

Supreme Court allows Chapter 13 after Chapter 7 discharge

The United States Supreme Court recently resolved a split in the circuits on the issue of whether a mortgage obligation that survives a Chapter 7 bankruptcy discharge can be reorganized in a subsequent Chapter 13 bankruptcy. Justice Marshall, writing for a unanimous Court, held that under the applicable bankruptcy law, a mortgage obligation was a "claim" and as such, could be restructured under a Chapter 13 plan, provided that other Chapter 13 requirements are met. *Johnson v. Home State Bank*, 111 S. Ct. 2150 (1991).

The facts in *Johnson* involved farm property that was mortgaged to the Home State Bank. After the mortgagor, Mr. Johnson, defaulted on his promissory notes to Home State, the bank initiated foreclosure proceedings. While these proceedings were pending, Johnson filed for relief under Chapter 7 of the Bankruptcy Code and eventually received a discharge. Although this discharge relieved Johnson of personal liability on his notes to the bank, the bank's *in rem* right to proceed against the farm pursuant to the mortgage obligation survived. 11 U.S.C. § 522(c)(2). Accordingly, after the automatic stay was lifted, the bank reinitiated foreclosure proceedings. After state court litigation, the bank eventually obtained an *in rem* judgment against the mortgaged property. A foreclosure sale pursuant to the *in rem* judgment was scheduled, but prior to this sale, Johnson filed for relief under Chapter 13 of the Bankruptcy Code. Although Johnson's first reorganization plan was rejected by the bankruptcy court as not feasible, Johnson went on to file an amended plan that treated the mortgage as a claim against the estate and proposed a payment plan equal to the bank's *in rem* judgment. The Bankruptcy Court confirmed this amended plan, over the bank's objection.

Home State Bank appealed the plan confirmation to the United States District Court. The bank presented alternative arguments. First, the bank argued that the Bankruptcy Code does not allow a debtor to use Chapter 13 to reorganize a mortgage obligation for which personal liability has been discharged. Chapter 13 provides for the reorganization of creditors' claims against the debtor. The bank contended that because the debtor's personal liability had been discharged, it no longer held any claim that could be reorganized. Second, the bank argued that Johnson's plan had not been filed in good faith and that it was not feasible.

The District Court reversed the Bankruptcy Court and ruled that the Bankruptcy Code did not permit Johnson to reorganize the obligation to the bank. *In re Johnson*, 96 Bankr. 326, 327-30 (D. Kan. 1989). It found that Chapter 13 authorizes the reorganization of "claims" and then noted that the Code defines a "claim" as a "right to payment." *Johnson*, 96 Bankr. at 330 (citing 11 U.S.C. § 101(4)). The court

Continued on page 2

8th Circuit rules on Chapter 12 requirements for livestock operations

An area that has not previously produced reported appellate case law, but involves a fundamental issue for livestock operations, is the lien retention requirement of the section 1225 confirmation standards. This issue was addressed in the Eighth Circuit case of *In re Hannah*, 912 F.2d 945 (8th Cir. 1990). The court contrasted the "cramdown powers" of the Ch. 12 debtor with the rights of a secured creditor with an interest in the debtor's livestock.

Section 1225(a)(5) sets forth the requirements for plan confirmation. A Ch. 12 plan that provides that the debtor retain possession of secured property cannot be confirmed without secured creditor approval unless the plan provides that the holder of a secured claim "retain the lien securing such claim." The court interpreted this requirement with regard to a creditor's interest in the debtor's livestock herd.

The objecting creditor in *Hannah* called for a literal reading of section 1225, that

Continued on page 2



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INSIDE

- Bibliography of ag law articles
- Bankruptcy setoffs of federal farm program payments
- Conference Calendar
- Postponement of US/USSR Conference
- State Roundup

IN FUTURE ISSUES

- The problem of non-UCC liens on agricultural collateral
- Trade secrets in biotechnology products and reverse engineering

reasoned that when a mortgage obligation is discharged, only the lien is retained. There is no longer any right to payment, only a right to the property. Thus, the mortgagee no longer holds a "claim" capable of reorganization and is no longer a creditor of the debtor. *Id.*

The Court of Appeals affirmed. *In re Johnson*, 904 F.2d 563 (10th Cir. 1990). This affirmance created a split in the circuits on the issue, with the Eleventh and the Ninth Circuits holding that a mortgage lien that is not supported by personal liability because of a Chapter 7 discharge is still a claim for purposes of Chapter 13 reorganization. See *In re Saylor*, 869 F.2d 1434, 1436 (11th Cir. 1989); *In re Metz*, 820 F.2d 1495, 1498 (9th Cir. 1987). The Supreme Court accepted certiorari to resolve this conflict. *Johnson v. Home State Bank*, 111 S. Ct. 781 (1991).

According to the Court, *Johnson* presented a straightforward issue—whether an *in rem* mortgage interest, without *in personam* liability is a "claim" subject to

inclusion in a Chapter 13 reorganization. In reaching its decision, the Court relied primarily on the definition of "claim" found in the Bankruptcy Code. The Court cited its previous ruling on this definition for the proposition that "Congress intended the broadest available definition." *Johnson*, 111 S.Ct. at 2154 (citing *Pennsylvania Dept. of Public Welfare v. Davenport*, 110 S.Ct. 2126 (1990)). The Court also noted that in *Davenport*, they had concluded that "right to payment" means] nothing more nor less than an enforceable obligation." *Johnson*, 111 S.Ct. at 2153 (citing *Davenport*, 110 S.Ct. at 2131).

Based on this expansive definition, the Court concluded that a mortgage holder does hold a "right to payment" even after the personal liability on the debt has been discharged. This "right to payment" can be found in the mortgage holder's right to the proceeds of the sale of the mortgaged property. Alternatively, because the Code also defines a "claim" as a "right to an equitable remedy for breach of performance if such breach gives rise to a right to payment," the Court noted that the surviving right to foreclose can be consid-

ered a "right to an equitable remedy" based on the debtor's default. *Johnson*, 111 S.Ct. at 2154.

On this basis, the Court reversed the judgment of the Court of Appeals and remanded the case for further proceedings. Because neither the District Court nor the Court of Appeals had addressed the alternative objections of the bank regarding good faith and feasibility, the Court directed the lower court to consider them on remand.

While the long range impact of *Johnson* is difficult to predict, the filing of a reorganization bankruptcy either under Chapter 12 or 13 may be an option that will now be considered by discharged farmers who wish to reorganize the debt on their mortgaged homestead property. This option may be particularly appealing to FmHA debtors who are ineligible for debt restructuring because of their discharge. See *Lee v. Yeutter*, 917 F.2d 1104 (8th Cir. 1990).

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CH. 12 REQUIREMENTS FOR LIVESTOCK OPERATION/CONT. FROM PAGE 1

not only must its security interest in the debtor's livestock be retained, but moreover that this security interest applies specifically to each animal in that livestock herd as of the time of filing.

In contrast, the debtor proposed a plan that would allow the sale of a portion of the livestock, free of the creditor's interest, for use in funding the plan and paying operating expenses. The plan provided for the granting of a second mortgage to the creditor as substitution for the security interest in the livestock to be sold, and provided for the creditor's retention of its interest in the remaining livestock.

At the time of confirmation, the value of the creditor's lien was approximately 120 percent of its claim. Under the proposed plan, its combined liens were estimated to be valued at 165 percent of its claim. Finding that the bank was adequately protected by the plan, the bankruptcy court confirmed the plan. On appeal, the district court affirmed this confirmation.

The Eighth Circuit court reversed the lower courts, holding that the debtor's plan did not meet the requirements of section 1225. It found that the replacement lien offered to the creditor was inconsistent with the requirement that the creditor "retain the lien" securing its claim. The substitution of other collateral was unacceptable in that it did not meet the specific requirement that the creditor retain "the lien."

The court, however, also rejected the creditor's strict interpretation of section 1225. A literal interpretation of the lien retention requirements of section 1225 would require the debtor to turn over all proceeds of annual sales to the secured creditor, making no funds available to fund the plan or pay operating expenses. The court observed that under this interpretation, a livestock operation could never obtain confirmation of its plan absent creditor acceptance. Noting that it did not believe that Congress could have intended such a result, the court relaxed the meaning of "retain the lien." It held that this requirement can be interpreted to provide for the retention of a lien on the herd, as opposed to a lien on the particular animals in existence as of filing. The court stated that "this interpretation affords family farmers in the livestock business the potential to reorganize under Chapter 12, but does not depart completely from the express terms of § 1225(a)(5)(B)(i)."

The court acknowledged, however, that this interpretation also presented a problem. Clearly section 1225 does not authorize the termination of the creditor's lien on individual livestock that are sold under the plan in order to pay other creditors. To resolve this problem, *Hannah* asserted that section 552(b) may also be applicable to the livestock lien.

Under section 552(b), the bankruptcy court may cut off a creditor's interest in certain proceeds, product, or offspring of

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prepetition collateral after notice and hearing "on the equities of the case." The court in *Hannah* noted that this section 552(b) hearing can be incorporated into the plan confirmation hearing. A ruling on section 552(b), however, should "focus on the collateral that must be sold to implement the plan and whether cutting off the lien on that collateral would leave the creditor's claim without adequate protection under the plan." Similarly, *Hannah* stated that the lien on the herd

must adequately protect the creditor's secured claim over the course of the plan.

Applying this standard to the facts in *Hannah*, the court reversed the lower court's acceptance of the debtor's plan. It held that the bank's equity cushion in the livestock herd could not be replaced with a second real estate mortgage. This replacement did not meet the "retain the lien" requirement of section 1225. Moreover, the court found insufficient assurance in the plan that the value of the herd

would be maintained. It stated that the plan assure the protection of the creditor's claim over the life of the plan. Thus, although the plan at issue in *Hannah* was rejected, the court did use this rejection to define the ways in which a livestock operation can be reorganized despite the restrictive provisions of section 1225.

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Bankruptcy setoffs of federal farm program payments

By Christopher R. Kelley and Susan A. Schneider

Federal farm income support payments are intended to offer "an income 'safety net' for persons who depend on a profitable pursuit of agricultural production for their livelihood." H.R. Rep. No. 100-391(I), 100th Cong., 1st Sess. 46 reprinted in 1987 U.S. Code Cong. & Admin. News 2313-1, 2313-46. However, the receipt of federal farm program payments is no guarantee against financial distress, and highly leveraged farmers often find that operating expenses, particularly interest, can exhaust farm earnings. When those farmers file bankruptcy, disputes often arise over their program payments. Because program payments often represent a major source of the debtor's farm income, the outcome of those disputes is critically important to creditors and the debtor alike.

A significant number of program payment disputes have arisen between the debtor or the bankruptcy trustee and an agency of the federal government seeking to set off the payments against a pre-petition debt. Occasionally, the agency asserting the setoff is the Commodity Credit Corporation (CCC), the agency that funds the federal farm programs, or the Agricultural Stabilization and Conservation Service (ASCS), the agency that administers the programs. More typically, however, the debtor has failed to repay a pre-petition loan from the federal agency, usually the Farmers Home Administration (FmHA) or the Small Business Administration (SBA).

This article focuses on a persistent issue in recent setoff litigation. That issue is whether program payments are a pre-petition obligation of the CCC or the ASCS when the debtor's enrollment in the farm program preceded bankruptcy but performance or payment is not accomplished until after the bankruptcy filing. Although a majority of courts have answered that question affirmatively, the reasoning for that result continues to be questioned or rejected by other courts. This article presents an overview of the most frequently cited cases and lists the

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most recent opinions on this issue.

Setoffs in bankruptcy

The equitable doctrine of setoff allows parties who are mutually indebted to set off those debts against each other instead of exchanging mutual payment. See R. Rogers, *Collier Farm Bankruptcy Guide* ¶ 2.12(1990)(hereinafter Rogers). "[S]etoff arose in a nonbankruptcy context as a practical tool to eliminate unnecessary transactions between parties holding mutual debts." *In re Braniff Airways, Inc.*, 42 Bankr. 443, 448 (Bankr. N.D. Tex. 1984).

The Bankruptcy Code does not create an independent right of setoff. However, section 553 of the Code recognizes setoff rights arising under state or federal law. Thus, within the limits imposed by section 553 and other applicable Code sections, including the automatic stay provisions of section 362, setoff rights created under state or federal law may be exercised within a bankruptcy. See 11 U.S.C. §§ 553, 362. In effect, where a right to setoff exists independently of the Code, section 553 imposes restrictions on the right's exercise in bankruptcy.

Section 553's restrictions on bankruptcy setoffs are commonly translated into three requirements that must be met before a setoff is permissible. First, the creditor must owe a debt to the debtor that arose prior to the bankruptcy's commencement. Second, the creditor must have a claim against the debtor that arose prior to the bankruptcy. Third, the debt and the claim must be mutual obligations. See, e.g., *In re Gore*, 124 Bankr. 75, 77 (Bankr. E.D. Ark. 1990) (citations omitted).

Although section 553 requires that the debt and the claim be mutual, the debt and claim to be set off do not have to arise out of the same transaction or be of the same character. "The basic test is mutuality, not similarity of obligation—something must be owed by both sides." Collier at ¶ 553.04[1] (footnote omitted).

Mutuality requires that "the debts must be in the same right and between the same parties, standing in the same capacity." *Id.* at ¶ 553.04[2] (footnote omitted). Thus, mutuality does not exist when "the debts to be set off arose between parties acting in different capacities." *Id.* (footnote omitted). See, e.g., *In re Jones*, 107 Bankr. 888, 898-899 (Bankr. N.D. Miss. 1989) (holding that the CCC was not entitled to set off debt owed by farm

corporation with payments owed to sole proprietorship, even though same individual was involved in both entities).

Even if the creditor can satisfy each of section 553's requirements, a setoff does not necessarily follow. "The right of setoff is permissive, not mandatory. Allowance of a setoff is within the discretion of the court — which must exercise that discretion consistent with general principles of equity." *In re Nielson*, 90 Bankr. 172, 174 (Bankr. W.D.N.C. 1988). See generally Collier at ¶ 553.02.

Setoffs of Farm Program Payments

It is well established that federal agencies such as the CCC, the ASCS, the FmHA, and the SBA have a setoff right independent of bankruptcy. The regulations authorizing setoff of farm program payments have been held to be sufficient to establish such a right for purposes of section 553. See, e.g., *In re Evatt*, 112 Bankr. 405 (Bankr. W.D. Okla. 1989), *aff'd*, 112 Bankr. 417 (W.D. Okla. 1990) (those regulations referenced, formerly found at 7 C.F.R. pt. 13, are now found at 7 C.F.R. pt. 1403). See also Rogers at ¶ 2.12 n. 1 (citing *United States v. Tafoya*, 803 F.2d 140, 141 (5th Cir. 1986) for the proposition that a right of setoff is "inherent in the United States Government and exists independent of any statutory grant of authority to the executive branch").

Also, the creditor's satisfaction of section 553's requirement of showing that it has a claim against the debtor that arose prior to the bankruptcy's commencement has not been a disputed issue. In the reported cases, the existence of a pre-petition debt in favor of either the CCC, the FmHA, the SBA, or other agency is usually conceded by the debtor. See, e.g., *In re Evatt*, 112 Bankr. 405, 412 (Bankr. W.D. Okla. 1989), *aff'd*, 112 Bankr. 417 (W.D. Okla. 1990).

The issues receiving the most attention have been whether the farm program payments in dispute arose out of a pre-petition obligation; whether the contract between the debtor and the ASCS is an executory contract; and whether the agency seeking setoff, if it was not the CCC or the ASCS, stands in the same capacity as the CCC or the ASCS. Of the three issues, the first two have been the more persistent. Most courts have now agreed that mutuality exists among federal agencies for purposes of section 553

setoffs. See, e.g., *In re Julien Co.*, 116 Bankr. 623, 624-25 (Bankr. W.D. Tenn. 1990).

Farm Program Payments as Pre-Petition Obligations

The majority of the reported decisions addressing the issue of whether the farm program payments in dispute were pre-petition obligations have held in the affirmative. This result is perhaps most easily reached in those cases where all program requirements but for payment by ASCS have been met prior to the bankruptcy filing. *Waldron v Farmers Home Administration (In re Waldron)*, 75 Bankr. 25 (N.D. Tex. 1987) (deficiency payments held to be pre-petition obligations when all qualifying acts and events had apparently occurred pre-petition); *In re Brooks Farms*, 70 Bankr. 368 (Bankr. Wisc. 1987) (deficiency payments held to be pre-petition obligations when all program requirements including determination of amount due to debtor occurred pre-petition); *In re Woloschak Farms*, 74 Bankr. 261 (Bankr. N.D. Ohio 1987) (disaster payments held to be pre-petition obligations where all qualifying events had occurred pre-petition; deficiency payments held to be post-petition obligations); *In re Lundell Farms*, 86 Bankr. 582 (Bankr. W.D. Wisc. 1988) (deficiency and specific CRP payments held to be pre-petition obligations where all qualifying acts and events had apparently occurred pre-petition); *In re Hazelton*, 85 Bankr. 400 (Bankr. E.D. Mich. 1988) (deficiency payments held to be pre-petition obligations where all qualifying acts and events occurred pre-petition but setoff denied on other grounds), *rev'd on other grounds*, 96 Bankr. 111 (E.D. Mich. 1988).

The same result has been reached in cases where little performance under the contract has been completed, relying primarily on the obligation created by signing the farm program contract. *Moratzka v. United States Agricultural Stabilization and Conservation Service (In re Matthieson)*, 63 Bankr. 56 (D. Minn. 1986); *In re Greseth*, 78 Bankr. 936 (D. Minn. 1987); *In re Parrish*, 75 Bankr. 14 (N.D. Tex. 1987); *In re Pinkert*, 75 Bankr. 218 (Bankr. N.D. Tex. 1987); *In re Ratliff*, 79 Bankr. 930 (D. Colo. 1987); *Buske v. McDonald (In re Buske)*, 75 Bankr. 213 (Bankr. N.D. Tex. 1987); *In re Britton*, 83 Bankr. 914 (Bankr. E.D.N.C. 1988). In each of these cases the debtor had en-

rolled in a farm program before bankruptcy but, as of the petition's filing, the debtor had not performed the program requirements nor had the ASCS made payment.

In re Matthieson is the seminal case holding that deficiency payments were a pre-petition obligation of the CCC/ASCS although certain acts or events triggering payment had not been performed or had not occurred when the petition was filed. 63 Bankr. at 60. The *Matthieson* court's reasoning is representative of the reasoning adopted by most other courts reaching the same result. See *Rogers* at ¶ 2.12[1] (characterizing *Matthieson* as "the leading case in the area").

In *Matthieson*, the debtors had enrolled in the 1984 deficiency program before bankruptcy. The debtors owed the government a pre-petition debt, and the ASCS moved to lift the automatic stay to set off the deficiency payments. The ASCS contended that the payments were pre-petition obligations because its obligation to pay arose at the time that the debtors contracted with it by enrolling in the program. The trustee countered by arguing that the obligations were post-petition because the ASCS's obligation to pay under the deficiency program is subject to various conditions precedent, none of which was met prior to the filing of the debtors' bankruptcy petitions. Those conditions included the debtors' fulfillment of the set-aside and filing requirements and the ASCS's final determination that a deficiency actually existed. *Id.* at 58-59.

In granting the ASCS's motion, the court began its analysis by noting that "[a] condition precedent calls for the performance of some act or the happening of some event after the contract is entered into, and upon the performance or happening of which its obligation is made to depend." *Id.* at 59 (quoting *Larke Company v. Molan*, 269 Minn. 490, 498-99, 131 N.W.2d 734, 740 (1964)). Then, it distinguished a condition precedent from a promise by observing that "[a] condition precedent . . . creates no rights or duties in and of itself but is merely a limiting or modifying factor." *Id.* (citations omitted).

Having defined a condition precedent and distinguished it from a promise, the *Matthieson* court next examined the "overall scheme of the deficiency program" to determine if the "various contract requirements" were conditions precedent

or promises. It found that under the program contract "the participants [essentially] agreed to the set aside, conservation, and filing obligations," and "[i]n return, ASCS agreed to make advance payments in appropriate cases and ultimately a deficiency payment in April 1985 based on a predetermined formula." *Id.* at 59-60. The court also noted that the contract and the underlying regulations also provided for liquidated damages if the program participant failed to comply with program requirements. *Id.* at 60.

Based on its assessment of the program's contractual and regulatory requirements, the court concluded that the requirements were "in the nature of contractual duties and promises rather than conditions precedent." *Id.* at 59. It inferred from the program's regulatory provisions "an intent by the parties to create mutual obligations under the contract." *Id.* at 60. Accordingly, the court held that "the obligations of ASCS under the deficiency program contracts arose at the time the contract was created and were thus pre-petition obligations subject to offset under 11 U.S.C. § 553." *Id.*

Courts that have followed *Matthieson* have adopted similar reasoning. Most have found that a pre-petition obligation is created at the time that the farm program contract is signed without addressing the distinction between a condition precedent and a promise. In further support, courts have occasionally relied upon additional contract analysis. For example, the court in *In re Parrish*, elaborated on *Matthieson* by noting that the deficiency program contracts at issue provided that "[t]his contract shall be effective when signed by the producer, each producer and an authorized representative of the CCC . . ." 75 Bankr. at 16. For the *Parrish* court, that contractual provision "clearly" indicated "a debt created pre-petition." *Id.*

Farm Program Payments as Post-petition Obligations

A minority of courts have concluded that farm program payments flowing from pre-petition contracts but dependent on the performance of some act by either the ASCS or the debtor or both occurring post-petition were post-petition obligations. *In re Hill*, 19 Bankr. 375 (Bankr. N.D. Tex. 1982); *Walat Farms, Inc. v. United States (In re Walat Farms)*, 69 Bankr. 529 (Bankr. E.D. Mich. 1987); *In*

Continued on page 6

re *Woloshack*, 74 Bankr. 261 (Bankr. N.D. Ohio 1987); *In re Fryar*, 93 Bankr. 101 (Bankr. W.D. Tex. 1988), *vacated as moot*, 113 Bankr. 317 (W.D. Tex. 1989); *In re Evatt*, 112 Bankr. 405 (Bankr. W.D. Okla. 1989), *aff'd*, 112 Bankr. 417 (W.D. Okla. 1990); *In re Gore*, 124 Bankr. 75 (Bankr. E.D. Ark. 1990). See also *In re Thomas*, 91 Bankr. 731 (N.D. Tex. 1988) (disaster payments held to be post-petition obligations where the legislation authorizing them was enacted post-petition), *modified*, 93 Bankr. 475 (N.D. Tex. 1988); *In re Stephenson*, 84 Bankr. 74 (Bankr. N.D. Tex. 1988) (same); *In re Nielson*, 90 Bankr. 172 (Bankr. W.D.N.C. 1988) (same).

Analytically, the courts have challenged the *Matthieson* result in several ways. In direct opposition to *Matthieson*, some courts have found that a sufficient obligation is not created by signing up for a particular farm program. This reasoning is based on requirements for compliance and eligibility that must still be met in order to obtain payment.

For example, the courts in *Fryar*, and *Matthieson* both state that although a debt must be "absolutely" owed before it is considered a pre-petition obligation, it need not be presently due or liquidated. *Fryar*, 93 Bankr. at 103; *Matthieson*, 63 Bankr. at 59. Yet, while *Matthieson* found the deficiency program contract sufficient to create a debt that is "absolutely owed," *Fryar* reached the opposite result. 93 Bankr. at 103-104; 63 Bankr. at 59-60. *Fryar* observed that the contract reserved to the CCC the right to consider program participants ineligible for payments if they did not comply with program requirements and reasoned that at the contract's inception, the CCC's obligation was contingent, not absolute. 93 Bankr. at 103-04. Citing the Fifth Circuit's decision in *In re Braniff Airways, Inc.*, 814 F.2d 1030, 1036 (5th Cir. 1987), *Fryar* held that debts dependent on the happening of condition or contingency at the petition's filing are excluded from the scope of section 553. Thus, the court concluded that the CCC had not acquired the requisite liability to the debtor to satisfy section 553. *But see, Britton*, 83 Bankr. at 918.

Taking a slightly different approach, courts have also found farm program contracts to be executory contracts that can be assumed or rejected under the Bankruptcy Code. 11 U.S.C. § 365. This finding produces two potential reasons for disallowing offset. First, the existence of unperformed obligations sufficient to constitute an executory contract supports the finding that a pre-petition obligation has not been created. Second, the assumption of an executory contract is accomplished by either a debtor in possession or the trustee, persons which may be

found to be different entities than the debtor for purposes of mutuality.

In re Walat Farms is the most frequently cited case following this approach. The *Walat Farms* court defined an executory contract as:

[a] contract under which the obligations of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other.

69 Bankr. at 531 (citing Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 Minn. L. Rev. 439, 460 (1973)). Considering the deficiency program contract before it, the court concluded that at the time of the petition's filing the debtor still owed the performance of his obligations to set-aside acreage and adopt conservation practices on it, and the CCC "still owed the entirety of its obligation, that is, to pay the deficiency amount." *Id.* at 531.

Having determined that the contract was executory, the court reasoned that once the contract was assumed in bankruptcy, "any right to a deficiency payment could only arise post-petition, and be owed to the debtor in possession *qua* trustee, not the debtor. Consequently, mutuality would not exist and setoff would be disallowed." *Id.* (citations omitted).

The *Walat Farms* approach has been followed by several courts. The *Fryar* court ultimately held that the deficiency contract at issue was executory and stated that "when the Debtor in possession assumes the contract and completes performance, the Debtor in possession as trustee and not the debtor has the right to payment. That payment accrues post-petition and is not subject to setoff under section 553." 93 Bankr. at 104; See also, *In re Fryar*, 99 Bankr. 747 (Bankr. W.D. Tex. 1989), *vacated as moot*, 113 Bankr. 317 (W.D. Tex. 1989) (subsequent decision holding that the debtor in possession could assume ASCS contracts); *Evatt*, 112 Bankr. at 410-12 (noting that *Fryar* had found that the payments were contingent and following the reasoning of *Fryar* and *Walat Farms*); *Gore*, 124 Bankr. at 78 (citing *Fryar* and reaching the same result). See also *In re Lech*, 80 Bankr. 1001, 1008 (Bankr. D. Neb. 1987) (storage program contract characterized as "executory"; setoff not at issue); *In re Lane*, 96 Bankr. 164, 167 (Bankr. C.D. Ill. 1988) (deficiency program contracts found to be executory; assumption of contracts, not setoff at issue); *In re Carpenter*, 79 Bankr. 316, 320 (Bankr. S.D. Ohio 1987) (whether CCC loan agreements are executory does not preclude inclusion in debt total for purposes of Chapter 12 eligibility). See also, *Pinkert*, 75 Bankr. at 221 (while *Walat* makes a "strong

argument," effect of assumption of executory contract on finding of pre-petition or post-petition obligation is "not ripe for determination by this Court"). *But see, Hazelton*, 85 Bankr. at 404 (when only payment by ASCS remains unperformed, contract is not executory); *Lundell*, 86 Bankr. at 588 (same); *Ratliff*, 79 Bankr. at 932 (CRP contract "bears all the classic earmarks of an executory contract," but if assumed, debtor would have to take burdens imposed by the contract, including FmHA right to setoff).

Discretion Consistent with the Principles of Equity

As noted previously, even if all of the specific requirements for setoff are met, it is still considered an equitable remedy that can be granted or denied on the basis of the court's discretion. This concept has offered farm debtors and bankruptcy trustees one last alternative for avoiding a farm program setoff. In several cases, it has proved successful.

In the Chapter 12 context, the court in *In re Cloverleaf Farmer's Cooperative* stated, "[I]t would be inconsistent with the rehabilitative purpose of the Bankruptcy Code and with Congress' efforts at saving the family farm to allow government agencies to pursue administrative offset in the context of a reorganization case." 114 Bankr. 1010, 1017 (Bankr. D.S.D. 1990). Similarly in the Chapter 7 context, the court in *In re Mehrhoff*, noted that the SBA offset requested would disrupt the planned priorities of the Code and produce a result that would be inequitable to the general unsecured creditors. 104 Bankr. 125, 127 (Bankr. S.D. Iowa 1989). See also *In re Butz*, 104 Bankr. 128, 131 (Bankr. S.D. Iowa 1989); *In re Nielson*, 90 Bankr. 172, 174 (W.D. N.C. 1988); *In re Hazelton*, 85 Bankr. 400, 405 (Bankr. E.D. Mich. 1988), *rev'd on other grounds*, 96 Bankr. 111 (E.D. Mich. 1988); *In re Rinehart*, 76 Bankr. 746, 754-55 (Bankr. D.S.D. 1987), *aff'd, United States v. Rinehart*, 88 Bankr. 1014, 1018 (D.S.D. 1988), *aff'd in part and rev'd in part on other grounds, Small Business Admin. v. Rinehart*, 887 F.2d 165 (8th Cir. 1989).

Conclusion

Although the setoff of farm program payments by government agencies is by no means a new bankruptcy issue, it remains one that produces sharp disagreements between the courts. Moreover, even among courts that agree in terms of the pre-petition/post-petition outcome, varying and sometimes inconsistent approaches may be used. Because farm program payments continue to be an important component of farm income, continued bankruptcy litigation on this issue can be expected.

State Roundup

FLORIDA. *Commercial buyers must inspect real property.* In *Futura Realty v. Lone Star Building Centers*, 16 FLWD960 (Fla. 3d DCA 1991), the Florida Third District Court of Appeal held that a corporate buyer had no rights to rescind a land purchase because of the seller's alleged nondisclosure of hazardous waste contamination of the property. The court held that *Johnson v. Davis*, 480 So. 2d 625 (Fla. 1985), did not apply. In *Johnson*, the Florida Supreme Court held that a seller of a home had a duty to disclose a latent defect in the home's roof. The *Futura* court held that commercial buyers must be held to a higher standard of diligence in inspecting real property than residential buyers. This case exhibits the urgency of conducting environmental audits before acquiring real property and of obtaining adequate representations and warranties from the seller.

—*Sidney F. Ansbacher, Brant, Moore, Sapp, MacDonald & Wells, Jacksonville, FL*

FLORIDA. *Pollution assessments charged against Florida farmers.* Florida farmers may be assessed up to \$150.00 per acre under a proposed settlement between the State of Florida and the federal government to clean up eutrophied surface water in the Everglades National park. The agreement would also require the farmers to obtain permits for the use of phosphate and nitrate containing fertilizers. Further, farmers would be required to limit their use of phosphate and nitrate containing fertilizers in order to implement a phase reduction of nutrients going into the Loxahatchee National Lime Life Refuge in the Everglades National Park.

—*Sidney F. Ansbacher, Brant, Moore, Sapp, MacDonald & Wells, Jacksonville, FL*

NEBRASKA. *Property owner's liability for child trespasser.* In *Widga v. Sandell*, 236 Neb. 798, 464 N.W.2d 155 (1991), the Nebraska Supreme Court held that the parent of a deceased child failed to allege facts sufficient to support a claim that a property owner knew or should have known of the presence of a pesticide at a location where it was ingested by the child. The court further held that the petition failed to allege facts sufficient to support a claim under the doctrine of *res ipsa loquitur*.

The parent of a child who died from pesticide ingestion commenced this action against a property owner to recover damages for the claimed wrongful death of her fifteen-month-old son. The claim

alleged that after the death of the child, a partial bag of an extremely toxic pesticide was found in a garage on the property owner's land. The parent's contention was that the property owner knew that the decedent and other children often played near the location where the dangerous pesticide was stored. The petition concluded that the child would not have died but for the negligence of defendant.

The court noted that a property owner is negligent when he knows or has reason to know that 1) children are likely to trespass; 2) an unreasonable risk of death or serious bodily harm exists; and 3) the children are unlikely to realize the risk involved. A court will balance the utility to the property owner of maintaining the condition and the risk to children involved. The court concluded that a property owner must exercise reasonable care to eliminate the danger or otherwise protect the children.

The controlling issue of *Widga* became whether the plaintiff had properly pled facts from which the court could reasonably infer that the property owner knew or should have known of the presence of the pesticide at that location. The court answered this question negatively, reasoning that although a partial bag of the pesticide may have been stored in the garage and used recently, these facts do not lead to an inference that the defendant spilled or otherwise placed the pesticide at the place where the child found it. Thus, the court held, since no reasonable inference could be drawn, the property owner is not liable for the child's death.

Additionally, the plaintiff attempted to invoke the doctrine of *res ipsa loquitur*. In order to invoke this doctrine, it was necessary for the plaintiff to prove that the pesticide was exclusively in the defendant's control, and that the event was one which ordinarily does not happen in the absence of negligence. The occurrence of the accident itself, in the absence of explanation by the property owner, affords evidence that the defendant was negligent. However, it is still necessary to show that defendant had control and management of the pesticide. Since the plaintiff failed to plead any degree of control and management on the part of the defendant, the Nebraska Supreme Court ruled that the plaintiff's effort to plead *res ipsa loquitur* was defective.

—*John Treangen, Law Student, The University of South Dakota School of Law*

Federal Register in brief

[Editor's note: *Federal Register in brief* is missing for this issue because the law library where I do the research was being renovated, and the *Federal Registers* were not available. The September 1991 issue of *Agricultural Law Update* will include both the months of July and August in that issue's *Federal Register in brief*.]

Postponement of conference

The USA/USSR Conference, The Role of Law in An Agricultural Market Economy, scheduled for Iowa State University on September 5-7, 1991, has been postponed. The event has been rescheduled for April 27-29, 1992, at Iowa State University. The three-day conference, expected to involve Soviet and US agricultural lawyers, will feature two plenary sessions and thirteen symposium sessions on a variety of agricultural law topics important to law reform in the USSR.

The three-day conference will be followed by an internship with Iowa law firms.

The conference is being organized by the Iowa State Bar Association's Agricultural Law Section and the Center for International Agricultural Law at Iowa State University with co-sponsorship by the American Agricultural Law Association and the University of Illinois. Additional information on the conference may be obtained from Neil E. Harl, 478 Heady Hall, Iowa State University, Ames, Iowa 50011-1070.

—*Neil E. Harl*

AG LAW CONFERENCE CALENDAR

Farm, Ranch, and Agri-Business Bankruptcy Institute

Oct. 17-19, 1991, Lubbock, TX
Topics include: creditor strategies in bankruptcy cases and environmental problems.

Sponsored by West Texas Bankruptcy Bar Association, and others.
For more info., call 1-806-744-1100.

The Impact of Environmental Law on Real Estate and Other Commercial Transactions

September 26-27, 1991, Grand Hyatt on Union Square, San Francisco, CA
Topics include: transaction-triggered environmental laws, state transfer notice laws, and super liens; the "innocent purchaser."

Sponsored by ALI-ABA.
For more info., call 1-800-CLE-NEWS.

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AMERICAN AGRICULTURAL LAW ASSOCIATION NEWS

AALA Membership

Your help in adding to our membership is solicited. You will soon receive your 1991 AALA membership directory. Take time to look at the membership in your state. Your Membership Committee knows there are persons working in agricultural law areas who could benefit from being members of our organization.

Conversely, the Association would benefit greatly from increased membership. As you know, the Association's operations and programs are funded almost entirely from dues. Expanded program benefits can best be funded by increased membership.

If you would take the time to make a couple of contacts with potential members, our membership could grow. If you prefer, provide the names of potential members to our national office in care of the University of Arkansas, School of Law, Fayetteville, AR 72701 or call (501-575-7389), and they will contact the people directly.

Let's add to the success of our association.

Paul Wright— Chairman, Membership Committee