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Reclamation law amendments

In response to heated controversy regarding administration by the Bureau of Reclamation of the Reclamation Reform Act of 1982, Congress adopted a relatively limited agenda of changes, signed into law by the President on December 22, 1987. The changes include:

1. The Bureau of Reclamation is required to conduct audits for compliance with reclamation law of all entities and operations that appear to exceed 960 acres. The audits are to be completed within three years.

2. All lands subject to extended recordable contracts (that is, recordable contracts executed prior to October 12, 1982, and extended pursuant to the provisions of the Reclamation Reform Act of 1982) are no longer exempt from full-cost pricing. Thus, railroad companies, oil companies and other owners of vast tracts of excess land subject to recordable contract, will now be subject to full cost pricing on all reclamation project water delivered to those lands. However, in almost every case, the lands have been and will continue to be leased to much smaller farming operations, usually of less than 960 acres. It will, therefore, generally be the tenants who will suffer the substantial increase in water cost resulting from this legislation.

3. If the Bureau of Reclamation in a subsequent review determines that the landowner has underpaid the amount due for reclamation project water, the underpayment will carry interest accruing from the date the required payment was due. The interest rate is to be determined on the basis of the weighted average yield of all interest-bearing marketable issues sold by the Treasury during the period of underpayment. (In other legislation signed into law the same day, Congress also authorized the IRS to treat any underpayment as income in the year the water was received. The subsequent payment of the underpayment and interest, according to the legislation, is *not* deductible in any year.)

4. New provisions were enacted that relate to revocable trusts. Under the legislation, lands placed in a revocable trust will generally be attributed to the landholding of the grantor (subject to certain exceptions).

New regulations implementing these provisions are anticipated from the Bureau of Reclamation. Furthermore, the Bureau is presently at work preparing "guidelines" for the purpose of interpreting the Reclamation Reform Act of 1982 and the various regulations promulgated thereunder. — *Kenneth J. Fransen*

Impact of the Budget Reconciliation Act

Rushing to meet the Christmas deadline, Congress adopted a budget reconciliation bill (Pub. L. No. 100-203, 12/22/87) which included a core agreement reached in the Congress–White House summit. By adopting the bill, across-the-board cuts under Gramm-Rudman were avoided, but the bill still included sizeable reductions, and in the case of agriculture, provided significant mid-course policy changes.

The two-year reduction is expected to total $2.5 billion for agriculture alone, with the bulk of the short-term savings coming from target price reductions and from an acreage limitation program for feed grains. The target price reductions for wheat, feed grains, cotton, and rice will total 1.4%, which will be over and above the scheduled reductions included in the Food Security Act of 1985. Milk received an assessment of 2.5 cents per cwt. which will be on top of the 50 cent support price reduction implemented January 1. Through FY 1989, the additional target price reductions and the dairy assessment are projected to save between $658 million and $695 million. As for the acreage limitation program for feed grains, the paid land diversion will be reduced from the current 15% to 10%, and the payment rate for corn will be reduced to $1.75 per bu. from the $2 rate paid in 1987. This adjustment is projected to save between $795 million and $860 million over two years.

Other policy revisions are as follows:

1) 0-92 option diversion program – the 50-92 program included in the 1985 Farm Act is amended for wheat and feed grains. Producers may retire their entire per-

(continued on next page)

mitted base acreage (total base acres minus the required set aside and voluntary paid diversion acres) and still receive 92% of their normal deficiency payment. There is a 50% limit on the amount of base acres that can be enrolled in any county, except disaster counties.

2) The Commodity Credit Corporation is required to find a total of $230 million in savings from expenditures for commercial storage, handling, and transportation for FY 1988 and 1989.

3) The discretionary 5% loan rate reduction authority given to the Secretary included in the 1985 Farm Act, is reduced to 3% for 1988. This reduction slows the growth of the spread between the loan rate and the target price for wheat, feed grains, cotton, and rice and aids in reducing deficiency payment outlays.

4) The program yield protection formula first adopted in a technical corrections bill after passage of the 1985 Farm Act is extended. No program payments can be made to a producer based on a program yield less than the new floor of 90% of his 1985 program yield.

5) Secretarial discretion to adjust county loan rates based on the national average loan price is limited to plus or minus 2%. Cotton and rice are not included.

6) The $250,000 limit on the amount of honey that can be placed in the loan is removed. The honey price support is slightly reduced through 1990.

7) Non-target price commodities, such as sugar, tobacco, peanuts, and wool, will have loan rate reductions of 1.4% or similar assessments. Soybeans will remain unchanged from the 1985 Farm Act assessments. Soybeans will remain unchanged from the 1985 Farm Act provisions which give the Secretary discretion to lower the support rate 5%.

8) New minimums for the farmer-owned reserve are established at 300 million bu. for wheat and 450 million bu. for feed grains.

9) Advance deficiency payments are established at no more than 50% nor less than 40% for wheat and feed grains and no more than 50% nor less than 30% for rice and cotton.

10) Wheat producers are eligible for 75% of their final Findley payments within 75 days of passage of this bill. The rest will be paid in July. Wheat producers at sign-up for the 1988 through 1990 crop years can elect to receive 75% of their final deficiency payments by December 15.

11) Significant reform of the $50,000 payment limitation was adopted, to be implemented by 1989. In an effort to eliminate the "Mississippi Christmas Tree" and "California PIC" organizational loopholes, Congress accepted the core of the Huckaby (D-La.) reform bill which limits the number of eligible entities to three in which a farmer can participate and receive payments. The dollar maximum will be $100,000 for a producer farming as an individual and participating in two additional farming corporations, or $75,000 if a farmer is only farming as a participant in three corporations. The key for eligibility is the determination of "actively engaged." With a couple of exceptions, eligible producers will have to make contributions of capital, equipment, or land and a substantial contribution of personal labor or active management. Troublesome issues involving past ASCS regulations on the financing rule as it related to family operations and custom farming are resolved.

Although agriculture policy decisions will continue to be budget-driven, with the possibility that new adjustments will have to be made, it is intended that this bill will incorporate the last major change in policy before the omnibus farm act is reauthorized in 1990. Certainly, it is unlikely that other major policy changes will be adopted during this election year.

- Chuck Culver

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Federal Register *in brief*

The following is a selection of items that have been published in the *Federal Register* in the last few weeks.

1. PSA; Certification of central filing system; Oklahoma. Dated Dec. 23, 1987. 52 Fed. Reg. 49056.

2. PSA; Certification of central filing system; New Mexico. Date Dec. 29, 1987. 53 Fed. Reg. 158.

3. CCC; Interest on delinquent debts; proposed rule. 52 Fed. Reg. 49028.

4. CCC; Milk price support program; interim rule. Effective date: Jan. 1, 1988; comments due: Mar. 7, 1988. 53 Fed. Reg. 107.

5. IRS; Income tax; taxable years of certain partnerships; temporary regulations. 52 Fed. Reg. 48994.

6. IRS; Passive activity losses and credits, investment interest, and personal interest limitations; allocation of interest expense among expenditures; public hearing on proposed regulations. Public hearing: Mar. 1, 1988, Washington D.C. 52 Fed. Reg. 49448.

7. IRS; Income taxes; taxable years of certain entities; temporary regulations. 52 Fed. Reg. 48524.

8. APHIS; Availability of environmental assessment and finding of no significant impact relative to issuance of permit to field test genetically engineered herbicide tolerant tobacco plants; notice. 52 Fed. Reg. 49457.

9. ASCS; Conservation Reserve Program; interim rule. Effective date: Jan. 11, 1988; comments due: Mar. 14, 1988. 53 Fed. Reg. 733.

10. ASCS; Section and functions of Agricultural Stabilization, State, County, and Community Committees; interim rule. Effective date: Dec. 23, 1987. 52 Feb. Reg. 48511.

11. FCA; Regulatory Accounting Practices – temporary regulations; loan policies and operations; loss sharing agreements. Effective date: Dec. 21, 1987. 52 Fed. Reg. 48673.

12. FCA; Organization; Farm Credit System Financial Assistance Corporation; Notice. Text of Charter and Articles of Incorporation of Financial Assistance Corporation. Dated Jan. 11, 1988. 53 Fed. Reg. 1679.

13. EPA; Worker protection standards for agricultural pesticides; notification to Secretary of Agriculture; proposed rule. Dated Dec. 30, 1987. 53 Fed. Reg. 1494.

14. SCS; Reservations in the conservation operations reconsideration and appeal procedures; final rule. Effective date: Jan. 21, 1988. 53 Fed. Reg. 1605.

- Linda Grim McCormick

STATE ROUNDUP

IOWA. *Security interests in farm program payments. In re Halls*, 79 Bankr. 417 (S.E. Iowa 1987) is a case that may have a significant impact on the financing of farm operations with federal farm program payments as collateral. The bankruptcy court rejected a secured creditor's claim to most of a debtor's farm program payments.

In 1986, the debtor had borrowed money from the FDIC's predecessor bank and had given a security interest specifically covering:

> entitlements and payments from all state or federal farm programs, whether now owned or existing or hereafter existing or acquired; . . . and the proceeds of any government farm program.

The court distinguished between payments earned in 1986 and 1987. Federal regulations concerning the procedure for assigning farm program payments provide that assignments can not be made to secure preexisting indebtedness. 7 C.F.R. Part 709. The court concluded that the FDIC had no right to 1987 program payments since the FDIC provided no financing for the 1987 crop. The court noted that the FDIC could have a claim for cash benefits earned in 1986, whether paid in 1986 or 1987.

The court also concluded that because the regulations provided that generic commodity certificates are not assignable, the FDIC did not have a security interest in any benefits paid in the form of certificates, ruling that "the certificates cannot be encumbered by nongovernment creditors."

The creditor in *Halls* argued that the "no assignment-no security interest" theory was contrary to the decision of the Eighth Circuit in *In re Sunberg*, 729 F.2d 561 (1984) as to the purpose of the assignment procedures, but the court ruled that *Sunberg* was "inapposite" because it dealt with an earlier version of the regulations. The court went on to conclude that state commercial law would have to bow to federal law governing farm program payments because of the supremacy clause.

The result in *Halls* is subject to criticism for several reasons, but most significantly for the failure to recognize a difference between use of the assignment procedures set out by federal regulation and the availability of state commercial law to control the treatment of security interests in farm program benefits. While perhaps perceived as a pro-farm debtor decision, the result of *Halls* may be an inability to use most federal farm program benefits as collateral to secure farm debt. — *Neil D Hamilton*

MONTANA. *Bureau of Indian Affairs distribution of irrigation project water.* The Flathead Irrigation Project in Montana is operated by the Bureau of Indian Affairs (BIA), which supplies water to farmers irrigating agricultural land. The project serves both Indian and non-Indian agricultural users.

In developing a water allocation plan for the irrigation system in 1986, the BIA established a strategy that provided greater protection for tribal fisheries than it had in the past. The non-Indian irrigators, through a joint board of control for the irrigation districts serviced by the project, brought suit alleging that the BIA had abused its discretion by failing to give consideration to the rights and interest of all of the irrigators in determining a water distribution strategy, and by inequitably distributing the water supplies of the project. The United States District Court for the District of Montana granted a preliminary injunction prohibiting the BIA from implementing the plan or any plan which failed to consider the rights of any interested party. The tribes appealed to the Ninth Circuit Court of Appeals

In reversing the District Court, the Ninth Circuit, in *Bd. of Control of Flathead, et al. Irr. D. v. U.S.*, 832 F.2d 1127 (1987), held that farmers irrigating agricultural land from the reservation water supply were not entitled to participate in a process by which the BIA and the tribes initially established quantification of the tribes' fishery rights, and thus neither the Bureau nor the tribes are subject to the duty of fair and equal distribution of reserved fishery waters; only after fishery waters are protected does the BIA, acting as the office in charge of an irrigation project, have the duty to distribute fairly and equitably remaining waters among irrigators of equal priority.

One result of the case is that to the extent that tribes enjoy treaty protected aboriginal fishing rights, the tribes are entitled to prevent other appropriators from depleting waters below protected fishery levels. — *Donald D. MacIntyre*

PENNSYLVANIA. *Farm liability insurance – exclusion of employees.* In the case of *State Auto. Ins. Ass'n v. Anderson*, 528 A.2d 1374 (1987), a neighbor was injured while loading silage on the farm owned by the insured. In the past, the neighbor had done some work for the farmer. On this occasion, no indication was made to the neighbor that he would be paid for his work.

After the injury, the farmer submitted a claim on his "Farmer's Comprehensive Personal Insurance" policy. The insurance company denied the claim, referring to a policy provision that excluded coverage for "bodily injury to any farm employee if the bodily injury arises out of and in the course of his employment with the insured. . . ." The term employee was not defined in the policy.

In the farmer's subsequent declaratory judgment action, the trial court found that the company had no duty to defend the claim. At the trial in the lower court, the farmer testified that he had understood that the policy would cover his liability in the case of an accident such as this; if, however, the neighbor had been a "regular employee", he would need to obtain workmen's compensation insurance.

On appeal, the farmer argued that the exclusion was ambiguous and the company should be precluded from denying coverage on those grounds. The farmer also argued that the neighbor was not an "employee" at the time of the injury and, therefore, the exclusion should not apply.

In discussing the applicability of the exclusion, the appellate court observed that the insurer's subjective intent to exclude from coverage all persons remuneratively engaged in farming operations would not control the interpretation of the contract. If there was not an actual or literal understanding of the obligations of a contract, then it is that which a reasonable person in similar circumstances understands these obligations to be that will control. Since the insurance company drafted the contract, interpretation of the clause should favor the person who did not draft it. The proper focus with regard to coverage is the reasonable expectation of the insured, citing *Collister v. Nationwide Ins. Co.*, 479 Pa. 579, 388 A.2d 1346, 1353-54 (1978).

The salesman's discussions with the farmer influenced the farmer's expectations regarding coverage of this policy. The farmer's understanding of the terms "employee" and "farm employee" were also influenced by custom and practice in the rural farm community. In light of these elements, the conclusion that, as a matter of law, the company had no duty to defend the claim was incorrect.

The order granting summary judgment was vacated and the case was remanded to the lower court.

— *John C. Becker*

(continued on page 6)

Some Observations on the Chapter 12 "family farmer" concept

by Julia R. Wilder

Introduction

Chapter 12 of the Federal Bankruptcy Code is entitled "Adjustment of Debts of a Family Farmer with Regular Annual Income." 11 U.S.C. § 1201 *et seq.* (West Supp. 1987). In order to obtain the specialized relief that Chapter 12 provides to debt-ridden farmers, a farm debtor must meet the Chapter 12 definitional requirements of "family farmer," "farming operation," and "regular annual income." 11 U.S.C. § 101. This article discusses some important court interpretations of these definitions.

"Family farmer" is the key

The ability of Chapter 12 to provide effective relief to victims of the recent farm economy depression has been briskly challenged by creditors who have filed motions to dismiss alleging that the debtor does not qualify as a "family farmer." 11 U.S.C. § 101(17) (West Supp. 1987). Thus, the "family farmer" definition has emerged as the threshold test facing the farmer-debtor in the pursuit of a confirmed Chapter 12 plan.

Under Chapter 12, a "family farmer" is defined as:

> (A) an individual and spouse engaged in a farming operation whose aggregate debts do not exceed $1,500,000 and not less than 80 percent of whose aggregate noncontingent, liquidated debts (excluding a debt for the principal residence of such individual or such individual and spouse unless such debt arises out of a farming operation), on the date the case is filed, arise out of a farming operation owned or operated by such individual or such individual and spouse, and such individual or spouse receive from such farming operation more than 50 percent of such individual's or such individual and spouse's gross income for the taxable year preceding the taxable year in which the case concerning such individual or such individual or spouse was filed; or
>
> (B) a corporation or partnership in which more than 50 percent of the outstanding stock or equity is held by one family, or by one family and the relatives of the members of such family, and such family or such relatives conduct the farming operation, and
>
> (i) more than 80 percent of the value of its assets consist of assets related to the farming operation;
>
> (ii) its aggregate debts do not exceed $1,500,000 and not less than 80 percent of its aggregate, noncontingent, liquidated debts (excluding a debt for one dwelling which is owned by such corporation or partnership and which a shareholder or partner maintains as a principal residence, unless such debt arises out of a farming operation), on the date the case is filed, arise out of farming operation owned or operated by such corporation or such partnership; and
>
> (iii) if such corporation issues stock, such stock is not publicly traded.
>
> 11 U.S.C. § 101(17).

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It should be noted that the fifty percent income requirement is imposed upon the "individual" family farmer, with no corresponding income requirement imposed upon the corporate or partnership family farmer entity. Instead, a rigid requirement is imposed upon the corporation or partnership that eighty percent of its assets be "related to the farming operation." Presumably, the explanation for this discrepancy is that the gross income test would not be a meaningful indicator for corporate or partnership family farm entities because the test could take into account the diversified (non-farming) interests of a corporation or the personal interests of the partners.

Aside from the income and assets requirements, a key term included in the "family farmer" definition is "farming operation." 11 U.S.C. § 101(20). A farming operation "includes farming, tillage of the soil, dairy farming, ranching, production or raising of crops, poultry, or livestock, and production of poultry or livestock products in an unmanufactured state." 11 U.S.C. § 101(20).

If the threshold "family farmer" requirement of 11 U.S.C. section 101(17) is met (which includes the "farming operation" requirement), the farmer-debtor may file a petition for relief under Chapter 12. Before the plan is confirmed, the "family farmer" must establish the requisite "regular annual income," which is defined as income that is "sufficiently stable and regular to enable such family farmer to make payments under a plan under Chapter 12." 11 U.S.C. § 101(18). Generally, the requisite financial information about the debtor will be collected and/or verified at the creditor's committee meeting. 11 U.S.C. § 341. In particular, the trustee presiding at the meeting will examine the debtor regarding information contained in the schedules filed in the case. If the debtor can meet the requirements of 11 U.S.C. section 101(18), the plan would be eligible for confirmation. The determination of whether a "family farmer" debtor has adequate annual income to fund the plan is made at the confirmation hearing. *See In re Welch*, 74 Bankr. 401, 405 (Bankr. S.D. Ohio 1987).

The term "family farmer" is a new term in the Bankruptcy Code. Pub. L. No. 99-554, § 251, 100 Stat. 3104 (1986). It defines a special sub-category of "farmer," a term which was introduced into federal bankruptcy law in 1898. 30 Stat. 544. Prior to the enactment of Chapter 12, farmer-debtors engaged in bankruptcy proceedings had to meet the requirements imposed by section 101(17) ("farmer") and section 101(18) ("farming operation"). Both of these definitions remain intact after the advent of Chapter 12. However, the "family farmer" requirement of section 101(17) supercedes the previous "farmer" requirement of section 101(17) (now section 101(19)) for the purpose of qualifying a farmer for Chapter 12 relief. The distinction between these key threshold terms – "farmer" and "family farmer" – indicates Congressional intent to limit Chapter 12 relief to debtors who actively operate relatively small-scale (and relatively high risk) farming operations, whether they are operated as a sole proprietorship (including a husband and wife "sole proprietorship"), 11 U.S.C. § 101(17)(A), or as a corporation or partnership. 11 U.S.C. § 101(17)(B). Congress enacted the "family farmer" provision to "ensure that only family farmers – not tax shelters or large corporate entities – will benefit." 132 Cong. Rec. S15076 (daily ed. Oct. 3, 1986) (statement of Sen. Grassley).

The "farming operation"

As stated above, a "family farmer" must satisfy the "farming operation" definition. The cases under Chapters 7, 11, and 13 which construe the terms used in Chapter 12, or analogous terms, are instructive for purposes of interpreting the scope, or suggested scope, of Chapter 12 terminology. In Chapter 11 cases which have construed "farming operation," the "risk-laden" nature of farming has frequently been the criterion applied. For example, in *Armstrong v. Corn Belt*

Bank, 55 Bankr. 755 (Bankr. C.D. Ill. 1985), the debtor had ceased active farming and had cash leased his land when a creditor began involuntary bankruptcy proceedings against him. The court held that since the debtor received cash rent on an unconditional basis, he did not bear any risk and therefore was not engaged in a farming operation. The court stated that the term "farmer" in the Bankruptcy Code indicates Congressional intent "to protect only those whose income is derived from operations that are subject to climate, farm price fluctuation, and uncertain crop production." 55 Bankr. at 761.

The issue of risk has also been a key criterion applied by the courts to the "farming operation" issue in Chapter 12. For example, in *In re Mary Freese Farms, Inc.*, 73 Bankr. 508 (Bankr. N.D. Iowa 1987), Chapter 12 protection was denied to a corporate debtor whose sole source of revenue was cash rent from farmland. The *Mary Freese* court found that the necessary "risk" was lacking because the debtor-landlord under the cash lease arrangement was protected by a statutory crop lien. *Id.* at 510. Interestingly, the *Mary Freese* court did allude to the possibility of recognizing a non-participatory lease as a phase of farming when it noted its consideration of the fact that there was "no evidence that any family member intends to engage in any farming operation in the foreseeable future." 73 Bankr. at 509.

In *In re Tim Wargo & Sons, Inc.*, 74 Bankr. 469 (Bankr. E.D. Ark. 1987), the court's opinion undermines the notion that the risk factor is solely determinative of the "farming operation" issue. In *Wargo*, after the Wargo family had personally farmed 440 acres of farmland for many years, they leased the land to a tenant farmer under a one-fourth crop share agreement. The farm was leased when the bankruptcy petition was filed. The *Wargo* court stated that "the fact that an entity derives its income from an activity that is subject to the same risks faced by farmers does not necessarily determine that such activity constitutes a 'farming operation.'" *Id.* at 473-74. The *Wargo* opinion was based on the court's finding that the debtor had relinquished control over the manner in which the tenant operated the farm and therefore did not have an active role in the farming operation. 74 Bankr. at 473. To the extent that the risk standard was applied, the debtor was found to be insulated from the risks of financial loss associated with farming since Arkansas law provides the debtor-landlord with a statutory lien for rent against the crops. 74 Bankr. at 474, n. 6.

Some courts have recognized that, irrespective of the issue of risk, farmers have traditionally leased part or all of their land and farming operations to others. *See, e.g., First National Bank & Trust Co. v. Beach,* 301 U.S. 435 (1937), *quoted in In re Maike,* 77 Bankr. 832, 837 (Bankr. D. Kan. 1987). In *Beach,* the court observed that "acres personally cultivated and those occupied by tenants are phases and aspects of a unitary calling." *Id.* at 440. While the facts in *Beach* involved a person who was actively farming one-fourth of his land and renting the remainder to other farmers, the court's reasoning suggests a liberal application to facts such as those in which, although a farmer has ceased farming, he remains committed to farming by perpetuating the activity as a lessor. *Id.*

Liberal relief for family farmers

While some courts have limited the scope of Chapter 12 through a restrictive interpretation of "farming operation," others have used their substantial equity powers to more liberally promote the extraordinary, and temporary, objects of Chapter 12. Such courts have adopted a stance more sympathetic to the needs and circumstances of financially-stressed farmers. These courts appear to be more familiar with how farms operate and are able to more accurately construe the scope of activities pursued by a "family farmer" or in a "farming operation." This knowledge includes familiarity not only with how farms traditionally operate in times of relative prosperity but also recognizes the warranted adjustments that farmers are forced to make during times of financial stress.

Courts taking this approach have determined that a cut back or "farming out" of crop or livestock production constituted either (1) the reality of traditional farming in certain parts of the country, or (b) special efforts being made by a farmer to survive the "farm crisis." This is important because many of the Chapter 12 cases present facts which reasonably might suggest an abandonment of farming or a diversification into non-farming sources of income. Two separate non-Chapter 12 opinions from the district of Minnesota are illustrative. In the first of these cases, *In re LaFond,* 791 F.2d 623 (8th Cir. 1986), the court of appeals recognized that the requirement that debtors meet the eighty percent test in the Chapter 7 Code definition of "farmer" would unfairly preclude many debtors legitimately engaged in farming from utilizing the section 522(f) lien avoidance remedy in the manner Congress intended. The court affirmed the view, espoused and held by both the bankruptcy and district courts below, respectively, that

> [a] more realistic definition [of farmer] should take into account the intensity of a debtor's past farming activities and the sincerity of his intentions to continue farming, as well as evidence that [the] debtor is legitimately engaged in a trade which currently and regularly uses the specific implements or tools exempted and on which lien avoidance is sought.

791 F.2d at 626.

The debtors had successfully moved to avoid a lien of the local PCA on certain large items of farm equipment. The PCA appealed the affirmation by the district court, arguing that the LaFonds did not qualify as farmers for the reasons that (a) they lost money farming, and (b) Mr. LaFond's primary occupation was as a policeman.

The court found sufficient evidence to support the conclusion that Mrs. LaFond was engaged in the trade of farming and that, notwithstanding the fact that Mr. LaFond derived income from outside employment, the debtors were making a bona fide effort to earn a living as farmers. The court observed that, "[g]iven the economics of small-farm agriculture under the harsh climatic conditions of Northeastern Minnesota, it is nearly impossible for most farmers to subsist without outside employment." 791 F.2d at 626.

Similarly, in *Middleton v. Farmers State Bank of Fosston,* 45 Bankr. 744 (Bankr. D. Minn. 1985), the court denied the debtors' request, pursuant to 11 U.S.C. section 522(f)(2)(B), to avoid certain non-possessory, non-purchase money liens held by a bank on the debtors' farm machinery and equipment. On appeal, the judge remanded the case to determine whether the appellants were farmers, i.e., either that they were farming at the time they filed the complaint or *that they intended to farm again in the future.* (emphasis added). 45 Bankr. at 747.

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The debtors in *Middleton,* wife and husband, began farming in early 1974. The court found that both debtors had been actively engaged in the farming operation as equal partners. Because of financial losses, the husband was forced to assume off-farm employment in 1983. The wife remained "on the farm as a farmer" up until the livestock and farm equipment were auctioned. The husband testified that farming was his preferred means of earning a living and that if at all possible he intended to resume farming in the future. 45 Bankr. at 746.

Addressing the section 101(17) definition of "farmer," the court stated that "one may be a farmer without meeting the defined requirements. 45 Bankr. at 747. The standard to be applied is that the debtor "must be engaged in farming at the time the exemption is claimed or *have a present intent to continue farming at some point in the future."* (emphasis added). *Id.* The court emphatically stated:

> If the 80% income was the only test, many debtors legitimately engaged in farming could be excluded from taking advantage of the needed benefits. They would be deprived of the benefits afforded to farm debtors by the Code because they are hardworking and produce income for (sic) sources other than farming. Each case must be judged upon its own particular facts and circumstances.
> 45 Bankr. at 747.

In comparison, the court in *Matter of Haschke,* 77 Bankr. 223 (Bankr. D. Neb. 1987), viewed the debtors' actions in a manner which precluded examination of the debtors' future plans. In *Haschke,* on the date the Chapter 12 petition was filed, all of the debtors' farmstead was leased to others, except their personal residence. They also had sold all of their farm equipment and were therefore physically incapable of farming. They were strictly engaged in receiving cash rent for their land. The only link with crops maintained by the debtors was that they were still storing and marketing crops that they had produced. The court held that the mere marketing and storing of crops does not constitute "production or raising of crops" pursuant to section 101(20). 77 Bankr. at 225. Thus, the debtors were deemed to have abandoned or ceased farming.

Chapter 12 cases have held also that the scope of "family farmer" and "farming operation" definitions must be liberally construed in order to properly administer Chapter 12. In *In re Welch,* 74 Bankr. 401 (Bankr. S.D. Ohio 1987), creditors challenged whether the debtors met the income requirements of 11 U.S.C. section 101(17)(A) at the date of filing the petition. The court determined that the debtors were qualified "family farmers" at the time they filed their petition by examining the debtors' activities over a course of years prior to the filing of the petition. The court recognized a certain "equity" in the fact that the debtors had engaged in dairy and grain farming for nearly fifteen years. Thus, they were found to have worked as farmers, working their own farmland and suffering the financial distress common to many farmers. That put them within the class of farmers for which Congress designed Chapter 12.

In *In re Maike,* 77 Bankr. 832 (Bankr. D. Kan. 1987), the bankruptcy court held that Chapter 12 debtors who derived a majority of their income from the breeding, raising, and sale of puppies were family farmers. In order to carry out the legislative intent that fueled the enactment of Chapter 12, the court applied a "totality of circumstances" test to determine the existence of a "farming operation." 77 Bankr. at 839. The court applied that test so as not to limit relief to farm enterprises that fall within a "single test of farming." *Id.* Instead, the court reasoned, Chapter 12 should afford relief to enterprises that reflect modern changes in agricultural enterprises. Thus, analogizing the debtor's business enterprises to a cattle feedlot, the *Maike* court stated that "if feeding and maintaining other people's cattle for ultimate resale is a farming operation, the same services performed with respect to dogs should also be considered farming." *Id.*

Maike sets forth an analytical method in which nontraditional activity will be characterized as a "farming operation" if it is reasonably analogous to any of the traditional farming operations prescribed in the Code. Therefore, the type of produce and its eventual market should be a factor in defining the farming operation. 77 Bankr. at 839. The court recognized that many farmers are beginning to diversify by growing crops not traditionally associated with farming in the state of the court's location. The court should not eliminate those products from the "farming operation" definition. *See* 77 Bankr. at 839.

"Regular annual income"

As stated earlier, the "regular annual income" requirement of Chapter 12 is relevant to the confirmation of the plan, and is not a threshold requirement to be satisfied at the time the petition is filed. *In re Hoskins,* 74 Bankr. 51 (Bankr. C.D. Ill. 1987) examined the income requirement imposed by the section 101(18) definition of "family farmer with regular annual income." 11 U.S.C. § 101(18). The issue was of first impression. Noting that the language of Chapter 12 is similar, if not identical, to the language employed in the analogous definition in Chapter 13, 11 U.S.C. § 101(29), the court stated that the meaning of section 101(18) can be determined by examining the meaning of section 101(29). 74 Bankr. at 53. In Chapter 13, the debtor is allowed to use various sources of income, including wages and income from property and capital, to meet the test. The court held that the Chapter 12 debtor should be similarly accommodated. Thus, in making the determination of whether the Chapter 12 debtor has sufficiently stable and regular income, the income to be calculated should include income from both farming operations and non-farming sources. *Id.*

Conclusion

The Chapter 12 debtor must meet the definitional requirements of "family farmer," "farming operation," and "regular annual income," in order to obtain a confirmed plan. As suggested by the above, meeting each of these requirements will likely present unique challenges in each Chapter 12 case.

State Roundup continued

CALIFORNIA. *Hazardous waste.* Recent legislation has added section 25359.7 to the California Health and Safety Code, requiring the owner of non-residential real property to give written notice of the release of hazardouse substances to any buyer prior to the sale of the property. Failure to abide renders the seller liable for actual damages and, if the failure was knowing and willful, a civil penalty of up to $5,000 for each separate violation. The new section also imposes on the lessee or renter of *any* real property an obligation to notify the owner that any hazardous substance has come to be located on or beneath the real property. Failure by the lessee or renter to give this notice makes the lease or rental agreement voidable by the owner (if the property is nonresidential), and if the failure is knowing and willful, a civil penalty of up to $5,000 for each separate violation.

– Kenneth J. Fransen

Lael's Law:
Hindsight is always 20/20.

Agricultural Credit Act of 1987

Late in December, 1987, Congress enacted a farm credit law which works a ubstantial revision on the organization and financing of the Farm Credit System and the Farmers Home Administration. The Act is lengthy and detailed – too long to cover adequately here – but all lawyers whose work touches on either the FCS or the FmHA will find it necessary to give this 160 pages close study.

By way of background it will be remembered that Congress sought to cure the apparent ills of the FCS when it enacted the Farm Credit Act Amendments of 1985. That legislation created, among many changes, the Farm Credit System Capital Corporation which was to issue debt obligations, the proceeds from which would be used to acquire bad loans from FCS banks. The debt obligations were to be acquired by system banks as a device for spreading the burden of bad loans over the System. Also, when the FCS declared that it had committed its available capital surplus and reserves to relief of distressed banks in the System, the Treasury could then acquire debt obligations of the FCS Capital Corporation. The Act further authorized the FCA to establish minimum levels of capital for each system bank, and to intervene in bank operations if necessary o assure avoidance of unsafe and unound banking practices.

Congress has now characterized the 1985 Act as a "self-help" program that has been "less than successful," and declared its acceptance of "the inevitability of Federal financial assistance to the Farm Credit System." It replaces the FCS Capital Corporation with a Farm Credit System Assistance Board (FAB) which has a limited-life and is to be the vehicle for delivering federal assistance to banks in the FCS system. The FAB is a separate supervising board which will receive applications for financial assistance from System banks or associations. Assistance will usually take the form of an authorization to issue non-dividend-bearing preferred stock, but in exchange the FAB has authority to prescribe management practices for the bank and to "take such other action as the Assistance Board determines may be necessary." Congress has declared that this authority includes removal of management. The preferred stock issued by distressed FCS banks will be acquired by a third entity – the Financial Assistance Corporation (FAC) – which will raise its capital by mandatory stock sale to member banks and (mostly) through he issuance of securities guaranteed by ne United States, which will also pay the interest due for the first five years.

Whereas the FAB and the FAC are to provide the bailout mechanisms, permanent financial restructuring is offered by creation of an FCS insurance pool to backstop System securities. This Farm Credit System Central Reserve Account (Central Reserve) is patterned after the FDIC, and will function to assure timely redemption of System securities purchased by investors. It is hoped that the reserve will allow for expeditious action in dealing with problem institutions. The Central Reserve will be part of the FCA and funded by assessment of the member banks.

A fundamental change in agricultural finance is the establishment of a secondary market for agricultural loans – the Federal Agricultural Mortgage Corporation – but to be known inevitably as Farmer MAC. It is modeled after FNMA and the Student Loan Marketing Association and will be owned by and serve all financial entities which originate and pool agricultural loans. The reader is aware of the important functions that secondary markets offer in such fields as residential housing and student loans, and there is no need to redraw the diagram here. Certain policy-makers have been urging the charter of such a market for years, and it will be interesting to observe whether investors find agricultural loans attractive, and whether the perceived advantages of secondary financing attract new sources of capital to the agricultural sector. Some concern is expressed in the legislative history that a secondary market will create competitive pressures too great for the FCS to withstand. Whether there is substance to this concern cannot be forecast, but it is likely that as Farmer MAC develops and issues its regulations, it will be a significant influence on agricultural financing during the coming years. At the very least, it's regulations will dictate the form and some of the substance of agricultural loans.

The Act also spells out a number of FCS duties which are intended to benefit borrowers directly, and which Congress sometimes refers to as "borrowers rights". Loan restructuring is required where a lender determines that the potential cost of restructuring the loan is less than or equal to the potential cost of foreclosure. Borrower-owned stock is guaranteed until the FCS has completed its recapitalization. Member banks are forbidden to foreclose on a borrower who has met all loan terms but has been asked to post additional collateral or reduce principal. When a borrower suffers foreclosure or voluntary liquidation, member banks take title subject to a right of first refusal in the original borrower. Other specific provisions for borrowers require disclosure of information by banks; notice of various actions by banks, and explanation of methods of calculating interest rates.

This legislation also contains a number of provisions dealing with FmHA financing and rewrites important parts of the Food Security Act of 1985. A long list of specific provisions deal with points that have been the subject of contention between FmHA and its borrowers. There is an attempt to put a cap on the *Coleman* litigation by requiring that FmHA borrowers receive written notice of all loan service programs available to assist financially distressed farmers. There are provisions dealing with additional collateral, appeals, right to information, income release, interest rate reduction programs, homestead protection, debt restructuring and others.

– *John H. Davidson*

Editor's Note

Prof. Neil Hamilton of Drake University has prepared a lengthy discussion of some aspects of the Agricultural Credit Act of 1987. Interested parties may contact Prof. Hamilton at Drake University Law School, Des Moines, Iowa 50311 for a copy.

AG LAW CONFERENCE CALENDAR

Ninth Annual AALA Conference and Annual Meeting.
Oct. 13-14, 1988. Crown Westin Center, Kansas City, MO.
Annual meeting and educational conference of the American Agricultural Law Association. Details to follow.
Reserve these dates now.

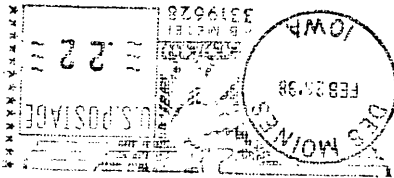
Ninth annual immigration law conference.
Mar. 17-18, 1988. Loew's L'Enfant Plaza Hotel, Washington, D.C.
Sponsored by the Federal Bar Association.
For more information, call Phyllis Kornegay at 202-638-0252.

Fourteenth annual seminar on bankruptcy law and rules.
Mar. 24-26, 1988. Marriott Marquis Hotel, Atlanta, GA.
Topics include: lender liability, Chapter 12, and partnership bankruptcies.
Sponsored by the Southeastern Bankruptcy Law Institute, Inc.
For further information, contact Myra Bickerman, 404-396-6677.

Agricultural labor-management developments 1988.
Mar. 4-5, 1988. The Dickinson School of Law, Carlisle, PA. Topics include: immigration reform, migrant and seasonal worker housing, and civil liability exposures of the farm owner.
Sponsored by The Dickinson School of Law and others.
For more information, call 717-243-4611, ext. 286.

USDA agricultural biotechnology conferences.
Mar. 28-30, 1988. John Ascuaga's Nugget Hotel, Reno, NV.
Apr. 18-20, 1988. Hyatt Regency, New Brunswick, N.J.
May 16-18, 1988. Minneapolis-St. Paul Airport Hilton, Minneapolis, MN.
For further information, call 202-447-8181 or 202-447-2798.

Address Correction Requested



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AMERICAN AGRICULTURAL LAW ASSOCIATION NEWS

Dues reminder: By now all members should have received a dues statement. If you have not received yours, you should send your dues directly to Mason E. Wiggins, Jr., Secretary-Treasurer, American Agricultural Law Association, Heron, Burchette, Ruckert & Rothwell, Suite 700, 1025 Thomas Jefferson St., N.W., Washington, D.C. 20007. The dues schedule is: regular membership, $45; student membership, $20; sustaining membership, $75; institutional membership, $125; and foreign membership (outside U.S. and Canada), $65. Please include any change of address or correction with your dues.

Membership Drive: An application form came with your dues statement. Please give it to a potential member.

1988 Writing Competition. Professor John Becker, Department of Agricultural Economics, Penn. State University, University Park, PA 16802 is in charge of the 1988 American Agricultural Law Association Writing Competition. Inquiries about the competition should be addressed to him.