income clause in their plan.[184] As the confirmed plan governs the rights of the parties in interest, the inclusion of this clause would render the debtor liable for actual disposable income payments regardless of the interpretation of the statutory requirement.[185]

Chapter 12 courts have similarly overlooked a literal and historical reading of the Chapter 12 modification provision.[186] Most creditors and courts have simply ignored § 1229 and the modification process set forth therein because modification is not discussed in most of the Chapter 12 cases that address disposable income. But, the language of § 1229 is directly relevant to the disposable income requirement, and it only makes sense as a

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as a "quid pro quo" for the § 1111(b) election, the absolute priority rule, and the opportunity to vote on the plan and stating that "history indicates that Chapter 12 is patterned after Chapter 13 and that these Chapter 11 provisions were purposefully omitted").

180. *Rowley*, 22 F.3d at 190.

181. 11 U.S.C. § 1229 (2000).

182. *Id*. § 1229(a)(1).

183. Several cases hold that disposable income can be raised as an objection to discharge and require a computation of actual disposable income at that time. *See* Hammrich v. Lovald (*In re* Hammrich), 98 F.3d 388, 389-90 (8th Cir. 1996); Broken Bow Ranch, Inc. v. Farmers Home Admin. (*In re* Broken Ranch, Inc.), 33 F.3d 1005, 1008-09 (8th Cir. 1994); *In re* Meyer, 186 B.R. 267, 268 (Bankr. D. Kan. 1995); *In re* Gage, 159 B.R. 272, 276 (Bankr. D. S.D. 1993); *In re* Schmidt, 145 B.R. 983, 985 (Bankr. D. S.D. 1991); *In re* Bowlby, 113 B.R. 983, 985 (Bankr. S.D. Ill. 1990).

184. *See, e.g.*, *In re* Wood, 122 B.R. 107, 111 (Bankr. D. Idaho 1990) (interpreting a Chapter 12 plan provision that required that "'[a]ll disposable income not used for the farming operation shall be paid to the trustee and the trustee may, at its discretion, use said disposable income for purposes of making additional payments to unsecured creditors during the term of the plan,'" and noting that all of the Chapter 12 trustees in that district required such a clause) (quoting the debtor's confirmed Chapter 12 plan).

185. 11 U.S.C. § 1227(a); *see also* 11 U.S.C. § 1229(b)(2) (stating that the plan becomes official as modified after notice and hearing).

186. *See supra* Part III.

means of relief when courts interpret the projected disposable income requirement literally.[187]

Among Chapter 12 creditors, only unsecured creditors are afforded the right to request modification.[188] As such, modification provides an opportunity to protect unsecured creditors' rights.[189] Clearly, unsecured creditors have only two primary protections built into Chapter 12—the liquidation test and the disposable income test.[190] As the liquidation test by its express terms is computed based on values "as of the effective date of the plan," modification would not be appropriate to effectuate this right.[191] Therefore, modification must provide an opportunity for an unsecured creditor to adjust the disposable income payments.[192] If the disposable income requirement is interpreted to require actual rather than projected income, there is no purpose for a modification provision. Ironically, it was the Eighth Circuit in Rowley that stated that "the legislature is presumed not to have done a vain thing, inserting language for no purpose."[193]

V. The Impact of the Chapter 12 Judicial Interpretation of Disposable Income

Based on the drafting history of the disposable income requirement and its interplay with an unsecured creditor's right to request modification, it seems clear that the Chapter 13 interpretation of projected disposable income reflects the most accurate reading of the statutory language.[194] Arguably, Chapter 12 courts should have interpreted the statute consistently with Chapter 13 because Congress implied that interpretation when it adopted the same language for family farm reorganization.[195] Courts are not free

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187. *See* 11 U.S.C. § 1229; *see also infra* notes 188-89 and accompanying text (describing the interpretation of the projected disposable income requirement in § 1229).

188. 11 U.S.C. § 1229(a) (granting the right to request modification to "the debtor, the trustee, or the holder of an allowed unsecured claim").

189. *See id*.

190. *Id.* § 1225.

191. *Id.* § 1225(a)(4).

192. *Id.* § 1229.

193. Rowley v. Yarnall, 22 F.3d 190, 192 (8th Cir. 1994).

194. *Compare supra* Part IV.A (describing the Chapter 13 disposable income test), *with supra* Part IV.B (describing the Chapter 12 disposable income test).

195. *See* HENRY J. SOMMER ET AL., CONSUMER BANKRUPTCY LAW AND PRACTICE §

to overlook statutes when they find that they would prefer a different approach.

Putting aside the issue of correct interpretation, however, the practical results of the misinterpretation of the disposable income requirement have not only run afoul of the literal language that Congress imposed, but they have sometimes thwarted the very intent underlying the adoption of Chapter 12.[196] If interpreting a projected disposable income requirement to be actual instead of projected was simply a mechanism to do what could otherwise be done through plan modification, there would be little practical significance to the misinterpretation. In reality, however, the imposition of an actual income requirement on farmers has resulted in a process that is subject to abuse, and in some cases has made the continuation of many postbankruptcy farming operations all but impossible.[197]

As courts have struggled to unwind the complex transactions that comprise an ongoing farming operation in an attempt to determine actual disposable income, they have expanded the definition of disposable income far beyond the terms of the statute.[198] Thus, the practical problems associated with courts' interpretations of the disposable income requirement are numerous, and each is discussed in turn.

A. The Courts' Insistence on Determining Actual Disposable Income Has Inappropriately Complicated the Analysis and Expanded the Definition of this Term

Perhaps the most significant problem that has resulted from the courts' misinterpretation of the disposable income requirement in Chapter 12 is the judicial expansion of the definition of disposable income. When courts in Chapter 13 cases project disposable

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16.5.4.3 (1988) ("The Chapter 12 disposable income requirement has been lifted verbatim from Chapter 13.").

196. *Compare supra* notes 185-92 and accompanying text (describing the disposable income requirement), *with* Part III (describing the legislative history of the disposable income requirement).

197. *See, e.g.*, *Rowley*, 22 F.3d at 192 (requiring payment of all disposable income under the plan and stating chapter 12 "was designed to 'give family farmers facing bankruptcy a fighting chance to reorganize their debts and keep their land'") (quoting H.R. REP. NO. 99-958, at 48 (1986), *reprinted in* 1986 U.S.C.C.A.N. 5227, 5249).

198. *See* 11 U.S.C. § 1225(b)(2) (2000).

income at confirmation and determine a fixed obligation, they look to specific annual cash flow statements, averaging income and expenses, to arrive at a reasonable assessment.[199] In contrast, courts in Chapter 12 cases have encountered many problems when trying to recreate the exact amount of disposable income available during a plan term.[200]

The disposable income requirement applies during the term of the plan, usually a three-year period.[201] The period begins "on the date that the first payment is due under the plan."[202] This structure is consistent with estimated payments based on average annual income and expenses multiplied by three.[203] When one attempts to discern actual disposable income during this artificially determined time period, problems result.

For example, it is very unlikely that the date the first payment is due under the plan will coincide with the beginning of the fiscal year for the farm business. More importantly, it is equally unlikely that the date the first payment is due will coincide with the production cycle of the farm. Because farms operate based on production and the sale of what is produced, income and expenses mid-year may be difficult for a court to assess. For example, the farm may have assets such as crops or livestock on hand on the date that the first plan payment is due, but that will be sold during the term of the plan. These assets would have been property of the estate as of confirmation, and as such, they had value to the estate.[204] Nevertheless, if sold, the court is likely to consider the sale proceeds to be income used in computing actual disposable income. If so, in order to truly assess disposable income accurately and specifically for the plan term, the debtor should be left with a similar value of assets at discharge. This, however, has not been the case.[205] To

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199. *See Rowley*, 22 F.3d at 190; *see also* Broken Bow Ranch, Inc. v. Farmers Home Admin. (*In re* Broken Bow Ranch, Inc.), 33 F.3d 1005, 1009 (8th Cir. 1994) (describing how the court calculated disposable income).

200. *See, e.g.*, Commercial Credit Corp. v. Killough (*In re* Killough), 900 F.2d 61 (5th Cir. 1990); Educ. Assistance Corp. v. Zellner, 827 F.2d 1222 (8th Cir. 1987); *In re* Edwards, No. 03-100818, 2004 WL 316418 (Bankr. D. Vt. 2004).

201. 11 U.S.C. § 1222(c) (stating that a Chapter 12 plan will be three years in length unless the debtor requests a longer period and the court, for cause, approves it, and in no case can it be longer than five years).

202. *Id.* § 1225(b)(1)(B).

203. *See supra* notes 90-92 and accompanying text.

204. 11 U.S.C. § 1207.

205. *See* Broken Bow Ranch, Inc. v. Farmers Home Admin. (*In re* Broken Bow

the contrary, the Eighth Circuit Court of Appeals requires that inventories at the end of the plan term be added to the income credited to the debtor.[206] In Broken Bow Ranch, Inc., the court held that "hay, silage, and corn inventories" with a value of $177,542 should be included in determining the debtor's disposable income.[207] The bankruptcy court, affirmed by the Eighth Circuit, characterized its disposable income determination as "subtracting its obligations from its inventories."[208] No accounting was done that reflected the inventories on hand at the beginning of the plan period.[209]

Additionally, included in what the court termed "inventories" were two federal farm program payments that were actually received after the end of the plan term.[210] The debtor argued that these should not be included because disposable income is defined as income "received by the debtor" during the term of the plan.[211] The court rejected this argument summarily, stating that "[w]hether or not these payments were entirely predictable, they were attributable to Debtor's farm operations during the plan period."[212] Yet the court did not account for the fact that the initial payments that the debtor received during the first year of the plan would have been "attributable to the debtor's farm operations during" the period prior to the date of the first plan payment.[213]

In a subsequent case decided by the Eighth Circuit Court of Appeals, the court again focused on the debtors' inventories as of discharge, as opposed to the income received during the plan period.[214] In Hammrich v. Lovald (In re Hammrich), the court calculated the debtors' "total inventories" and, following Broken Bow

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Ranch, Inc.), 33 F.3d 1005, 1009 (8th Cir. 1994).

206. *Id*.

207. *Id*.

208. *Id*.

209. *See id*.

210. *Id*.

211. 11 U.S.C. § 1225(b)(1)(B) (2000); *In re Broken Bow Ranch, Inc.*, 33 F.3d at 1008.

212. *In re Broken Bow Ranch, Inc.*, 33 F.3d at 1009. For a discussion of farm program payments in bankruptcy and an analysis of when the debtor has a right to payment, see Susan A. Schneider, *Who Gets the Check: Determining When Federal Farm Program Payments are Property of the Bankruptcy Estate*, 84 NEB. L. REV. (forthcoming 2005).

213. *In re Broken Bow Ranch, Inc.*, 33 F.3d at 1009. The court acknowledged, however, that the debtor had received substantial government farm program payments both before and during the bankruptcy. *Id*.

214. *See* Hammrich v. Lovald (*In re* Hammrich), 98 F.3d 388, 390 (8th Cir. 1996).

Ranch, Inc., included farm program payments that had not yet been received.[215] In addition, the court further muddied the disposable income waters by holding that the value of 326 calves that were not yet at marketable weight would also be included in the calculation of the debtors' disposable income.[216] Despite this expansive view of income, the court held that the debtors could not include either real estate taxes that were paid for the final year of the plan or the repayment of a loan because neither obligation actually became due until after discharge.[217]

B. Significant Obligations Are Assessed Only at the End of the Plan Term

Given courts' expansive interpretation of disposable income, it is unsurprising that debtors have been assessed significant obligations at discharge, even when they have complied with whatever disposable income was projected and approved at plan confirmation.[218] For example, in In re Hammrich, the court found the debtors owed $95,885.86 at discharge.[219] In Broken Bow Ranch, Inc., the court found an obligation of $81,862.[220]

When an obligation is assessed, the debtor is in a difficult predicament. If the debtor is unable to pay the obligation, the court can dismiss the case, and the entire Chapter 12 reorganization is lost.[221] The Eighth Circuit explained the process: "Either [the d]ebtor will make the $81,862 disposable income payment and receive a discharge, or it will fail or refuse to make the payment and the case will be dismissed without a discharge."[222] Although the court referenced the possibility of approving deferred payments, considering the tight cash flows upon which courts base Chapter 12 plans, this obligation might not be possible to sustain, even paid out over time.[223] Moreover, the debtor, in this position, will be in such a

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215. *Id*.
216. *Id*.
217. *Id*. at 390-91.
218. *See id*. at 390.
219. *Id*.
220. Broken Bow Ranch, Inc. v. Farmers Home Admin. (*In re* Broken Bow Ranch, Inc.), 33 F.3d 1005, 1008 (8th Cir. 1994).
221. *See id*.
222. *Id*.
223. *Id*.

difficult bargaining situation that it will be difficult, if not impossible, to advocate for favorable payment terms.[224]

C. Objections Are Delayed and Obligations Are Difficult to Assess

By allowing disposable income objections to be heard at discharge, trustees and creditors in some districts have waited to raise objections at that time, generally not objecting during the plan term.[225] They have not sought modification as may have been appropriate under § 1229.[226] At this point in time, often years after the transactions in question have been completed, many debtors are ill prepared to defend their actions.[227] Moreover, the threat of case dismissal at a discharge hearing places undue pressure on a debtor to settle the case at any cost.[228]

D. The Retroactive Assessment Is Problematic When Funds Have Already Been Expended

The retroactive nature of the assessment means that the debtor can be expected to pay an obligation based on "disposable income" that may have been invested in the farming operation long ago. In no reported case in which courts found a disposable income obligation have courts alleged that the debtor has the cash on hand with which to pay the full obligation. Rather, a court will most often find profit earned in one year of the plan that the debtor used in the continuation of the farming operation. For example, if a court finds disposable income existed in year one of the plan and the debtor used this income to plant crops during year two, whether or not any income remains in year three depends on the success of crops that year. This problem is exacerbated in situations in which a court, at discharge, assesses each year independently. In one case, a court

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224. *See id*.

225. *See In re* Meyer, 186 B.R. 267, 268 (Bankr. D. Kan. 1995).

226. *See id*.

227. *See id*. Addressing the difficulty associated with objections to disposable income at the end of the plan term, the court noted the following:

> The debtors made a good faith effort to reconstruct their financial transactions five years after the fact. In fairness, although the debtors submitted monthly reports that were deficient in the nature and format of disclosure, neither the standing trustee, debtors' counsel, nor any creditor objected to the monthly reports submitted.

Id.

228. *See id*.

refused to offset crop profit in year one with losses in years two and three. Because disposable income, by its terms, cannot be a negative figure, the debtor was found to be obligated for the year-one profits.[229]

E. Expensive Disposable Income Battles at Discharge Leave Debtors Ill Prepared to Continue the Farming Operation

Litigation involving disposable income at discharge can involve a complicated reconstruction of years of farm activities.[230] As an example of the extent of the investigations involved, in one South Dakota case, the debtor was served with a subpoena duces tecum for the production of documents, full scale discovery was undertaken, and the court held a Bankruptcy Rule 2004 examination.[231] In that case, the creditor, Farm Credit Bank of Omaha, sought administrative compensation of $13,166.35 for its actions against the debtor.[232] This request was initially granted, but eventually overturned on appeal.[233] But, these costs reflect the type of attorney fees that the debtor may owe for the debtor's own counsel.

Similarly, because the courts have not adhered to a more consistent, predictable process of establishing projected disposable income, creditors may pursue aggressive action against debtors.[234] One court described it as follows:

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229. *See, e.g.*, *In re* Weber, 25 F.3d 413, 415 (7th Cir. 1994). The farm generated a profit of more than $120,000 in 1987 and losses the following two years totaling $300,000. *Id*. The bankruptcy court, in a decision affirmed by the district court, stated that

> "[t]he plan does not contemplate payment of the net disposable income over a total of three years, thus permitting a loss in any one year to offset the profit from another year. Instead, the plan requires payments for each crop year. Thus, each year stands alone and must be considered independently. As a result, the debtors are not permitted to offset their income from 1987 with the losses they sustained in 1988 and 1989."

Id. at 415 (quoting Weber v. Farm Credit Servs. of Mid-America, ACA, CIV No. L 92-49, 1993 WL 669430 (N.D. Ind. June 7, 1993) (mem.)).

230. *See* U.S. Tr. v. Farm Credit Bank of Omaha (*In re* Peterson), 152 B.R. 612, 613 (D. S.D. 1993).

231. *Id*.

232. *Id*.

233. *Id*. at 614.

234. *See In re* Wood, 122 B.R. 107, 116 n.11 (Bankr. D. Idaho 1990).

> Trustee's microscopic examination of Debtors' financial records of income and expenses causes him to claim there is over $218,000 in disposable income which should be distributed. However, in his review, all doubts have been resolved against Debtors on any arguable items, and his approach is extreme. For example, his disposable income calculations include non-cash items, such as a $10,411 "depreciation deduction" and a $14,522 "net operating loss carryover," and a variety of small dividends earned by Debtors, but not actually received on insurance and annuities. Much of the disparity focused upon by Trustee stems from his heavy reliance on budget and tax return figures, instead of actual receipts and disbursements.[235]

While motions to modify a confirmed plan under § 1229 provide an opportunity for adjustments to be made to a disposable income projection during the plan, absent significant changes to the debtor's situation, the debtor should not be forced to litigate issues that the creditor should have raised at confirmation.

F. Reliance on Trustee for Equitable Outcome

The published decisions on the issue of disposable income do not reflect the experience of all debtors. In jurisdictions with particularly conscientious and impartial trustees, the system can work well.[236] For example, in the district serving West Texas agricultural regions surrounding Lubbock, the trustee has received praise for his efforts.[237] Feasibility issues were thoroughly researched prior to confirmation, debtors were required to provide monthly reports, disposable income was calculated each year, and the debtor was allowed to retain funds for the following year's production costs.[238]

The trustee's efforts in performing duties in this manner are commendable, and the success of Chapter 12 cases in this area is undoubtedly a direct result. The difficulty, however, is that there is little to assure this outcome. Trustees are not required to perform

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235. *Id*.
236. *See infra* text accompanying notes 237-40 .
237. Letter from the Honorable Judge John C. Akard to Susan A. Schneider (Oct. 2, 2005) (on file with author) (describing the work of Chapter 12 Trustee, Walter O'Cheskey).
238. *Id.*

the proactive services needed to prevent end-of-plan problems, and in fact, as they are paid according to the percentage of payments received, some may feel an incentive to seek and find disposable income at discharge.[239] With federal circuit court case law such as Rowley and Broken Bow Ranch, Inc. as precedent, creditors and trustees may be empowered to act in a way that undermines the underlying purpose of Chapter 12.[240]

VI. Congressional Action to Revise the Disposable Income Requirement

As Congress debated overall bankruptcy reform, legislators with farming constituents also sought amendments to the Chapter 12 bankruptcy provisions.[241] Foremost among the changes sought were efforts to make Chapter 12 a permanent part of the Bankruptcy Code.[242] The problems associated with the disposable income requirement, however, were also the subject of early reform efforts.[243] As early as November 1999, Senator Russ Feingold succeeded in offering an amendment that would prevent courts from retroactively assessing actual disposable income.[244] This amendment provided the language that eventually made its way into law as part of the 2005 Bankruptcy Reform Act.[245] A press release that announced the amendment explained:

> Chapter 12 . . . is designed specifically to protect family farms. The amendment would strengthen these protections by prohibiting retroactive assessment of disposable income. To qualify for bankruptcy, a debtor must commit projected disposable income to pay unsecured debts. Some courts have started assessing these fees retroactively which is especially burdensome to farmers who need to make large advance payments for their next year's

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239. 11 U.S.C. § 586(e)(1) (2000).

240. *See supra* Part V.A-B.

241. *See* Susan A. Schneider, *Chapter 12 Sunsets, Caught in Political Battle*, AGRIC. L. UPDATE, Feb. 2004, at 3.

242. *Id*.

243. *See id*.

244. Feingold Amendment No. 2745 to Consumer Bankruptcy Bill, S. 625 (1999), 145 CONG. REC. S14125-03, S14171 (daily ed. Nov. 5, 1999), *available at* 1999 WL 1003530.

245. Press Release, Senator Russ Feingold, Feingold Wins Passage of Amendment to Protect Struggling Farmers (Nov. 9, 1999), *available at* http://feingold.senate.gov/~feingold/releases/99/11/ 991109b.html.

> operations. The Feingold amendment would allow courts to modify only future payments based on projected income. . . . We must make sure that farmers have enough income left over when they comply with their Chapter 12 plans to prepare for the next season's crops and livestock.[246]

Through years of debate, Senator Feingold's amendment tracked the reform legislation and was eventually enacted as § 1006 of the new bankruptcy reform law—Prohibition of Retroactive Assessment of Disposable Income.[247] This amendment combines changes to the Chapter 12 confirmation requirements with restrictions on the postconfirmation plan modification provisions.[248] The Collier Special Pamphlet analysis of the 2005 Act interpreted the amendment as follows:

> Sections 1225 and 1229 are modified to provide that the disposable income provisions are based on projected disposable income and that plan payment amounts may not be modified after such payments are due and may not be modified in the last year of the plan in a way that leaves the debtor insufficient funds to carry on the farming operation after the plan is completed.[249]

How the § 1006 changes accomplish the above result requires analysis. While the intent is clear, it was somewhat problematic to devise language that would accomplish this result.[250] Prohibiting creditors from objecting to discharge for failure to pay actual disposable income when projected obligations were satisfied would have been one possible approach.[251] Wisely, however, the drafters of the new language must have anticipated that this would have simply forced creditors to raise their objections prior to the discharge hearing, perhaps invoking § 1229 modification rights.[252] Creditors could seek to modify the plan after the fact, demanding actual disposable income at any point prior to discharge. Given the established precedent that seemed to favor creditors' rights to farm

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246. *Id*.

247. 2005 Bankruptcy Act, Pub. L. No. 109-8, § 1006, 119 Stat. 23, 187 (codified at 11 U.S.C. § 1225(b)).

248. *See id*.

249. Alan N. Resnick & Henry J. Sommer, *The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005: A Section-by-Section Analysis*, COLLIER SPECIAL PAMPHLET 30 (2005).

250. § 1006, 119 Stat. at 187.

251. Resnick & Sommer, *supra* note 249.

252. *Id.*

inventory without regard to concerns about the future operation of the farm, drafters were likely hesitant to offer this possibility to the courts. Therefore, the Legislature adopted a more complex solution.[253]

Under the new law, § 1225(b), the provision requiring disposable income payments in the event of an objection by an unsecured creditor or the trustee, is modified.[254] Three alternatives are offered to the debtor for confirmation.[255] The first two alternatives remain unchanged.[256] The debtor can pay the full value of the unsecured claims under § 1225(b)(1)(A).[257] As a second alternative, the original "projected disposable income" language is retained as § 1225(b)(1)(B).[258] A new third alternative is provided; the debtor's plan may provide that the "value of the property to be distributed under the plan . . . is not less than the debtor's projected disposable income."[259]

This change, and particularly the difference between the second and third alternatives, requires an understanding of the history of farm debtors' prior problems with courts' interpretation of disposable income. Under a literal interpretation of the unchanged second alternative, the payment of projected disposable income is all that was ever required of the debtor.[260] Drafters of the changes were faced with the odd task of forcing compliance with the projected income requirement in Chapter 12 to bring it in line with Chapter 13 interpretations of the same language.[261] Faced with this dilemma, providing the third alternative is ingenious. It allows the debtor's plan to provide that the value of property distributed not be less than the projected amount of disposable income as determined at

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253. § 1006, 119 Stat. at 187.
254. *See* Resnick & Sommer, *supra* note 249.
255. *Id*.
256. *Id*.
257. *Id*.
258. *Id*.
259. 2005 Bankruptcy Act, Pub. L. No. 109-8, § 1006, 119 Stat. 23, 187. The full provision is "the value of the property to be distributed under the plan in the 3-year period, or such longer period as the court may approve under section 1222(c), beginning on the date the first distribution is due under the plan is not less than the debtor's projected disposable income for such period." *Id*. (codified at 11 U.S.C. § 1225(b)(1)(c)).
260. *See* discussion *supra* Part II.
261. *See* discussion *supra* Part II. Changing the language of the second alternative in Chapter 12 could have had repercussions on the meaning of the unchanged language in Chapter 13. *See* discussion *supra* Part II.

confirmation.[262] This affirms the reliance upon projected income, mirroring the language used to address secured claims under § 1225(a)(5)(B)(ii): "the value . . . of property to be distributed . . . under the plan . . . is not less than the allowed amount of such claim."[263] In addition, by using the term "value," it offers the debtor the ability to provide for payment of the projected amount through a property distribution.[264]

Section 1006 of the new law also amends § 1229—Modification of Plan After Confirmation—to restrict changes to the plan once it has been confirmed.[265] This provision expressly provides that a debtor's obligations under a confirmed Chapter 12 plan may not be modified "to increase the amount of any payment due before the plan as modified becomes the plan."[266] Under this new provision, modifications will be allowed only to create new obligations for the future, capturing future income that is greater than that anticipated when the plan was originally confirmed.[267] This change will prevent courts from looking back to retroactively assess past disposable income obligations.[268]

Section 1006 also provides that no party except for the debtor can call for any increase based on disposable income that would "increase the amount of payments to unsecured creditors required for a particular month so that the aggregate of such payments

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262. *See* 2005 Bankruptcy Act, Pub. L. No. 109-8, § 1006, 119 Stat. 23, 187 (2005) (to be codified in 11 U.S.C. § 1225(b)(1)(c)).

263. *See* 11 U.S.C. § 1225(a)(5)(B)(ii) (2000).

264. 2005 Bankruptcy Act, § 1006. Section 321(c) of the 2005 Bankruptcy Act amends §1129(a) to include a new disposable income requirement for confirmation in individual debtor Chapter 11 cases. *See* 2005 Bankruptcy Act, § 321(c). This provision is similar, but not identical, to the new requirement in Chapter 12. *See id.* It provides that if the holder of an unsecured claim objects, either the plan must provide that the value of property to be distributed on account of such claim must be at least the amount of such claim, or it must be "not less than the projected disposable income of the debtor (as defined in section 1325(b)(2)) to be received during the 5-year period beginning on the date that the first payment is due under the plan, or during the period for which the plan provides payments, whichever is longer." *Id.* While interpretations of this provision in Chapter 11 individual debtor reorganizations could be helpful in interpreting the similar language in Chapter 12, it is likely that other confirmation problems for individual debtors may be more significant and thus receive more attention in the courts. *See supra* notes 24-26 and the accompanying text.

265. §1006, 119 Stat. at 187.

266. *Id*.

267. *See id*.

268. *See generally* discussion *supra* Part V.D (discussing issues encountered due to the courts' retroactive assessment practices).

exceeds the debtor's disposable income for such month."[269] This provision also prevents the court from being able to go back into the debtor's past, either at a discharge hearing or during the plan term to impose a new obligation that is greater than what the individual can presently afford to pay from disposable income that month.[270]

Finally, § 1006 provides that the plan may not be modified "in the last year of the plan by anyone except the debtor, to require payments that would leave the debtor with insufficient funds to carry on the farming operation after the plan is completed."[271] This provision emphasizes the importance of allowing the debtor sufficient income for the continuation of the farming operation, consistent with the definition of disposable income.[272]

These provisions should prohibit the type of retroactive accounting that has been undertaken by courts at discharge when courts have attempted to reconcile early projections with what the trustee or creditors argue is actual disposable income through litigation at discharge.[273]

VII. Implementation Suggestions

Given the changes to Chapter 12, debtors should propose Chapter 12 plans that reflect the literal interpretation of the projected

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269. § 1006, 119 Stat. at 187.

270. *See id*.

271. *See id*.

272. 11 U.S.C. § 1225(b)(2) (2000) (excluding from the definition of disposable income that "which is not reasonably necessary to be expended . . . for the payment of expenditures necessary for the continuation, preservation, and operation of the debtor's business"). One might question why the provision gives the debtor the authority to "require payments that would leave the debtor with insufficient funds to carry on the farming operation after the plan is completed." § 1006, 119 Stat. at 187. It could be that the drafters sought the maximum flexibility for the debtor in the critical final year of the plan, perhaps allowing the debtor to negotiate with a creditor that was willing to extend operating credit after the completion of the plan.

273. *See* discussion *supra* Part V.D. This issue has been complicated by the proposal and confirmation of plans that require the debtor to pay actual disposable income. *See* discussion *supra* Part V.D. Although these plans have been the direct result of judicial interpretation of the disposable income requirement as requiring actual accounting at discharge, if this is what the debtor's plan provides, the debtor will be bound to its terms regardless of the statutory change. *See* discussion *supra* Part V.D. Given the evidence that Congress intended to correct an erroneous interpretation of the law, one can argue that pre-existing plans that were silent as to the issue of actual or projected disposable income should be interpreted in a manner consistent with the new law. Taking this a step further, it might be possible for debtors to argue that they should be allowed to modify a plan calling for actual disposable income to bring it into conformance with the new language.

disposable income requirement. Whenever possible, all disputes regarding disposable income should be raised at the plan confirmation hearing, and a reasonable disposable income payment should be determined at that time. For judges who are concerned that this would produce an "absurd result," attention should be directed to the courts that have made such determinations in Chapter 13 cases involving farm debtors.[274] Similarly, courts can consider the feasibility analysis that is already required for confirmation as a model for assessing projected income and expenses.[275] The fixing of a certain sum as an obligation provides the debtor with a clear benchmark and the creditors with a defined expectation of payment.[276] Changes in income or expenses that occur during the plan term and that are significant should be addressed according to the modification provisions set forth in § 1229.[277] As shown by the difficulty presented with determining actual disposable income, it is predicted that the courts will find that the literal interpretation of the projected disposable income requirement now mandated by the 2005 Bankruptcy Reform Act will in fact be an easier and fairer standard to apply.

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274. *See, e.g.*, *In re* Edwards, No. 03-10018, 2004 WL 316418, at *12 (Bankr. D. Vt. Feb. 13, 2004) (mem.) (holding that the farm debtor's proposed Chapter 13 plan did not commit all of his projected disposable income to plan payments and denying confirmation); *In re* Schyma, 68 B.R. 52, 63 (Bankr. D. Minn. 1985) (holding that the farm debtors' proposed Chapter 13 plan committed all of their projected disposable income to plan payments, but denying confirmation on other grounds). In both cases, the courts were able to consider the financial information presented and make a reasonable assessment of projected disposable income. *See In re Edwards*, 2004 WL 316418, at *12; *In re Schyma*, 68 B.R. at 63.

275. *See, e.g.*, *In re* Novak, 252 B.R. 487, 492 (Bankr. D. N.D. 2000) (considering the debtor's cash flow and finding that the debtors' plan was not feasible).

276. *See* 11 U.S.C. § 1229 (2000).

277. *See id.*