An Agricultural Law Research Article

Chapter 12 Family Farmer Bankruptcy

by

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I. INTRODUCTION

The American farm economy is in its worst financial condition since the 1930s. Plummeting land values, low crop prices, and high interest rates have put farmers and agricultural creditors in a financial squeeze. As farm incomes have declined, and as the security position of farm lenders has deteriorated, farm foreclosures and bankruptcies have increased to levels not seen since the Great Depression. Farmers have tried, largely in vain, to reorganize under chapter 11 of the federal Bankruptcy Code. This led to the enactment of a new family farmer bankruptcy option, chapter 12 bankruptcy reorganization, in 1986. Many farmers facing financial difficulty have now been given the option of having a farm reorganization plan confirmed under chapter 12. Whether this will lead to the ultimate survival of the reorganized family farm enterprise remains to be seen.

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Although farm real estate values appear to be stabilizing,[1] the current financial difficulties facing farmers are not likely to abate soon. Federal farm program payments have become highly controversial, and are scheduled for annual reductions to the year 1990.[2] These reductions in farm program payments will be reflected in reduced farm income for cash grain farmers. Long-term predictions indicate that the promise of dramatically increased agricultural productivity through biotechnology may exacerbate the current overproduction problem of farm commodities.[3] If current estimates on the impact of biotechnology on farming are anywhere close to being accurate, the resulting financial upheaval will make the current financial difficulties seem mild. Thus farm bankruptcies are, and probably will continue to be a significant part of the rural landscape. Any rural practitioner, whether he or she engages in bankruptcy practice or not, must become conversant with the fundamentals of farm bankruptcies.

This article surveys the bankruptcy options available to farmers, including the legal developments leading to enactment of chapter 12. Part II discusses the farm economy, describing the land boom of the

1. B. JOHNSON & R. HANSON, DEP'T OF AGRIC. ECONOMICS, UNIV. OF NEBRASKA, REPT. NO. 151, NEBRASKA FARM REAL ESTATE MARKET DEVELOPMENTS (1987) (hereinafter REAL ESTATE DEVELOPMENTS)

2. *See* Comment, *Gramm-Rudman-Hollings and the Farm Bill: Solution or Suicide Pact?*, 31 *S.D.L.Rev.* 541, 545 (1986). Under the original Gramm-Rudman debt reduction statute agricultural programs would have been required to take a 17.7% budget reduction to meet a 4.3% federal deficit reduction goal. Even though provisions of the original Gramm-Rudman federal debt reduction statute are likely to be modified, agricultural programs still will probably be disproportionately reduced to help balance the budget, due primarily to agriculture's waning political clout.

3. OFFICE OF TECHNOLOGY ASSESSMENT, U.S. CONGRESS, REPT. NO. OTA-F-285, TECHNOLOGY, PUBLIC POLICY, AND THE CHANGING STRUCTURE OF AMERICAN AGRICULTURE (1986) (hereinafter TECHNOLOGY, POLICY AND STRUCTURE). OTA estimates that the total number of farms will fall 44% from 1982 to 2000. The number of small farms (up to $99,000 in annual gross sales) will fall 48%, the number of moderate sized farms ($100,000 to $199,000 in annual gross sales) will fall 58%, while the number of large farms (at least $200,000 in annual gross sales) will increase 44%. Adjusting the decline in the number of moderate sized farms for those that will become large farms, the net decline is still 29%. *Id.* at 9. (derived from table 1.2). This reduction in the number of total farms will continue the already high current rate of farmers leaving agriculture involuntarily.

> Operators of small and moderate-sized farms, the so-called backbone of American agriculture, are becoming increasingly less able to compete, partly because they lack access to the information and finances [sic] necessary for adopting the new [agricultural production] technologies effectively. Many such farmers must relocate, change to other kinds of farming, or give up farming altogether. The disappearance of these farm operations is causing repercussions for other businesses in the rural community and for the [national] labor pool in general, which must absorb all those whose livelihood once depend on agricultural production.

Id. at 3.

late 1970s, the succeeding bust in the 1980s, and their impact on farmers and farm lenders. Part III discusses the legal options available to farmers and farm creditors when the farm loan is in default. Particular attention is paid to the bankruptcy options available to farmers prior to chapter 12, and the particular features of chapter 11 and chapter 13 bankruptcies that made farm reorganizations difficult. Part IV provides a brief legislative history of chapter 12, discussing the Congressional reaction to the failure of farmers to obtain bankruptcy reorganization relief. Part V discusses chapter 12, including an analysis of how to prepare a chapter 12 reorganization plan.

II. FARM LENDING AND THE FARM ECONOMY

The current problems in agriculture are in part a response to the farmland boom beginning in the early 1970s. Poor worldwide harvests in 1972 and 1974 led Russia to enter the international market in 1976, sending already high crop prices soaring.[4] The high crop prices contributed to a rise in farm real estate values.[5] Other factors contributing to land boom include inflation, tax shelter opportunities in agriculture, and optimism regarding continued high crop prices. Agricultural spokesmen, including President Nixon's Secretary of Agriculture Earl Butz, encouraged American farmers to produce "fencerow to fencerow" for the export market.[6] However, crop prices started to decline in the late 1970s, due in part to increased foreign

4. J. WESSEL, TRADING THE FUTURE ch. 2 (1983). Cash corn prices increased from \$1.18 in 1972 to \$1.78 in 1973, a 51% annual increase. Cash corn prices increased again to \$2.79 in 1974, a 56% annual increase, and a 136% increase over two years. The large drop in crop prices occurred in 1977, when cash corn prices fell from \$2.42 to \$1.97, a 19% annual decline, and a 29% decline from the 1974 peak. DEP'T OF AGRIC. ECONOMICS, UNIV. OF NEBRASKA, REPT. NO. 150, CROP AND LIVESTOCK PRICES FOR NEBRASKA PRODUCERS (1987). Similar price increases and decreases occurred for soybeans and wheat. *Id.*

5. The following table indicates the annual percentage changes in Nebraska farmland values:

Year	Change	Year	Change	Year	Change
1970	−5.4%	1976	18.7%	1982	−11.8%
1971	−2.1%	1977	8.1%	1983	−13.6%
1972	3.1%	1978	−9.5%	1984	−15.0%
1973	9.9%	1979	14.4%	1985	−30.5%
1974	18.8%	1980	5.3%	1986	−20.8%
1975	5.1%	1981	−0.3%	1987	−10.3%

REAL ESTATE DEVELOPMENTS, *supra* note 1, at 40. The land boom began in 1973 and ended in 1982. The real price of average Nebraska farmland (adjusted for inflation increased 91% from 1972 to 1981, and declined 68% from 1981 to 1987. *Id.* The real value of Nebraska farmland is now 61% of its 1972 pre-boom value. Regarding the relationship between crop prices and farm values, *see also* Harl, *The Architecture of Public Policy: The Crisis in Agriculture*, 34 KAN.L.REV. 425, 431-32 (1986).

6. J. ANDERSON & J. MORRIS, CHAPTER 12 FARM REORGANIZATIONS § 1.02 n. 21 (1987).

agricultural production, and high world-wide interest rates. Real estate value declines started in 1981, attributable in part to falling world crop prices and high interest rates from the Reagan administration's anti-inflation policy.

The rising crop and land prices of the early 1970s along with the economic promise of producing for the new farm export market made farmers and farm lenders bullish regarding agriculture's prospects. Farmers, eager to expand, used the steadily increasing land values to finance that expansion. Farm lenders were similarly eager to lend, taking land with its steadily increasing values as collateral.[7] When crop prices started to decline in 1977, farm operating losses resulted. However, most lenders were still oversecured (collateral value significantly exceeded loan balance) as land prices were still rising, and lenders were willing to extend the loan. The continuing inflation in land values covered questionable loans: even if the farming operation did not show a positive cash flow the lender was protected on paper so long as collateral values continued to increase annually. At this time most farmers and lenders probably expected that the turndown in farm prices was temporary, so lenders were willing to carry farmers so long as they were oversecured. Hindsight shows that this optimistic expectation was incorrect. As land values began to decline, lenders' policies became more conservative, particularly as their security position changed from oversecured to only adequately secured to in many cases undersecured (collateral value less than loan balance).

To better understand how these macroeconomic developments affected agricultural finance, one needs to understand farm credit practices. Generally a farmer will have a single operating lender, a bank or Production Credit Association (PCA) which supplies the farmer an operating line of credit.[8] In return for this credit the lender will have encumbered all or most of the farm assets. Thus, the farmer's operating lender will normally have the first secured position on all property. If the farmer had expanded during the land boom, his real estate

7. The major value of all farm assets, including crops, livestock, equipment, and land, is in real estate. In 1981, the peak of the farmland boom, real estate constituted 71% of total farm assets. In 1987, after farmland values had fallen by 68%, real estate still constituted 60% of all farm assets. REAL ESTATE DEVELOPMENTS, *supra* note 1, at 5.

8. In 1984 commercial banks extended 51% of the non-real estate farm credit in Nebraska, the Commodity Credit Corporation 17%, trade creditors 16%, Production Credit Associations 10%, and the Farmer's Home Administration 6%. Credit extended through these operating loans totaled $6 billion. In the last decade the proportion of bank and PCA lending declined, government (CCC and FmHA) lending increased, and dealer lending was largely unchanged. In 1974 the distribution of farm debt secured by personal property was banks 62%, PCAs 19%, trade creditors 17%, CCC 1%, and FmHA 1%. Credit extended totaled $2 billion. U.S. DEP'T OF AGRICULTURE, ECONOMIC INDICATORS OF THE FARM SECTOR, March 1984, 221, 241 (1986).

lender would have first priority on the land securing the expansion debt. Conventional farm real estate lenders include the Federal Land Bank, insurance companies, and private individuals (i.e. landowners financing the sale of their land on a contract for deed).[9] During the 1970s boom in farmland prices, some farmers borrowed against their rising land values to expand their operations through equipment and land purchases. These purchases were included in the farmer's operating line of credit rather than being set up on a conventional intermediate term note. This led to cash flow problems as farmers had financed intermediate asset acquisition on a short term basis. Before land prices began to fall many farmers received no credit from trade suppliers (seed, feed, chemical, and fuel suppliers). The trade suppliers were generally paid by the farmer prior to harvest with funds advanced by operating lender. The operating loan was paid in turn when the crop was harvested and marketed.

When farmers started developing operating losses and began carrying an operating deficit, most lenders continued to carry the loan so long as they were oversecured. As land values started their rapid decline, and as it became clear that crop prices would not rebound, the operating lender's position became more precarious. Lenders began cutting the farmer's operating line of credit off when the loan was in default. Lenders did not necessarily foreclose, however, because their after acquired property clause gave them first lien on future crops even with no further credit advances if the farmer could find other operating financing. If the farmer continued to operate, it was often due to credit extended by trade suppliers who may have mistakenly believed they had the first security position on the new crop. In fact, a trade creditor's security interest would come ahead of the operating lender's prior security interest and after acquired property clause only if the original loan was in default at least six months prior to the planting of the new crop.[10] Trade creditors were rarely secured. If they did obtain a security interest, they generally were subject to the operating lender's after acquired property clause.[11]

9. In 1984 Federal Land Banks extended 42% of the farm real credit secured by estate, individuals 26% (largely through seller financed land contracts), insurance companies 16%, Farmer's Home Administration 10%, and banks 6%. Credit extended totaled $4.3 billion. Land contract financing and insurance company lending declined, while land bank credit increased over the last decade. In 1974 the distribution of farm real estate debt was individuals 43%, land banks 24%, insurance companies 20%, FmHA 9%, and banks 3%. Credit extended totaled $1.5 billion. *Id.* at 220, 240.

10. NEB. REV. STAT. (U.C.C.) § 9-312(2) (Cum. Supp. 1986).

11. Unsecured creditors took some steps to improve their status through trade supplier lien statutes. Legislation in 1977 established crop liens in favor of those providing fertilizers, soil conditioners, or agricultural chemicals or applying such products. NEB. REV. STAT. §§ 52-1101 to 1104 (1984 & 1986 Cum.Supp.). *See* Circle 76 Fertilizer v. Nelson, 219 Neb. 661, 365 N.W.2d 460 (1985). In 1985, similar legis-

In some cases the farmer and lender were able to restructure the farmer's debt through a "workout"; essentially a privately negotiated financial reorganization.[12] In some cases lenders probably undertook workouts where they believed that modest debt restructuring would allow the farm to survive and the debts to be repaid. These workouts were probably extension agreements, where the lender agrees to accept repayment over a longer period of time, reducing current payment requirements and improving the debtor's cash flow. These workouts probably did not include significant debt write-off (composition agreements), in part because there were few effective legal options available to farmers facing foreclosure or bankruptcy. While farmers can delay foreclosure through a mortgage foreclosure stay or by filing bankruptcy, unless the farmer can find alternative financing or negotiate a reorganization, his efforts will simply delay the inevitable.[13] Chapter 11 bankruptcy reorganization was not an effective alternative to farmers prior to important 1986 Eight Circuit farm bankruptcy decisions. Further, chapter 13 debt callings were too low for most commercial farmers. If farm debt workout negotiations were unsuccessful, or not even pursued, the lender's ultimate option was foreclosure, which often led to the farmer's emergency bankruptcy filing.

III. BANKRUPTCY AND NONBANKRUPTCY OPTIONS PRIOR TO CHAPTER 12

If the farmer could not negotiate a workout with his creditors he was subject to foreclosure. Foreclosure remedies provide a farmer/debtor various rights. Mortgage foreclosure involves an optional nine month stay if so requested by the debtor,[14] and now involves redemp-

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lation established crop liens in favor of those supplying seed, and/or electricity to farmers. NEB.REV.STAT. §§ 52-1201 to 1204 (1986 Cum.Supp.). In addition priority issues were clarified in 1985 regarding threshers's liens, veterinarians liens, petroleum products liens, and fertilizer liens. NEB.REV.STAT. §§ 52-504, 52-702, 52-905, 52-1104 (1986 Cum. Supp.).

12. J. ANDERSON & J. MORRIS, *supra* note 6, at § 1.03; R. AARON, BANKRUPTCY LAW FUNDAMENTALS § 1.02 (1987). For a sample farm workout *See* Stowell, A Case Study in Agricultural Workouts and Hearsay (Nebr. Continuing Legal Educ. May 31, 1985).

13. The exception to this scenario would be if crop prices (and land prices) rose substantially. Most farmers are optimistic and are willing to take this kind of gamble. They remember the windfall profits cash grain farmers realized in the early 1970s as the result of poor worldwide harvests and the resulting high feedgrain prices. *See* TRADING THE FUTURE, *supra* note 4.

14. NEB.REV.STAT. § 25-1506. (1985) Mortgage foreclosures are generally governed by sections 25-2137 to 2155. If the debtor elects to pursue the one year automatic stay, he forfeits his appeal rights. Carley v. Mortgan, 123 Neb. 498, 243 N.W. 631 (1932). Regarding mortgage foreclosures, *see* Berger, *Solving the Problem of Abusive Mortgage Foreclosure Sales*, 66 NEB.L.REV. 373 (1987); Comment, *Avoidance*

tion rights as well as rights to cure default.[15] Trust deed foreclosures are not subject to a stay but now are subject to redemption rights as well as an opportunity to cure default.[16] Land contract forfeiture generally results in loss of the land.[17] Regarding personal property, a perfected secured party may obtain possession of collateral pledged by a defaulting farmer and sell it.[18]

One way for the farmer to avoid foreclosure prior to chapter 12 was to file for reorganization bankruptcy under chapter 11 or chapter 13.[19] The other bankruptcy option for farmers not wishing or able to reorganize was chapter 7 liquidation. The farmer's bankruptcy options prior to chapter 12 were not good. The adequate protection requirement and the absolute priority rule made farm chapter 11 plans virtually unconfirmable. In response Congress enacted chapter 12, the objective of which is to confirm a farm reorganization plan rather than to negotiate one.

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of Foreclosure Sales As Fraudulent Transfers Under Section 548(a) of the Bankruptcy Code: An Impetus to Changing State Foreclosure Procedures, 66 NEB.L.REV. 383 (1987).

The Farmer's Home Administration is subject to special administrative foreclosure regulations. *See* Comment, *Suing the Farmer's Home Administration—Federal Farm Borrowers' Last Stand*, 31 S.D.L.REV. 297 (1986); Comment, *Agricultural Law: FmHA Farm Foreclosures, An Analysis of Deferral Relief and the Appeals System*, 23 WASHB.L.J. 287 (1984).

15. Execution upon agricultural land is now subject to special homestead redemption rights as well as rights to cure default. NEB.REV.STAT. §§ 76-1901-1916 (Supp. 1987).
16. *Id.* Regarding trust deeds *see* NEB.REV.STAT. § 76-1001 to 1018 (1986), Butler, *Trust Deeds Come of Age in Nebraska: A Survey and Analysis*, 17 CREIGHTON L.J. 283 (1984); Comment, *In Deed an Alternative Security Device: The Nebraska Trust Deeds Act*, 64 NEB.L.REV. 92 (1985).
17. Comment, *Installment Land Contracts: Remedies in Nebraska*, 60 NEB.L.REV. 750 (1981).
18. NEB.REV.STAT. (U.C.C.) § 9-501 *et seq.* (1980). *See* Delay First Nat'l Bank & Trust Co. v. Jacobson Appliance Co., 196 Neb. 398, 243 N.W.2d 745 (1976).
19. The topic of agricultural bankruptcies has received significant law journal attention. Recent articles include: Bland, *Insolvencies in Farming and Agribusinesses*, 73 KY.L.REV. 795 (1985); R. Hershner & W. Boyer, *The Farmer in Distress—Can Bankruptcy Help?* ANN.SURV.BANKR.L. 177 (1985); Looney, *The Bankruptcy Reform Act of 1978 and the Farmer: A Survey of Applicable Provisions*, 25 S.D.L.REV. 509 (1980); Kunkel, *Farmers' Relief Under the Bankruptcy Code: Preserving the Farmers' Property*, 29 S.D.L.REV. 303 (1984); Kunkel, *The Fox Takes Over the Chicken House: Creditor Interference With Farm Management*, 60 N.D.L.REV. 795 (1985); Reiley, *Farming Failures and Drafting Failures: The Uncertain Posture of Crop Financing Under Article 9 and Section 547 of the Bankruptcy Code*, ANN.SURV.BANKR.L. 29 (1983); Rosentrater, *Protecting the Lender's Rights When Farmers File for Bankruptcy*, 29 S.D.L.REV. 333 (1984). For a helpful introduction to the bankruptcy process, *see* R. AARON, BANKRUPTCY LAW FUNDAMENTALS, ch. 1 (1987).

A. Chapter 7 Liquidations.[20]

Chapter 7 is a liquidation proceeding. Nonexempt assets are liquidated andor turned over to creditors by a bankruptcy trustee. Filing the case initiates an automatic stay against debt collection efforts, and generally stops interest accruing on outstanding loans. Exempt assets are retained by the debtor and form the basis for the debtor's fresh start. Prepetition liens are valid, however, unless avoided in bankruptcy proceedings. Most debts not paid in chapter 7 are discharged if the debtor is an individual, and taxable gains realized through postpetition liquidation in chapter 7 are not taxed to the debtor even if the taxes are not paid in the bankruptcy proceeding. This avoidance of taxes arising from asset liquidation and debt forgiveness is one of the significant advantages of chapter 7 liquidation over nonbankruptcy farm liquidations.[21] The bankruptcy trustee may avoid certain prepetition transactions, including preferential transfers and fraudulent conveyances, to increase recovery by creditors. The debtor may avoid certain prepetition liens, including liens on certain exempt property. Chapter 7 bankruptcy allows a farm debtor to avoid deficiency judgments and taxes resulting from property liquidation, and allows the farm debtor an opportunity for a fresh financial start largely free of prepetition debt.

Eligibility. Chapter 7 cases may be voluntary or involuntary.[22] Farmers are protected from involuntary filings if they meet the bankruptcy definition of a farmer.[23] Farmers are defined by section 101(19) as a person who has received more than 80 percent of his gross income during the prior taxable year from a farming operation owned or operated by that person.[24] If a farmer does not qualify as a "farmer" under the Code, the farmer is subject to involuntary bankruptcy.[25] Small farmers will more likely not meet the farm income

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20. A brief overview of the structure of the Bankruptcy Code, 11 U.S.C.A. §§ 101 - 1330, (West 1979) may be helpful. Chapter 1 deals with general provisions relevant to all bankruptcy proceedings; chapter 3 deals with with case administration (procedure), and chapter 5 deals with creditors, the debtor, and the estate; i.e. the substance of bankruptcy case administration. Chapter 7 deals with liquidation proceedings, chapter 11 deals with business reorganizations, chapter 12 deals with family farmer reorganizations, and chapter 13 deals with debt adjustment proceedings. Most provisions of chapter 1, 3, and 5 apply to chapters 7, and 11-13 unless they are replaced by more specific provisions.
21. However, taxes arising from prepetition liquidations are not dischargeable but can be paid in bankruptcy if the bankruptcy estate has sufficient assets and if the debtor makes the short year election. *See infra* text accompanying notes 91-95.
22. 11 U.S.C.A. §§ 301, 303 (West 1979).
23. *Id.* §§ 303A, 1112(c).
24. Farming operation is defined to include "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." *Id.* § 101(20).
25. *Id.* §§ 303(h), 303(b). However, farmers who qualify as family farmers are now

tests necessary to qualify as a farmer, and therefore will be subject to involuntary bankruptcies.[26]

Automatic stay. The order of relief (i.e. the filing of a voluntary bankruptcy petition[27]) automatically stays all debt collection activities against the debtor.[28] The automatic stay is a feature of all bankruptcy cases. The stay provides the debtor in any bankruptcy case the opportunity to deal with claims of creditors and others in a single proceeding. The stay gives the debtor some breathing room and prevents one creditor from enforcing its lien to the detriment of other creditors.[29] In reorganization cases creditors may petition the court for relief from the stay if the debtor is unable to provide adequate protection of the creditor's interest, or if the debtor has no equity in the property and if it is not necessary for an effective reorganization.[30] Once the order of relief is entered, interest on secured debts is stayed unless the creditor is oversecured, in which case the debtor must pay interest at the contract rate to the extent of the equity cushion.[31] The order of relief stops interest on unsecured debts unless the debtor is solvent, in which case interest is paid at the legal rate to the extent of solvency.[32]

Bankruptcy estate. When the bankruptcy case is initiated, a separate entity, the bankruptcy estate, is created.[33] The bankruptcy estate includes property seized by creditors prior to the filing of the petition,[34] postpetition property acquired by the debtor within 180 days of filing, including property received by gift or inheritance,[35] and postpetition proceeds, product, offspring, and rents or profits.[36] The inclu-

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also exempt from involuntary chapter 7 cases. 11 U.S.C.A. § 303(a). *See infra* text accompanying notes 310-314.

26. The farm income tests are based on gross income, not net income, ergo most commercial farmers should easily meet the bankruptcy farm income tests, even if a significant portion of their net income is off farm income. Many farmers depend significantly on off-farm income, particularly during periods of low crop prices, even though off farm income is a relatively small portion of their gross farm income. *See* K. FORSYTHE & B. JOHNSON, DEPT. OF AGRIC. ECONOMICS, UNIV. OF NEBRASKA, OFF-FARM INCOME AND EMPLOYMENT IN NEBRASKA: IMPACTS AND IMPLICATIONS (Staff Paper No. 6, July 13, 1987).
27. 11 U.S.C.A. § 301 (West 1979).
28. *Id.* § 362(a). Actions against the debtor not stayed are enumerated in § 362(b).
29. *In re* Ahlers, 794 F.2d 388, 393-94 (8th Cir. 1986), *cert. granted*, 55 U.S.L.W. 3852 (1987).
30. 11 U.S.C.A. § 362(d) (West 1979).
31. *Id.* § 506(b).
32. *Id.* § 362(a). Secured claims, administrative expenses, priority unsecured claims, and unsecured claims are all paid in full before any interest on unsecured claims is paid. *Id.* § 726(a)(1)-(5). When interest is paid it is paid at the legal rate, not the contract rate. *Id.* § 726(a)(5).
33. *Id.* § 541(a).
34. United States v. Whiting Pools, Inc., 462 U.S. 198 (1983).
35. 11 U.S.C.A. § 541(5) (West 1979).
36. *Id.* at § 541(6). Postpetition alfalfa cuttings are property of the estate. *In re* Beck, 61 Bankr. 671 (Bankr. D. Neb. 1985).

sion of postpetition property in the bankruptcy estate increases payment on unsecured claims, including secured loan deficiencies and unsecured creditors. Postpetition personal service income of the debtor is not considered property of the estate.[37] Filing the bankruptcy petition usually cuts off an after acquired property clause in a security agreement.[38] However, if the prepetition security interest covers proceeds, products, offspring, rents or profits, the security interest attaches to such property.[39]

Classification of creditors's claims. The bankruptcy claim of a secured creditor will not necessarily be a secured claim. The concept of secured and unsecured differs significantly in bankruptcy from their nonbankruptcy meaning. Creditors's claims are secured only to the extent of the value of collateral.[40] If a creditor is undersecured, i.e. the current value of the collateral is less than the outstanding balance due, the creditor has a secured claim to the extent of the value of the collateral, and an unsecured claim to the extent of the deficiency. For example, if the loan balance is $50,000 and the collateral is worth $30,000, the loan deficiency is $20,000. The creditor would have a $30,000 secured claim and a $20,000 unsecured claim for its $50,000 debt. Thus the undersecured creditor is both a holder of a secured claim and a holder of an unsecured claim in bankruptcy. Given the recent decline in agricultural land, most farm lenders are likely to be undersecured. Trade creditors, such as seed, fuel, feed and chemical dealers, are likely to be unsecured as they traditionally have not required collateral as a condition of extending credit.

Exempt property. Debtors are entitled to claim certain property as exempt from creditors's claims in bankruptcy.[41] The general effect of the exemption is to preclude unencumbered property from liquidation. Consensual liens on exempted property generally will survive bankruptcy[42] unless the liens are avoided.[43]

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37. 11 U.S.C.A. § 541(6) (West 1979). Custom farming income is not considered property of the estate. In re Lotta Water Land Co., 25 Bankr. 32 (Bankr. N.D. Tex. 1982). Exclusions from property of the estate are enumerated at 11 U.S.C.A. § 541(b). (West 1979). The corpus of a spendthrift trust is not property of the estate. *In re* Leimer, 54 Bankr. 587 (Bankr. D. Neb. 1985).

38. 11 U.S.C.A. § 522(a) (West 1979).

39. *Id.* § 522(b); *In re* Hillyard, 48 Bankr. 10 (Bankr. W.D. Mo. 1984); *In re* Lawrence, 41 Bankr. 36 (Bankr. D. Minn. 1984); *In re* Jackels, 55 Bankr. 67 (Bankr. D. Minn. 1985); *In re* Beck, 61 Bankr. 671 (Bankr. D. Neb. 1985); *In re* Wobig, 73 Bankr. 292 (Bankr. D. Neb. 1987). *See* Kunkel, Walter & Lander, *The Reach of Prefiling Security Interests in Postfiling Proceeds of Agricultural Collateral—An Analysis of Bankruptcy Code Section 552*, 8 J.AGRIC. TAX'N & L. 311 (1987).

40. 11 U.S.C.A. § 506(a) (West 1979).

41. *Id.* § 522. *See generally*, Duncan, *Through The Trap Door Darkly: Nebraska Exemption Policy and the Bankruptcy Reform Act of 1978*, 60 NEB.L.REV. 219 (1981).

42. 11 U.S.C.A. § 522(c)(2) (West 1979).

The major personal property exemptions in Nebraska include: all immediate personal possessions;[44] kitchen utensils and household furniture up to $1500;[45] professional tools or equipment up to $1500;[46] six months food and fuel;[47] an additional $2500 wildcard personal property exemption for debtors not qualifying for the homestead exemption;[48] up to $10,000 cash value in a life insurance policy[49] and/or annuity,[50] and most retirement plans.[51] The homestead real estate property exemption is $10,000,[52] although the exemption may be waived for mortgages.[53] Judicial liens and nonpossessory, nonpurchase money liens in certain exempt personal property, including professional tools, may be voided in bankruptcy if the property is held primarily for personal, family, or household purposes.[54]

Trustee's avoiding powers. The bankruptcy trustee may avoid certain prepetition transactions, including preferential transfers[55] and fraudulent conveyances.[56] Any property recovered by the trustee increases the recovery of unsecured claimants at the expense of the party (typically secured) giving up the property recovered.

Preferential transfers. Preferential transfers are prepetition

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43. *Id.* § 522(f).
44. NEB.REV.STAT. § 25-1556(1) (1985).
45. *Id.* § 25-1556(2).
46. *Id.* This exemption may be claimed by both spouses in a joint case. *In re* Keller, 50 Bankr. 23 (Bankr. D. Neb. 1985).
47. NEB.REV.STAT. § 25-1556(2) (1985).
48. *Id.* § 25-1552. This would include a head of household whose homestead exemption was ineffective against a mortgagee. NEB.REV.STAT. § 40-103 (1984). A wife is entitled to claim this wildcard exemption even though her husband claimed a homestead exemption. *In re* Hartmann, 19 Bankr. 844 (Bankr. D. Neb. 1982). *See also In re* Welborne, 63 Bankr. 23 (Bankr. D. Neb. 1986).
49. NEB.REV.STAT. § 44-371 (Supp. 1987). Sickness and accident insurance proceeds up to $200 per month are also exempt, as are disability lump-sum settlements. *Id.* §§ 44-754- to 755 (1984), 25-1563.01 - 1563.02 (Supp. 1987). *But see id.* § 44-755. Insurance benefits from fraternal societies were completely exempt prior to August 29, 1987. *Id.* § 44-1089 (Cum.Supp. 1986), *amended* (Supp. 1987).
50. *Id.* § 44-371 (Supp. 1987). Prior to August 29, 1987, annuities in any amount were exempt. *Cf. id.* (1984). Under current law up to $10,000 in life insurance cash values, annuities, and fraternal society insurance proceeds are exempt. *Id.* §§ 44-371, 44-1089 (Supp. 1987). The new exemptions apply to cases filed after August 29, 1987. 1987 Neb. Laws, LB 335 sec. 6.
51. NEB.REV.STAT. §§ 25-1563.01 (Supp. 1987).
52. NEB.REV.STAT. § 40-101 (Cum.Supp. 1986). For married spouses, only the husband is entitled to claim the homestead exemptions as the head of household. *In re* Hartmann, 19 Bankr. 844 (Bankr. D. Neb. 1982).
53. NEB.REV.STAT. § 40-103 (Reissue 1984). *See id.* §§ 40-101 to -117.
54. 11 U.S.C.A. § 522(f) (West 1979). Federal agencies are subject to exemptions on the same basis as any other creditor. *In re* Kight, 49 Bankr. 437 (Bankr. W.D. Pa. 1985); *In re* Bubert, 61 Bankr. 362 (W.D. Tex. 1986), *aff'd'* 809 F.2d 259 (5th Cir. 1987); United States v. Victory Highway Village, Inc., 662 F.2d 488 (8th Cir. 1981).
55. 11 U.S.C.A. § 547 (West 1979).
56. *Id.* §§ 548, 544.

transfers to favored (or, perhaps, insistent) creditors. For instance, a farmer who in good faith sells crops and livestock pledged to his operating creditor, takes the sale proceeds, pays family living expenses and local trade creditors, and is unable to pay the operating creditor in full, may have made a preferential transfer. Another scenario is where the debtor anticipates filing bankruptcy and pays favored creditors in full before filing. Finally, a creditor may coerce a debtor into making payments in or outside of the regular course of business, or may setoff mutual debts. Any of these prepetition transactions may constitute preferential transfers that could be voided by the bankruptcy trustee.

The Bankruptcy Code defines preferential transfers as a transfer of the debtor's property to or for the benefit of a creditor for or on account of an antecedent debt of the debtor. The transfer must have been made while the debtor was insolvent,[57] within 90 days of the bankruptcy petition (one year for insiders,[58]) and enabling the creditor to receive more than the liquidated value of the creditor's claim if the transfer had not been made.[59] Such transfers are not void, but are voidable by the trustee.[60] Transfers not considered preferential transfers include transfers for new value and transfers made in the ordinary course of business.[61] The trustee has the burden of proving that the transfer is voidable, while the creditor has the burden of proving that it qualifies for an exception.[62] If the trustee succeeds in voiding the preferential transfer, the property becomes property of the estate and is available for distribution to creditors. The creditor who received the transfer loses the benefit of his preference, and obtains only the liquidated value of his claim, while the recovery of other creditors, particularly those holding unsecured claims, is increased accordingly.

Fraudulent conveyances. Occasionally a desperate creditor may seek to keep property, encumbered or unencumbered, from creditors. Property may be transferred to relatives or other insiders as a gift or for less than full market value. The transfer of encumbered property denies the secured creditor its collateral. The transfer of unencumbered property denies the undersecured creditor property it could reach through a deficiency judgment, as well as property that should be available to satisfy the claims of unsecured creditors. A more re-

57. A debtor is presumed to be insolvent on and during the 90 days prior to filing a bankruptcy petition. *Id.* § 547(f). Insolvency is defined as debts exceeding fairly valued assets. *Id.* § 101(31).

58. Insiders are broadly defined to include relatives and business associates. *Id.* § 101(30).

59. *Id.* § 547(b). Regarding the determination of a claim's liquidated value, *see infra* note 131 and text accompanying notes 475-81.

60. 11 U.S.C.A. § 547(6) (West 1979); *See* Federal Deposit Ins. Corp. v. Davis, 10 C.B.C.2d 1413, 733 F.2d 1083 (4th Cir. 1984).

61. 11 U.S.C.A. § 547 (c) (West 1979).

62. *Id.* § 547(g).

cent issue raised in this area of the law is whether foreclosure sales for significantly less than full market value constitute fraudulent conveyances.[63]

The Bankruptcy Code has two provisions dealing with fraudulent conveyances, one relying on state law and the second relying on bankruptcy law. Section 544 allows the trustee to void transfers defined as fraudulent under state law if a unsecured claim holder exists in the case.[64] Section 548 allows the trustee to void fraudulent transfers made (whether voluntary or involuntary) and obligations incurred, within one year before filing the bankruptcy petition, when the intent of the transaction was to hinder, delay, or defraud a creditor.[65] The section 544 fraudulent conveyances authority is significantly more powerful than that available under section 548: conveyances for less than fair consideration may be fraudulent without actual fraudulent intent, and conveyances up to four years prior to bankruptcy may be challenged.

The section 544 power to avoid fraudulent transfers depends upon state law to define whether a transfer is fraudulent. Nebraska has adopted the Uniform Fraudulent Conveyances Act.[66] The major feature of the act is that conveyances made by debtors for less than adequate consideration are fraudulent per se against creditors even where the debtor lacked actual fraudulent intent.[67] Such transactions include conveyances which render the debtor insolvent,[68] conveyances which leave a the debtor's business undercapitalized,[69] and conveyances made when the debtor believes he is unable to pay debts as they mature.[70] Conveyances by debtors are also fraudulent when undertaken with actual intent to hinder, delay or defraud creditors.[71] The statute of limitations is four years, significantly longer than the one year fraudulent conveyance limitation of section 548(a)(1).[72]

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63. 11 U.S.C.A. § 101(50)(West 1979); *In re* Ruebeck, 55 Bankr. 163 (Bankr. D. Mass. 1985); *In re* Hulm, 11 C.B.C.2d 152, 738 F.2d 323 (8th Cir. 1984), *cert. denied*, 469 U.S. 990, 1984. *See* Berger, *supra* note 14; Comment, *supra* note 14.
64. 11 U.S.C.A. § 544(b) (West 1979) *See In re* Falcone, BK83-736 (D. Neb. 1985); *In re* Kock, 20 Bankr. 453 (Bankr. D. Neb. 1982).
65. 11 U.S.C.A. § 548(a)(1)(West 1979).
66. NEB.REV.STAT. §§ 36-601 to -613 (1984).
67. *Id.* § 36-601.
68. *Id.* § 36-604, 36-602.
69. *Id.* § 36-605.
70. *Id.* § 36-606.
71. *Id.* § 36-607. Regarding fraudulent conveyances of partnership assets *see id.* § 36-608.
72. *Id.* § 25-207 (1985). The statute probably begins to run upon discovery of facts constituting the fraud or facts sufficient to put an ordinarily intelligent and prudent person on inquiry which if pursued would lead to such discovery. Abels v. Bennett, 158 Neb. 699, 64 N.W.2d 481 (1954); Hollenbeck v. Guardian Nat'l Life Ins. Co., 144 Neb. 684, 14 N.W.2d 330 (1944). Creditors may have a fraudulent

Property distribution. Property distribution in a chapter 7 bankruptcy case is first to secured claim holders before unsecured claim holders, although special rules apply to unsecured priority bankruptcy claims. A creditor with an allowed claim secured by a lien against property of the estate is entitled to repayment of the debt to the extent of the collateral before any other creditor is paid from the estate.[73] If the creditor is oversecured, i.e. if the collateral value exceeds the secured claim, the secured creditor may recover postpetition interest up to the amount of the equity cushion.[74] If the creditor is undersecured, i.e. the amount of the debt exceeds the collateral fair market value, the balance of the claim (i.e. the deficiency balance) is treated as an unsecured claim.[75]

Once holders of secured claims have received their collateral or its value, any remaining property is available for distribution to holders of unsecured claims. However, certain unsecured claims are entitled to priority treatment in that they will be satisfied first in full before any distribution is made to general holders of unsecured claims. There are seven priority claims categories, the most important of which in farm liquidations typically are administrative expenses[76] and allowed unsecured tax claims.[77] A priority category must be paid in full before claimants in a lower priority category receive anything.[78] If there are not sufficient assets to pay a priority class in full, the members receive a pro rata share.[79]

After the payment of priority unsecured claims, any remaining property is available for distribution to the remaining unsecured cred-

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conveyance set aside unless the purchaser is an innocent purchaser for value. NEB.REV.STAT. § 36-609 (1984).

73. 11 U.S.C.A. § 506(a) (West 1979). The value used is the collateral's fair market value. *In re* Courtright, 57 Bankr. 495 (Bankr. D. Ore. 1986).

74. 11 U.S.C.A. § 506(a) (West 1979); *In re* Glenn, 796 F.2d 1144 (9th Cir. 1986). *But see In re* Churchfield, 62 Bankr. 399 (Bankr. E.D. Mich. 1986). The recovery of postpetition interest by oversecured creditors reduces the amount of property available to satisfy unsecured claims.

75. 11 U.S.C.A. § 506(a) (West 1979).

76. *Id.* § 507(a)(1). Administrative expenses include unpaid filings fees, costs associated with preserving the estate, taxes incurred by the estate, and trustee compensation. *Id.* § 503(b). Trustee's fees are limited in a chapter 7 case to a maximum of up to 15% of the first $1000 in cash disbursed to creditors, 6% for cash disbursements between $1000 and $3000, and 3% for cash disbursement amounts exceeding $3000. *Id.* § 326(a). Property turned over to secured creditors is not included in the trustee's fee calculations. H. R. REPT. NO. 95-595, 95th Cong., 1st Sess. 327 (1977), *reprinted in* 5 U.S.CONG. & ADM. NEWS 5787 (1978). *But cf.* 11 U.S.C.A. § 506(c) (West 1979) 506(c). Trustee's fees must be reasonable. *Id.* § 330(a)(1). Regarding debtors's attorney fees *see id.* § 329.

77. *Id.* § 507(a)(7).

78. *Id.* § 726(a)(1).

79. *Id.* § 726(b).

itors.[80] If any property remains after unsecured claims have been paid, interest is paid at the legal rate from the date of filing on any unsecured claim (including priority unsecured claims).[81] Any remaining property is paid to the debtor.[82]

Debt discharge. Most debts not paid through the chapter 7 liquidation process are discharged if the debtor is an individual.[83] Major exceptions to discharge include: certain prepetition taxes,[84] unscheduled claims,[85] and claims based on the receipt of money, property, or services obtained by fraud, false pretenses or a materially false written statement about the debtor's financial condition made to deceive creditors and reasonably relied upon thereby.[86] A discharge will be denied where the debtor has committed fraud in connection with the case.[87] A discharge cannot be obtained if the debtor received a discharge under chapter 7 in a case begun within six years before filing the petition.[88] Debts otherwise entitled to discharge may be affirmed if the affirmation is in writing, was made after the order of relief, and has been approved by the court.[89] Creditors or the trustee may object to debt discharge on the basis that the debtor is not entitled thereto.[90]

Income taxes. Taxable gains realized through liquidating assets in chapter 7 are not taxed to the debtor even if the taxes are not paid in the bankruptcy proceeding.[91] Taxes arising from prepetition liquidations may also be paid in bankruptcy (at the expense of unsecured claim holders) if sufficient assets exist and if the debtor takes the short year election. The debtor may elect to end his tax year the day before he files bankruptcy.[92] If he does so the tax claim becomes a priority expense, which may then be paid as part of the bankruptcy proceedings before unsecured claims are paid.[93] Any unpaid taxes

80. *Id.* § 726(a).
81. *Id.* § 726(a)(5).
82. *Id.* § 726(a)(6).
83. *Id.* § 523.
84. *Id.* § 523(a)(1).
85. *Id.* § 727(a)(3).
86. *Id.* § 727(a)(2).
87. *Id.* § 727(a)(2)-(7).
88. *Id.* § 727(a)(8).
89. 11 U.S.C.A. § 729(a)(10)(West 1979).
90. 11 U.S.C.A. § 727(c).
91. I.R.C. § 6012(a)(9)(West 1986). *See* Flaccus, *Taxes, Farmers, and Bankruptcy and the 1986 Tax Changes: Much Has Changed But Much Has Remained the Same*, 66 NEB.L.REV. 459 (1987); McCobb, *Tax Planning for Farmers Under Financial Distress*, 5 J.AGRIC. TAX'N & L. 76 (1983); Moratzka, *A Farmer's Tax Liability in the Event of Liquidation In or Out of Bankruptcy*, 30 S.D.L.REV. 198 (1985); Shepard, *The Bankruptcy Tax Act and the Bankruptcy Code: A Study With Reference to the Distressed Farm Economy*, ANN.SURV.BANKR.L. 159 (1986).
92. I.R.C. § 1398 (d)(2). *See* Flaccus, *supra* note 91, at 462-64.
93. 11 U.S.C. 507 (a)(7).

arising from prepetition liquidations are not discharged.[94] The possibility of being able to avoid taxes arising from asset liquidation and debt forgiveness is one of the significant advantages of chapter 7 liquidation over nonbankruptcy liquidations.[95]

B. Chapter 11 Reorganizations.[96]

Chapter 11 is a reorganization proceeding, the purpose of which is to save the debtor's business by restructuring his finances. The restructuring may involve an extension agreement, where creditors are paid in full but repayment terms are extended; a composition agreement, where creditors accept reductions in the amount repaid; or some combination of the two. In a voluntary chapter 11 case the petitioner proposes a reorganization plan to creditors, a majority of which must approve the plan. The usual focus of a chapter 11 proceeding is the negotiation of the reorganization plan between the debtor and his creditors. If the plan is disapproved by creditors, a cramdown plan may be approved by the bankruptcy court over the objection of dissenting creditors if the creditors receive at least the liquidation value of their claim, subject to the absolute priority rule. Chapter 11 proceedings are often marked by considerable litigation, typically regarding relief from the automatic stay and use of cash collateral.[97]

Eligibility. Chapter 11 cases may be voluntary or involuntary although farmers are exempted from involuntary proceedings.[98] However, involuntary plans (including liquidating plans) may be filed by creditors in a voluntary case if the farmer has not proposed a reor-

94. *Id.* § 527 (a)(1)(A).

95. However, if assets are abandoned by the trustee pursuant to § 554(a) as having inconsequential or no value to the estate, i.e. where the debtor has little or no equity in the assets, the debtor may realize gain when the assets are repossessed by creditors. *See* Mason v. Commissioner, 646 F.2d 1309 (9th Cir. 1980); *In re* Sonner, 53 Bankr. 859 (Bankr. E.D. Va. 1985); *See also* Flaccus, *supra* note 91, at 482-84.

96. *See generally* R. AARON, *supra* note 19, § 1.04; Anderson and Rainach, *Farmer Reorganizations Under the New Bankruptcy Code*, 28 LOYOLA L.REV. 439 (1982); Landers, *Reorganizing a Farm Business Under Chapter 11*, 5 J.AGRIC. TAX'N & L. 11 (1983).

97. *See* R. AARON, *supra* note 19, § 1.04 at 1-13 to 1-14.

98. 11 U.S.C.A. §§ 301, 303 (West 1979). Normally farmers are exempt from involuntary bankruptcy proceedings. *Id.* § 303(a). If up to but not more than 80% of the farmer's gross income was not from farming in the year prior to filing, however, the farmer not a farmer for bankruptcy purposes, and therefore is subject to an involuntary filing. *Id.* § 101(19). Many small farmers with significant off-farm income cannot meet the 80% gross income test and therefore are subject to involuntary bankruptcies. *See* Dole, *The Availability and Utility of Chapter 13 of the Bankruptcy Code To Farmers Under the 1984 Bankruptcy Amendments*, 16 TEXAS TECH L.REV. 433, 440 n.53 (1985). Now farmers qualifying as family farmers are also exempt from involuntary chapter 11 proceedings. 11 U.S.C.A. 303(a). *See infra* text accompanying notes 310-17.

ganization plan within 120 days.[99]

Debtor in possession. The debtor's business is operated during bankruptcy proceedings by the debtor acting as the debtor in possession.[100] The debtor in possession will be replaced by an independent trustee only upon a showing of fraud, incompetence, or gross mismanagement.[101] The debtor in possession enjoys all the powers of a bankruptcy trustee, including the lien avoidance powers.[102] The debtor in possession will operate the business unless the bankruptcy court intervenes at the request of a party in interest.[103] Overseeing the debtor in possession is the statutory creditors's committee which is typically made up of trade creditors willing to serve.[104] The committee is responsible for supervising the management efforts of the debtor in possession as well as attempting to negotiate an acceptable reorganization plan.[105]

Operating the business. The debtor is allowed to operate its business in the normal course although certain actions require bankruptcy court approval. The debtor may use, sell or lease property of the estate in the normal course of business without court approval.[106] If the sale or property use falls outside the normal course of business, court approval is required after notice and an opportunity for a hearing if one is requested.[107] The debtor in possession may also affirm or disaffirm executory contracts and leases,[108] as well as cure any de-

99. The debtor has the exclusive right to file a plan for 120 days within the order of relief. 11 U.S.C. § 1121(b). (1982) The date of the order of relief is the date the bankruptcy petition was filed in a voluntary chapter 11 case. *Id.* § 301. A creditor may file a plan, including a liquidating plan, after 120 days. *Id.* § 1121(c)(2); *In re* Button Hook Cattle Co. Inc., 747 F.2d 483 (8th Cir. 1984); *In re* Jasik, 727 F.2d 1379 (5th Cir. 1984). *See* Note, *Bankruptcy Law and the Farmer: Are Farmers Really Exempt From Forced Liquidation Under Chapter 11?*, 25 WASHBURN L.J. 264 (1986).

100. 11 U.S.C. § 1101(1)(1982).

101. *Id.* § 1104(a)(1). Alternatively the bankruptcy court may appoint an examiner rather than replace the debtor in possession. Id. § 1104(b). Either alternative is rarely used. *See* Aaron, *supra* note 19, § 1.04 at 1-15.

102. 11 U.S.C. § 1107(1982).

103. *Id.* § 1108.

104. *Id.* § 341.

105. *Id.* § 1103.

106. *Id.* § 363(c).

107. *Id.* §§ 363(b), 102(a), Bankruptcy Rules 9007, 9013, and 9014 (Supp.III 1985).

108. 11 U.S.C. § 1123(a)(5)(G) (1982). In farm bankruptcies a controversial issue is whether land contracts are contracts which may be disaffirmed, or whether the land contract was really a lien created for financing the real estate sale. For a case holding that a land contract is not an executory contract, see *In re* Booth, 19 Bankr. 53 (D. Utah 1982). *See also* Grossman, *Installment Land Contracts for the Sale of Farmland: Some Considerations in Bankruptcy*, 8 J.AGRIC. TAX'N & L. 208 (1986); Grossman, *Pre-Bankruptcy Forfeiture of Installment Land Contracts for the Sale of Farmland*, 8 J.AGRIC. TAX'N & L. 357 (1987). Regarding farm

faults.[109] Special procedures must be followed to use cash collateral. Cash collateral is broadly defined to include any sale of pledged inventory or equipment or collection of accounts.[110] The debtor in possession may not use cash collateral without consent of the secured party or a court hearing which considers whether the interest of the secured party is adequately protected.[111] Secured claimants are also entitled to adequate protection of their collateral if it is used in operating the business and the creditor requests relief from the automatic stay.[112]

Operating credit. Postpetition trade creditors who do business with the debtor in possession may be paid immediately.[113] Trade creditors have first priority unsecured claim as an administrative expense.[114] If operating creditors are unwilling to extend credit on such terms, they may be granted a "superpriority" lien on property of the estate with bankruptcy court approval if existing lienors on the same collateral are adequately protected (i.e. oversecured).[115]

Reorganization plan. While the debtor in possession is operating the business, the debtor is also negotiating a reorganization plan with his creditors. The debtor in possession has an exclusive right to propose a reorganization plan within 120 days after the order of relief is entered.[116] Thereafter, unless an extension is granted, any party in interest may propose a plan,[117] including a liquidating plan.[118] The plan may involve an extension or composition, a partial liquidation, or a bulk sale to another entity. The procedural steps to reach agreement on a plan include negotiation among the debtor in possession, the creditors's committee, secured claim holders, and equity holders (if any).

The plan must group the creditors' claims by class according to their legal interests.[119] Typical groupings are made as follows: (1) each secured claim holder is placed in an individual class, (2) unsecured claim holders owed small amounts are grouped in a class, (3) all priority unsecured claims are grouped in a class, and (4) all other

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leases in bankruptcy *see* Grossman & Fischer, *The Farm Lease in Bankruptcy: A Comprehensive Analysis*, 59 NOTRE DAME L.REV. 598 (1984).

109. 11 U.S.C. § 365 (1982). The rejected contract obligor or lessor has a claim for the breach of contract. *Id.* §§ 365(g), 502.

110. *Id.* § 363(a).

111. *Id.* §§ 363(c)(2), 363(c)(3), 361. *See also infra* text accompanying notes 167-78.

112. 11 U.S.C. § 362(d)(1) (1982). *See also infra* text accompanying notes 149-66.

113. *Id.* § 364(a).

114. *Id.* §§ 364(a), 503(b)(1)(A), 507(1).

115. *Id.* § 364(c)-(d).

116. *Id.* § 1121(b). If an independent trustee has been appointed, the debtor loses the exclusive right to propose a plan during the first 120 days of the case. *Id.* § 1121(c)(1); Bankruptcy Rule 3017 (Supp.III 1985).

117. 11 U.S.C. § 1121(c).

118. *Id.* § 1123(b)(4). *See* Comment, *supra* note 99.

119. *Id.* § 1122; Bankruptcy Rule 3013 (Supp.III 1985).

unsecured claim holders are placed in a class.[120] The plan must identify how each class will be treated.[121] It will typically be proposed that the class of small unsecured claims be paid in full.[122] The priority claims must be proposed to be paid in full, although payment may be deferred.[123] Proper grouping is important to obtaining successful acceptance of the plan. Classes vote according to a weighted majority.[124] For creditors, the weighted majority is one half of the class by number and two thirds by debt amount.[125] Only those claims voting are counted. All classes must accept the plan to avoid a cramdown;[126] if one class dissents the plan has been defeated. A single secured claim holder therefore may unilaterally defeat a plan if that particular creditor's class (of which the creditor would typically be the only member) votes against the plan.

Only impaired classes actually vote on a proposed reorganization plan. A class which will be paid in full under the plan is not impaired and therefore is deemed to have accepted the plan without a vote.[127] Typically the classes of small unsecured claims and priority claims are unimpaired in a proposed reorganization plan. A class which is offered nothing under the plan, e.g. unsecured creditors, is deemed to have rejected the plan without a vote.[128] Impaired claims, those (typically secured) which will not be paid in full under the plan but which would receive some payment will vote on the plan.

Once the debtor in possession proposes a plan, the debtor may canvass the impaired classes.[129] The bankruptcy court must approve the debtor's disclosure statement prepared to adequately inform the impaired classes regarding the plan.[130] The plan must indicate how all classes will be treated, whether a class is impaired, and the liquidated value of all claims.[131] After the disclosure statement has been approved, the ballots are distributed to the impaired classes along with

120. *See* R. AARON, *supra* note 19, § 1.04 at 1-21 to 1-22.
121. 11 U.S.C. § 1123(a)(2), 1123(a)(3) (1982).
122. This is so that at least one class will be deemed to have accepted the plan in case a cramdown is attempted. *Id.* § 1126(f). *See also infra* text accompanying notes 131-34.
123. 11 U.S.C. §§ 1123(a)(1), 1129(a)(9) (1982).
124. Bankruptcy Rule 3018 (Supp. III 1985).
125. 11 U.S.C. § 1126(c) (1982).
126. *Id.* § 1129(a)(8).
127. *Id.* § 1126(f). This also applies to claims where prepetition default is proposed to be cured under the plan. *Id.* at § 1124(2).
128. *Id.* § 1126(g).
129. *Id.* § 1125.
130. *Id.* § 1125(b).
131. R. AARON, *supra* note 19, § 1.04 at 1-23. The liquidated value of a claim is what the claimant would receive in chapter 7 bankruptcy. 11 U.S.C. § 1129(a)(7)(1982). This is referred to as the best interests of creditors. Under the reorganization, creditors are guaranteed that they will receive at least what they would have received in bankruptcy liquidation proceedings.

the disclosure statement[132] and, typically, a copy of the reorganization plan itself.

Confirmation standards. After the impaired classes have voted the bankruptcy court holds a confirmation hearing.[133] The plan can be confirmed only if all confirmation requirements are met.[134] One requirement is that all creditors receive as a minimum the liquidated value of their claim.[135] In addition, the plan must be feasible, i.e. unlikely to result in liquidation or further reorganization.[136] Each impaired class must have voted to accept the plan by weighted majority.[137] If an impaired class has rejected the plan, it cannot be confirmed unless additional confirmation requirements, the cramdown requirements, are met.

The purpose of the cramdown option is to prevent a holdout creditor from unreasonably blocking plan confirmation. To be approved by the bankruptcy court over the objection of an impaired class, a cramdown reorganization plan must not discriminate unfairly among impaired classes, and it must be fair and equitable regarding impaired classes.[138] Fair and equitable treatment of impaired secured claims means that under the plan (1) the secured claim holder will retain its lien, and receive deferred cash payments totaling at least the value of the collateral as of the plan's effective date, (2) the proceeds of any sale of collateral is subject to the secured claim holder's lien, or (3) the secured claim holder realizes the "indubitable equivalent" of its claim.[139] Fair and equitable treatment of impaired unsecured claims (which includes the unsecured claims of undersecured creditors) means that under the plan (1) unsecured claim holders will receive or retain property valued on the effective date of the plan equal to the allowed amount of the claim (i.e. the claim is paid in full), or (2) that no junior claim or interest will receive or retain any property (the absolute priority rule).[140] Thus, for the debtor to retain any property under the plan all dissenting impaired unsecured claims must be paid in full, even if the liquidated value of such claims is zero.[141]

Section 1111(b)(2) election.[142] One additional option available to

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132. Bankruptcy Rule 3017(d)(Supp.III 1985).
133. 11 U.S.C. § 1128 (1982).
134. *Id.* § 1129(a).
135. *Id.* § 1129(a)(7). *See supra* note 131.
136. *Id.* § 1129(a)(11). An exception is if the plan is a liquidating plan. *Id.*
137. *Id.* § 1129(a)(8).
138. *Id.* § 1129(b)(1). *See* Klee, *All You Ever Wanted to Know About Cram Down Under the New Bankruptcy Code*, 53 AM.BANKR.L.J. 133 (1979).
139. 11 U.S.C. § 1129(b)(2)(A)(1982).
140. *Id.* § 1129(b)(2)(B)(ii). *See also infra* text accompanying notes 179-91.
141. This applies to individual reorganizations. For corporate reorganizations, dissenting impaired creditors would need to be paid in full before shareholders could receive anything.
142. *See* Pusateri, Swartz & Shaiken, *Section 1111(b) of the Bankruptcy Code: How*

undersecured creditors that can further complicate plan acceptance is the section 1111(b)(2) election. Generally an undersecured creditor's claim is divided into a secured claim to the extent of the collateral value, and an unsecured claim for the deficiency.[143] Section 1111(b)(2) authorizes a class of unsecured claimants that include undersecured creditors to elect to have the claim treated as secured to the extent of the entire claim, not simply to the extent of the collateral value, and to waive the deficiency claim.[144] This provides the undersecured creditor with some interesting options. If the creditor has enough votes to reject the plan it will not make the 1111(b)(2) election. However, if the undersecured creditor does not have the votes to control the class, it can make the 1111(b)(2) election. If the plan is approved, the undersecured creditor gains the opportunity to share in any appreciation of the collateral up to the full amount of the allowed claim, rather than being limited to the asset's value on the effective date of the plan.

Effect of confirmation. A confirmed plan (whether creditor approved or cramdown) binds all parties, vests all property in the debtor (subject to the plan's debt repayment requirements), and effects a discharge on the unpaid portion of debts.[145] A discharge cannot be obtained if the debtor received a chapter 11 discharge in a case begun within six years before filing the petition.[146] If the plan is not confirmed, the bankruptcy court is likely to approve a creditor's liquidating plan if one has been filed, or to dismiss the case and leave creditors to their state debt collection remedies.

Problems with chapter 11 farm reorganizations. Confirmation of a chapter 11 reorganization plan has been difficult for farmers since unsuccessful reorganizations have resulted in liquidation.[147] The major legal obstacles have been the adequate protection requirement, cash collateral disputes, and the absolute priority rule. While the 1986 *Ahlers*[148] decision has relaxed both the adequate protection and the absolute priority rules in farm chapter 11 reorganizations in the Eight

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Much Does the Debtor Have to Pay and When Should the Creditor Elect?, 58 AM.BANKR.L.J. 129 (1984).

143. 11 U.S.C. § 506(a) (1982); *See also supra* text accompanying note 40.

144. 11 U.S.C. § 1111(b)(2) (1982). Undersecured creditors are ineligible for the § 1111(b)(2) election if their claims are worthless or of little value, or if the loan is with recourse and the collateral will be sold under the plan or while the case is being administered. *Id.* § 1111(b)(1)(a)(ii). In the latter case the creditor will have an opportunity to bid on the collateral at sales and would still have an unsecured claim for any deficiency.

145. *Id.* § 1141.

146. *Id.* § 727(a)(8).

147. If the farmer's reorganization plan was not confirmed and a liquidating plan had been filed, the farmer would be subject to involuntary liquidation. *See supra* note 99 and accompanying text. Otherwise, the automatic stay would be lifted and creditors would then be free to pursue debt collection remedies.

148. *In re* Ahlers, 794 F.2d 388 (8th Cir. 1986), *cert. granted*, 55 U.S.L.W. 3852 (1987).

Circuit, the prior inability for farmers to successfully reorganize in chapter 11 was a major factor leading to enactment of chapter 12.

Adequate protection. A major stumbling block to successful chapter 11 farm reorganizations is the adequate protection requirement. Secured creditors are entitled to receive adequate protection of the value of their collateral in reorganization proceedings.[149] The issue is raised when a creditor requests relief from the automatic stay. Creditors may petition the bankruptcy court for relief from the stay if the debtor is unable to provide adequate protection of the creditor's interest, or if the debtor has no equity in the property and it is not necessary for an effective reorganization.[150] What constitutes adequate protection is not defined by the Code, but does include cash payments, periodic cash payments, an additional or replacement lien to compensate the creditor for a decrease in the value of its collateral,[151] or such other relief that will allow the secured party to realize the indubitable equivalent of its interest in the property.[152] In farm cases this would include any collateral value declines resulting from normal asset depreciation plus any land value declines. If the debtor cannot provide adequate protection, the secured creditor is entitled to obtain relief from the automatic stay and to pursue state law debt collection remedies.[153] To provide adequate protection the debtor must give the secured creditor cash payments or additional collateral to the extent that the bankruptcy stay or use of the collateral reduces collateral value.[154] In addition the secured creditor is allowed to realize the "indubitable equivalent" of its interest in the collateral.[155] Some (but not all) courts have ruled that the indubitable equivalent includes compensating the creditor for the loss of the right to foreclose, the right of reinvestment, and other lost opportunity costs.[156] These cases have awarded creditors postpetition interest payments on the value of the collateral in addition to cash payments for any decline in collateral value.[157] However, the Eighth Circuit has taken a more limited approach, ruling that adequate protection *may* include postpetition in-

149. 11 U.S.C. § 361(1982). *See* Molbert, *Adequate Protection for the Undersecured Creditor in a Chapter 11 Reorganization: Compensation for the Delay in Enforcing Foreclosure Rights*, 60 N.D.L.REV. 515 (1984).

150. *Id.* § 362(d).

151. *Id.* § 361(1)-(2).

152. *Id.* § 361(3).

153. *Id.* § 362(d)(1).

154. *Id.* §§ 361(1)-(2).

155. *Id.* § 361(3).

156. *In re* American Mariner Indus. Inc., 734 F.2d 426 (9th Cir. 1984); Grundy Nat'l Bank v. Tandem Mining Crop., 754 F.2d 1436 (4th Cir. 1985). *Contra In re* Timbers of Inwood Forest Assocs. Ltd., 793 F.2d 1380 (5th Cir. 1986).

157. Normally, postpetition interest on secured debts is stayed unless the creditor is oversecured in which case the debtor must pay interest at the contract rate to the extent of the equity cushion. 11 U.S.C. § 506(b)(1982).

terest payments in compensation for the delay of enforcing the creditor's foreclosure rights.[158]

If farmers filing bankruptcy could afford to pay postpetition interest, they probably would not be in bankruptcy. Thus, adequate protection requirements have posed a significant threshold requirement for farmers seeking chapter 11 protection. If relief from the automatic stay is granted for failure to provide adequate protection the farmer's reorganization efforts are in effect ended. The Eighth Circuit, in the important 1986 *Ahlers*[159] decision, promulgated special adequate protection rules which gave farmers in chapter 11 relief from the adequate protection requirements. The Court of Appeals affirmed its earlier ruling that adequate protection may include postpetition interest payments.[160] But, the Court ruled that adequate protection payments should not begin until the creditor could have recovered the collateral under state law, sold the collateral, and reinvested the proceeds.[161] In real estate foreclosures this would include preforeclosure notice periods, any stays, and any redemption period.[162] It also stated that adequate protection payments regarding personal property collateral would not begin until the creditor applied for them.[163] Collateral would be valued for adequate protection purposes when payments began.[164] Adequate protection payments would be made after farm products were sold rather than monthly.[165] The Court also ruled that a lien on future crops could constitute an adequate protection payment.[166] The Court did not discuss whether an adequate protection payment of postpetition interest would be appropriate in a farm reorganization case.

The *Ahlers* ruling which delays adequate protection payments on farm real estate until the creditor could have obtained the land through foreclosure gives the reorganizing farmer additional time to have his plan confirmed. Prior to *Ahlers* the request for relief from the stay and the demand of adequate protection requirement doomed most farm reorganizations from the beginning. If postpetition interest payments would not strain the reorganizing farmer's fragile cash flow, the payments for postpetition collateral value declines would.

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158. *In re* Briggs Transp. Co., 780 F.2d 1339, 1350 (8th Cir. 1985).
159. *In re* Ahlers, 794 F.2d 388 (8th Cir. 1986), *cert. granted*, 55 U.S.L.W. 3852 (1987).
160. *Id.* at 395, citing *In re* Briggs Transp. Co., 780 F.2d 1339, 1350 (8th Cir. 1985), *cert. granted*, 55 U.S.L.W. 3852 (1987).
161. *In re* Ahlers, 794 F.2d 388, 396 (8th Cir. 1986), *cert. granted*, 55 U.S.L.W. 3852 (1987).
162. *Id.* at 395-96.
163. *Id.* at 396.
164. *Id.* at 396-97.
165. *Id.* at 397.
166. *Id.*, citing *In re* Martin, 761 F.2d 472 (8th Cir. 1985), discussed *infra* at notes 172-78.

Ahlers does not dismiss the adequate protection requirement, however, and postpetition interest plus payments reflecting a loss of value which occurrs after the creditor would have obtained the land through foreclosure may be imposed on reorganizing farmer under the adequate protection rule. However, *Ahlers* does give reorganizing farmers in chapter 11 an additional period free of real estate adequate protection payments. This additional period may give the farmer sufficient time to propose a reorganization plan, which may ultimately enhance the farmer's chances for a successful chapter 11 reorganization.

Cash collateral. Prior to *Ahlers* few chapter 11 farm reorganizations survived past the relief from the automatic stay-adequate protection hearing. If they did, however, they typically would face additional difficulties in obtaining permission to use cash collateral to operate the farm pending reorganization. Cash collateral, which is defined broadly to include nearly any current asset,[167] cannot be used without the consent of the lienor unless the bankruptcy court authorizes its use.[168] If the lienor does not consent, the court may authorize the cash collateral use if the lienor's interest is adequately protected.[169] Adequate protection may be provided by cash payments, periodic cash payments, an additional or replacement lien to compensate the lien holder for any reductions in collateral value, or such other relief that will allow the secured party to realize the indubitable equivalent of its interest in the collateral.[170] In farm reorganizations the debtor typically requests permission to use the proceeds obtained from selling encumbered crops or livestock for operating expenses rather than turning the proceeds over to creditors. To meet the adequate protection requirement farm debtors will propose to give creditors a lien on next year's crop as a substitute lien. The future crop generally will be available for a replacement lien because any after acquired property interest in crops planted postpetition will be cut off by the automatic stay.[171]

The considerations in providing adequate protection for use of cash collateral are somewhat different from those regarding relief from the automatic stay. Regarding the latter, the creditor is requesting compensation for the delay in its foreclosure rights. Regarding cash collateral, the creditor is seeking to insure that the value of its collateral is maintained, even though the corpus of the collateral may change. In

167. 11 U.S.C. § 363(a)(1982).
168. *Id.* § 363(c)(2).
169. *Id.* § 363(e).
170. *Id.* § 361.
171. *Id.* § 552(a). *See In re* Beck, 61 Bankr. 671, 673 (Bankr. D. Neb. 1985), citing *In re* Sheehan, 38 Bankr. 859 (D.S.D. 1984). Livestock and perennial crops, such as alfalfa, are however likely to be subject to any prepetition security interests. 11 U.S.C. § 552(b)(1982). *See also In re* Wobig, 73 Bankr. 292 (Bankr. D. Neb. 1987), discussed *infra* notes 433-36.

both cases the creditor is seeking to protect its interest, but its interest is not the same in both cases. Adequate protection as it relates to use of farm cash collateral was considered by the Eight Circuit in *In re Martin*.[172] In *Martin* the debtor farmer proposed to sell stored grain subject to a Commodity Credit Corporation (CCC) lien, use the proceeds to plant a new crop, and provide CCC with a substitute lien on the future crop.[173] The farmer also proposed to assign federal crop insurance proceeds to the CCC.[174] The Eighth Circuit ruled that in considering requests to use cash collateral, the bankruptcy court must establish the value of the secured creditor's interest, identify the risks to secured party's value resulting from the proposed cash collateral use, and determine whether the debtor's offer of adequate protection protects collateral value as nearly as possible against risks to value consistent with the concept of indubitable equivalence.[175] Regarding use of a substitute lien on future crops, the Court indicated that the bankruptcy court's factual determinations should include (1) the anticipated crop yield in light of the land's productivity, (2) the farmer's husbandry practices, including proven crop yields from prior years, (3) the health and reliability of the farmer, (4) the condition of the farmer's machinery, (5) whether encumbrances on the machinery may subject it to repossession before the crop is harvested, (6) any competing liens on the future crop, (7) crop insurance availability and the likelihood of an uninsured loss, and (8) anticipated market prices for the crop.[176] The Court indicated that the bankruptcy court should enjoy broad discretion in requiring modification of the proposed adequate protection to protect creditors's interests, and should reject the offer of adequate protection if creditors's interests are not adequately protected thereby.[177]

Cash collateral disputes are unlikely to hinder a farm reorganization if the farmer is able to offer adequate protection to creditors with replacement liens on cash collateral. Where the farmer is unable to

172. *In re* Martin, 761 F.2d 472 (8th Cir. 1985).

173. Regarding the CCC, *see* Comment, *The Commodity Credit Corporation's Price Support Loan Program: Should It Continue?*, 31 S.D.L.REV. 350 (1986).

174. Regarding federal crop insurance, *see* 7 U.S.C. § 1508(a) (1982); 1 DAVIDSON, AGRICULTURAL LAW § 1.31 (1981 & Cum.Supp. 1986).

175. *In re* Martin, 761 F.2d 472, 476-77 (8th Cir. 1985).

176. *Id.* at 477. The market price criterion would also involve a consideration of possible or likely changes in farm programs. *See generally* Comment, *supra* note 173; Comment, *Federal Direct Price Support Payment Programs*, 31 S.D.L.REV. 363 (1986). Normally cash grain farmers can predict next year's price with a high degree of certainty if they participate in the federal farm program. Only the future yield would be unknown. *See In re* Ahlers, 794 F.2d 388, 408-10 (8th Cir. 1986), *cert. granted*, 55 U.S.L.W. 3852 (1987).

177. *In re* Martin, 761 F.2d. 472, 477-78 (8th Cir. 1985). The Court also suggested that CCC would be entitled to interest payments if the farmer's repayment of its CCC loan were delayed through the use of cash collateral. *Id.* at 477.

provide cash collateral, of course, the reorganization attempt is doomed. In some cases the expense and perhaps more significantly the delays occasioned by cash collateral litigation may be sufficient to frustrate the farm debtor's reorganization attempt.[178]

Absolute priority rule. If the farm debtor can survive the adequate protection challenges and cash collateral disputes, he then can propose a reorganization plan. If an undersecured creditor objects to the plan, however, the absolute priority rule will in virtually every case prevent plan confirmation, even as a cramdown. Under the absolute priority rule if any impaired class rejects the plan, the class must be paid in full before any junior class (including equity holders, e.g. the reorganizing farmer) can receive anything, even in a cramdown.[179] Thus, since in most farm reorganization cases there are no or insufficient unencumbered assets available to satisfy unsecured claims for deficiencies, the farmer could not retain an equity interest in the farm unless all dissenting classes were paid in full. The absolute priority rule amounts to an absolute bar to confirmation, in farm reorganizations and in virtually all noncorporate reorganizations, if the plan is not accepted by creditors.[180] As a result, courts have fashioned exceptions to the absolute priority rule which allow shareholders to retain an equity interests in the reorganized business, even if dissenting unsecured claims were not paid in full, to the extent that the shareholders contributed new value essential to a successful reorganization as part of the reorganization plan.[181] In *Ahlers*, the Eight Circuit extended this fresh contribution exception to farm reorganizations where the farmer contributes his labor and management to the reorganization effort.[182]

In *Ahlers* undersecured creditors argued that the debtor could not propose a confirmable plan because the creditors intended to vote against any plan that would not pay unsecured claims in full, preventing cramdown confirmation under the absolute priority rule.[183] How-

178. An issue in *Martin* was whether the appeal was mooted by the passage of time, i.e. planting had already occurred when the appeal was held. The Court of Appeals held that the issue was not moot, but instructed the bankruptcy court to reconsider the cash collateral issue only if the debtor still needed to use the cash collateral, i.e. had not made other financial arrangements. *Id.* at 474, 478-79.

179. 11 U.S.C. § 1129(b)(2)(B)(ii)(1982).

180. This feature of the absolute priority rule has been criticized as being appropriate only to corporate reorganizations where shareholders and managers are distinct groups. Comment, *In re Ahlers*: *The Farm Reorganization Exception to the Absolute Priority Rule*, 32 S.D.L.REV. 167, 172-74(1987).

181. Case v. Los Angeles Lumber Products Co., 308 U.S. 106 (1939); *In re* Landau Boat Co., 13 Bankr. 788 (Bankr. W.D. Mo. 1981); *In re* Marston Enterprises, Inc., 13 Bankr. 514 (Bankr. E.D.N.Y. 1981). *See* Comment, *supra* note 180 at 174-75.

182. *In re* Ahlers, 794 F.2d 388, 402-403 (8th Cir. 1986), *cert. granted*, 55 U.S.L.W. 3852 (1987).

183. *Id.* at 399-401.

ever, the Court, after reviewing the fresh contribution exception cases, concluded that the absolute priority rule was subject to a fresh contribution exception where the debtor "contributes to the reorganization enterprise something that is reasonably compensatory and is measurable."[184] The Court then asserted that "a farmer's efforts in operating and managing his farm is essential to any successful farm reorganization, and that such yearly contribution is measurable in money or money's worth."[185] The Court suggested that in determining the value of the farmer's contributions, it would not be difficult to value the farmer's labor, experience and expertise. But, it concluded that valuing the retained ownership interest would be more difficult.[186] The Court suggested, however, that no ownership equity would mature until the plan had been completed and all secured claims paid.[187] To protect unsecured claimants the Court suggested that any income in excess of that anticipated by the reorganization plan should be paid to unsecured claimants on a prorata basis up to full payment without interest.[188]

One factor noted by the Eighth Circuit but not formally incorporated into its ruling was that Ahlers proposed to pay the unsecured claims in full without interest, as opposed to no recovery if the farm were liquidated.[189] The Court noted that Ahlers had excellent prospects for rehabilitation in that if his debt was restructured to reflect current asset values he could pay all secured claims and "make substantial payments to unsecured creditors."[190] Nowhere in its opinion does the Court suggest that its ruling is contingent upon the creditor making substantial payments to unsecured creditors. Yet one won-

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184. *Id.* at 402.

185. *Id.*

186. *Id.* at 403. One commentator has suggested that the cost of farm management services could be used to value the farmer's labor and management contribution, and that a capitalized earnings test could be used to calculate ownership equity. Comment, *supra* note 180, at 177-78.

187. *In re* Ahlers, 794 F.2d 388, 403 (8th Cir. 1986), *cert. granted*, 55 U.S.L.W. 3852 (1987).

188. *Id.* at 403. The Court also suggested that if any encumbered property were sold during the period of the plan, any surplus should be distributed to unsecured claim holders. *Id.*

189. *Id.* at 413. This outcome was dependent on Ahlers being able to achieve their projected farm income, which includes future crop yields and crop prices, both of which are uncertain. In addition, because the farm price supports are scheduled to decrease from from 1985 to 1990, and because further price support reductions may result from Gramm-Rudman-Hollings or other deficit reduction measures, both suggest that Ahlers projected farm income should be reduced to accommodate these expectations. *See* Comment, *Food Security Act of 1985: Price Support Programs*, 31 S.D.L.REV. 490 (1986); Comment, *Gramm-Rudman-Hollings and the Farm Bill: Solution or Suicide Pact?*, 31 S.D.L.REV. 541 (1986).

190. *In re* Ahlers, 794 F.2d 338, 399 (8th Cir. 1986), *cert. granted*, 55 U.S.L.W. 3852 (1987).

ders if the outcome would have been the same if unsecured creditors would have received little or no payment. Implicit in the Court's analysis is the assumption that the unsecured creditors were substantially better off with the plan than they would be in liquidation.[191] If this suggestion is correct, the *Ahlers* fresh contribution exception is implicitly subject to the limitation that unsecured claimants must receive significantly more than the liquidated value of their claim (which often is nothing). In a case where unsecured claimants would receive little more than the liquidated value of their claim under the proposed reorganization plan there would seem to be little economic benefit (generally or to creditors) from approving the reorganization, and therefore, no reason for invoking the fresh contribution exception to the absolute priority rule.

Prior to *Ahlers* the absolute priority rule constituted a near absolute barrier to farm chapter 11 reorganizations. To the extent that *Ahlers* creates a fresh contribution exception to the absolute priority rule for farm reorganizations, it provides farm debtors with the possibility of a successful chapter 11 farm reorganization. The debtor may be required to demonstrate, however, that unsecured claimants will significantly benefit from the reorganization relative to liquidation. In the absence of such a showing, the justification for allowing a fresh contribution exception might fail.

C. Chapter 13 Debt Adjustments.[192]

Chapter 13 differs markedly from chapter 11. Based on wage earner bankruptcies under former bankruptcy law, the goal of chapter 13 is confirmation of a debt adjustment plan rather than negotiation and creditor acceptance of the plan.[193] Chapter 13 is intended by Congress to provide an inexpensive alternative for consumers to chapter 7 liquidation which gives at least partial payment to unsecured creditors who would otherwise generally receive nothing in chapter 7. While creditors may seek relief from the automatic stay, the short time period of chapter 13 proceedings effectively makes seeking each relief a moot effort.[194] There is no absolute priority rule, and the debt adjustment plan may be "crammed down" objecting secured claim holders. If unsecured claim holders object to the plan then they are entitled to share any of the debtor's disposable income during the life of the plan. A chapter 13 debtor is eligible for a broader "super discharge" similar to a chapter 7 or 11 discharge. Congress drew heavily on chapter 13 in drafting chapter 12.

191. *Id.* at 402-03.

192. *See generally* R. AARON, *supra* note 19, § 13; Dole, *supra* note 98.

193. *See* R. AARON, *supra* note 19, § 13.01[1] at 13-14.

194. 11 U.S.C. 1301 (1982). Debt collection against codebtors on consumer debts is also stayed. *Id.*

Eligibility. Chapter 13 is voluntary only.[195] Eligibility is limited to individuals, sole proprietorships, and married couples filing jointly with no more than $350,000 of secured debt and $100,000 of unsecured debt, which would exclude most commercial farmers.[196] Business debtors are eligible for chapter 13 if they are neither incorporated nor a partnership.[197] Farm couples who own and operate property jointly are not automatically considered partners, and may be eligible for chapter 13.[198] The filing fee is $90.[199] The debtor must have sufficiently stable and regular income to make the proposed payments.[200] Farmers have been held to have an income sufficiently stable and regular to qualify for chapter 13.[201] A case may be converted from chapter 7 or 11 to chapter 13 only by the debtor.[202] The debtor may convert a chapter 13 case to chapter 7 or 11, or dismiss the case.[203] A chapter 13 case may be converted to chapter 7 or 11 at creditors's request but not against a farmer.[204]

Case administration. The debtor remains in possession of his property during the proceeding: there is no separate bankruptcy estate.[205] The chapter 13 plan must be filed within 15 days of the petition,[206] which may be one reason many farm bankruptcy attorneys have opted for chapter 11 rather than chapter 13. The plan or summary is sent to creditors as part of the notice for the confirmation hearing, which must be held within 25 days of the notice.[207] This will be approximately at the same time as the first meeting of creditors, which must be held within 20-40 days after filing the bankruptcy petition.[208] Plan payments must begin within 30 days of the petition unless the bankruptcy court orders otherwise, even if the plan has not been con-

195. *Id.* § 303(a). Attempts have failed to authorize involuntary chapter 13 cases to avoid abuse of chapter 7 liquidations. *See* R. AARON, *supra* note 19, § 13.01[1], at 13-3.
196. 11 U.S.C. § 109(e) (1982).
197. *Id.* § 101(29).
198. *See In re* Hansen, 60 Bankr. 359 (Bankr.D. Neb. 1982), *appeal dismissed*, 702 F.2d 728 (8th Cir. 1983) *cert. denied* 463 U.S. 1208 (1983); Ogallala Fertilizer Co. v. Salsbery, 186 Neb. 537, 184 N.W.2d 729 (1971); Dole, *supra* note 98, at 446-47.
199. 28 U.S.C.A. § 1930 (West Supp. 1987). A financially distressed debtor may pay the fee in up to four installments over up to 180 days. Fed. Bankr. R. 1006(b). The debtor's attorney may not be paid until the filing fee has been paid. *Id.* 1006(b)(3).
200. 11 U.S.C. § 101(18).
201. *See* Dole, *supra* note 98, at 447-48.
202. 11 U.S.C. §§ 706, 1112(d) (1982).
203. *Id.* § 1307(a),(b),(d).
204. *Id.* § 1307(c),(d),(e), 303(a). For the bankruptcy definition of a "farmer", *see supra* text at note 24.
205. *Id.* § 1306(b).
206. *Id.* 3015.
207. *Id.* 2002(b).
208. Fed. Bankr. R. 2003(a).

firmed.[209] Creditors are subject to the automatic stay, although there is an additional stay for codebtors on consumer debt.[210] Creditors may apply for relief from the automatic stay, and cash collateral rules apply in chapter 13 proceedings in the same fashion as in chapter 11. The major difference is that chapter 13 proceedings are so short relative to chapter 11 proceedings that adequate protection issues will not loom as large as they do in chapter 11 proceedings.[211] There is some dispute regarding whether chapter 13 debtors may claim property exemptions (as they retain all property) or may exercise lien avoidance powers.[212]

Chapter 13 plan. The plan must be filed with the petition or 15 days thereafter.[213] The debtor typically will classify creditors as secured (with each creditor normally being a separate class), priority, and unsecured.[214] Some cases have approved a special category for unsecured creditors essential to the debtor's future operation and have proposed that the plan pay such creditors more than other unsecured creditors.[215] The plan may modify the rights of secured or unsecured claim holders,[216] and provide for the curing or waiving of any default.[217] Plans may be three to five years long,[218] and secured claims may be paid over a longer period.[219] Unsecured claim holders do not vote on the plan, although they may object to confirmation.[220] Secured claim holders may reject the treatment of their claim in the plan.[221]

Confirmation standards. Any creditor may object to confirmation.[222] To be confirmed the chapter 13 plan must provide that enough of the debtor's income will be given to the trustee to make payments under the plan,[223] that all priority claims will be paid in full

209. 11 U.S.C. § 1326(a) (Supp.III 1985).
210. *Id.* § 1301.
211. *See* R. AARON, *supra* note 19, § 13.02[3] at 13-18.
212. *Id.* § 13.02[4]-[5].
213. Fed. Bankr. R. 3015.
214. 11 U.S.C. § 1322(a)(3)(1982).
215. *See* Dudley v. Mealey, 147 F.2d 268 (2d Cir. 1945); *In re* Realty Assocs. Sec. Corp., 53 F.Supp. 1010 (E.D.N.Y. 1943); Amfac Dist. Corp. v. Wolff., 22 Bankr. 510 (9th Cir. 1982).
216. 11 U.S.C. § 1322(b)(2) (1982). However a residential mortgage cannot be modified. *Id.*
217. *Id.* § 1322(b)(3),(5).
218. *Id.* § 1322(c).
219. *Id.* §§ 1322(b)(2),(3),(5), 1328(a)(1).
220. *Id.* § 1325(b)(1) (Supp.III 1985).
221. *Id.* § 1325(a)(5)(A) (1982).
222. *Id.* § 1324.
223. *Id.* § 1325(a)(1), 1322(a)(1). The court may order any entity from which the debtor receives income to pay any or all of the income directly to the chapter 13 trustee. *Id.* § 1325(c) (Supp.III 1985).

unless the claim holder accepts different treatment,[224] that the same treatment will be provided for all claims within a particular class,[225] that at least the liquidated value of all unsecured claims will be paid,[226] that the plan is proposed in good faith,[227] and that the plan is feasible.[228] A secured claim holder may accept the plan, thereby consenting to whatever treatment of its claim was proposed therein.[229] If a secured claim holder rejects the plan it must either retain its lien under the plan and receive the liquidated value of its claim,[230] or receive the collateral.[231] If the trustee or an unsecured claim holder objects to confirmation, the objecting unsecured claim holder must either be repaid in full or else the debtor must commit all disposal income to plan payments.[232]

Implementing the plan. The debtor must provide enough of his income to the trustee who will then make payments to creditors.[233] In chapter 13 cases the fees for a standing or U.S. trustee is up to 5% of all payments made under the plan.[234]

Chapter 13 debt discharge. The scope of the chapter 13 debt discharge is much broader than chapter 7 debt discharge. The only debts that are not discharged are debts for alimony, child support, and long term debt.[235] Priority claims (including priority tax claims) can be discharged, as can secured claims paid within the period of the plan. In addition, a chapter 13 debtor's super discharge could include discharge from a debt resulting from a forged check,[236] conversion of collateral,[237] or the obtaining of loans under false pretenses.[238] The justification for this super discharge is to encourage debtors to elect chapter 13 bankruptcy rather than chapter 7 liquidation.[239] Discharge occurs when the debtor has made all payments under the

224. *Id.* §§ 1325(a)(1), 1322(a)(2)(1982).
225. *Id.* §§ 1325(a)(1), 1322(a)(3).
226. *Id.* § 1325(a)(4).
227. *Id.* § 1325(a)(3).
228. *Id.* § 1325(a)(6).
229. *Id.* § 1325(a)(5)(A).
230. *Id.* § 1325(a)(5)(B).
231. *Id.* § 1325(a)(5)(C).
232. *Id.* § 1325(b)(1)(Supp. III 1985). Disposal income is income not required or maintenance or support of the debtor and his family. *Id.* § 1325(b)(2)(A). For a business debtor disposal income also includes income not required for the continuation, preservation and operation of the debtor's business. *Id.* § 1325(b)(2)(B).
233. *Id.* § 1326(c).
234. *Id.* § 1326(b).
235. *Id.* § 1328(a) (1982).
236. Cleveland Trust Co. v. Keckler, 3 Bankr. 155 (Bankr. N.D. Ohio 1980).
237. Overland Park Dodge, Inc. v. Graff, 7 Bankr. 426 (Bankr. D. Kan. 1980).
238. *In re* Marlow, 1 Collier Bankr. Cas. 2d 705 (Bankr. N.D. Ill. 1980).
239. *See* R. AARON, *supra* note 19, § 13.01[1], at 13-2.

plan.[240] The chapter 13 debtor may also be able to qualify for a "hardship discharge." The bankruptcy judge may discharge the debtor from any remaining liability under the plan if (1) the debtor has made a good faith effort to implement the plan but cannot do so for circumstances beyond the debtor's control, (2) the plan could not be implemented even if modified, and (3) unsecured claim holders had received the liquidated value of their claims.[241] The debtor would still be liable only for debts consisting of alimony, child support, and long term debt.[242] An earlier chapter 13 discharge does not bar a subsequent chapter 7 discharge within six years if the debtor paid 100% of the unsecured claims, or the debtor paid 70% of the unsecured claims, the plan was proposed in good faith and was the debtor's best effort.[243]

Chapter 13 has many advantages for farm debtors if they can meet the debt and entity limitations. The absence of the absolute priority rule is a significant advantage, as is the super discharge. The possible ability to separately classify unsecured creditors essential to future operations and give them favored repayment terms is another significant advantage. The debt and entity limitations of chapter 13, however, preclude most commercial farmers from utilizing these advantages. To those farmers who can qualify under the chapter 13 debt ceiling and entity requirements, chapter 13 is an attractive reorganization alternative.[244]

IV. CONGRESSIONAL RESPONSE

Until the *Ahlers* decision was handed down in 1986 farmers had no realistic chance of reorganizing in chapter 11 bankruptcy. Adequate protection requirements, particularly postpetition interest, led to creditors obtaining relief from the automatic stay, resulting in loss of the farmer's land and dooming any reorganization attempt. If a farmer could survive the relief from the automatic stay, the absolute priority rule virtually insured that farmers could not propose a confirmable reorganization plan, leaving farmers vulnerable to creditor's liquidating plans. Chapter 13 provided an attractive farm reorganization alternative, but was not available to corporations, partnerships, or farmers with debts exceeding the relatively modest debt limitations. In addition the chapter 13 plan had to be submitted within 15 days, a requirement many otherwise qualified farmers found difficult to

240. 11 U.S.C. § 1328(a)(1982).
241. *Id.* § 1328(b).
242. *Id.* § 1328(c).
243. *Id.* § 727(a)(9).
244. A South Dakota State University study indicated that 22% of the farmers filing for chapter 11 could have qualified for chapter 13. JANSSEN & SCHMIESING, DEP'T OF ECONOMICS, UNIV. OF SOUTH DAKOTA, REPT. NO. 87-6 EXAMINATION OF FARM BANKRUPTCY DEBTORS AND THEIR CREDITORS (1987).

meet. Thus, most farmers had no effective bankruptcy reorganization alternative.

In response to these problems, farm bankruptcy bills were introduced in Congress in 1985 which resulted in the Bankruptcy Judges, United States Trustees, and Family Farmers Bankruptcy Act of 1986. Family farmer bankruptcy legislation was first enacted in the House in 1985. The House bill allowed those qualifying as family farmers to reorganize in chapter 13 if their total debt did not exceed $1 million. The Senate instead established a new family farmer bankruptcy chapter as chapter 12 in its bill. The Senate version ultimately was adopted by the Conference Committee and was signed by President Reagan on October 27, 1986.[245]

H.R. 1397 and 1399 were introduced in the House of Representatives on March 5, 1985. Both bills modified chapter 13 proceedings and to a lesser extent modified chapter 11 proceedings for those who qualified as family farmers. H.R. 1397, introduced by Representative Rodino, would have defined family farmer as a person receiving at least 75% of his gross income for the preceding year from farming.[246] Incorporated family farms would have qualified for family farmer bankruptcy treatment if 90% of the stock was owned by the farm family and the stock was not publicly traded.[247] Those qualifying as family farmers could file for chapter 13 bankruptcy if they had regular annual income and their total debt did not exceed $1 million.[248] Family farmer debtors would have been given up to seven years to complete a chapter 13 reorganization plan,[249] which would offer greater repayment of unsecured claims. In a family farmer chapter 13 case the bankruptcy judge would have been authorized to allow repayments to begin within a reasonable time after the plan were filled rather than the standard 30 days.[250] This would reflect the fact that most farmers receive their income on a yearly basis.[251] H.R. 1397 also would have modified chapter 11 reorganizations for family farmers. The exclusive period for the debtor's filing a chapter 11 reorganization plan would have been extended for farmers from 180 days to 240 days, while the exclusive period for the debtor to obtain plan approval

245. Bankruptcy Judges, United States Trustees, and Family Farmers Bankruptcy Act of 1986, Pub.L., 99-554 § 225, 100 Stat. 3088, 3105 (codified as amended at 11 U.S.C. §§ 1201-1231). For a brief legislative history of chapter 12 *see* J. ANDERSON & J. MORRIS, *supra* note 6, at § 1.23.

246. H.R. 1397 sec. 1(b), 99th Cong., 1st. Sess. (1985).

247. *Id.* § 1(b).

248. *Id.* § 2.

249. *Id.* § 4.

250. *Id.* § 5.

251. This would be true for most cash grain farmers with a single cropping season, as would generally be the case in the plains and midwest. Dairy farmers market their products weekly, however, and many livestock producers market their production several times a year.

would have been extended for farmers from 180 days to 300 days.[252] Finally, H.R. 1397 would have reduced the farm income requirement from 80% to 75% regarding which farmers were protected from involuntary bankruptcy liquidations.[253] In his introductory statement Representative Rodino commented on the poor farm economy, the inability of farmers to have a chapter 11 plan approved, the inability of most family farmers to qualify for chapter 13 protection, the vulnerability of chapter 11 farm debtors to creditor's liquidating plans, and the likelihood that most farmers seeking to reorganize in bankruptcy would likely end up in liquidation.[254]

H.R. 1399, the Family Farmer Bankruptcy Reform Act of 1985, introduced by Representative Synar, was similar in most respects to H.R. 1397, except that it dealt exclusively with chapter 13. To qualify as a family farmer for chapter 13, a person would have had to receive more than 50% of his gross income from farming.[255] An incorporated family farm could qualify as such if the majority of the shares was owned by the farm family (including relatives) and the stock was not publicly traded.[256] Family farmers would have been eligible for chapter 13 if their debts did not exceed $1 million.[257] Family farmers would have had up to ten years to complete their chapter 13 reorganization plan.[258] The chapter 13 cramdown provision would have required (1) the secured claimant to retain the lien and receive the liquidated value of its claim, (2) the lien to attach to sale proceeds if the collateral was sold, or (3) the secured claimant to realize the indubitable equivalent of its claim,[259] similar to chapter 11. Family farmer payments on a chapter 13 plan would have been required to begin within 270 days after the plan was filed, rather than the standard 30 days.[260] In his introductory comments Representative Synar stated that the purpose of his bill was "to give family farmers facing bankruptcy a fighting chance to reorganize their debts and keep their land. The bill offers family farmers the important protection from creditors that bankruptcy provides while, at the same time, ensuring that farm lenders—rural banks, the Farmers Home Administration, farm implement dealers, seed companies and others—receive a fair repay-

252. H.R. 1397 § 3, 99th Cong., 1st. Sess. (1985).

253. *Id.* § 1(a). The bill would not have applied to existing bankruptcy cases. *Id.* sec. 7.

254. 131 CONG.REC. E778-79 (daily ed. March 5, 1985).

255. H.R. 1399 § 2, 99th Cong., 1st. Sess. (1985).

256. *Id.*

257. *Id.* § 3. Residential mortgages on family farms would have been excluded from the section 1322 requirement that residential mortgages not be modified in chapter 13. *Id.* § 4(b).

258. *Id.* § 4(c).

259. *Id.* § 4(d)(5).

260. *Id.* § 4(e). *See supra* note 251. The bill would not have applied to existing bankruptcy cases. *Id.* § 6.

ment."[261] Representative Synar commented at length on the economic difficulties farmers were facing as a result of the poor farm economy and the legal difficulties farmers encountered in attempting to have a chapter 11 reorganization plan confirmed, particularly their vulnerability to creditor's liquidating plans.[262]

The two bills were combined into a new bill, H.R. 2211, introduced by Representatives Rodino, Synar, and others on April 24, 1985. H.R. 2211 as introduced would have affected farm reorganizations in chapters 11 and 13. The minimum percentage farm income test in the family farmer definition was dropped in favor of a farm debt requirement: at least 80% of the farmer's debt would have had to be related to the farming operation.[263] Family farmers would have been eligible for chapter 13 if they had regular annual income and their debts did not exceed $1 million.[264] A chapter 13 trustee's fees in family farmer cases would have been limited to up to 10% of the first $450,000 in plan payments, and up to 3% thereafter.[265] Farm mortgages including the farmstead mortgage could have been rewritten, and family farmer chapter 13 plans could not extend beyond seven years.[266] Payments on a family farmer chapter 13 plan could, in the court's discretion, have begun later than usual 30 days after the plan was filed.[267] The exclusive period in which the debtor may file a chapter 11 reorganization plan would have been extended for farmers from 180 days to 240 days, while the exclusive period for the debtor to obtain plan approval would have been extended for farmers from 180 days to 300 days.[268] Family farmers would also have been exempt from involuntary bankruptcies.[269]

The combined bill was reported out of the Judiciary Committee on June 20, 1985 with few changes. The committee report added a requirement for incorporated family farms which stated that at least half the stock be held by the farm family and that the stock not be

261. 131 CONG.REC. E777 (daily ed. Mar 5, 1985)(statement of Rep. Synar).

262. *Id.* Rep. Synar also mistakenly asserted that only one percent of all operating farmers were immune from involuntary bankruptcy, citing an unnamed U.S. Department of Agriculture study concluding that only the top 1% of agricultural producers earned more than 70% of their income from farming. *Id.* Apparently the U.S.D.A. report referred to farmers's net income, whereas the involuntary bankruptcy protection test is a gross income test, not a net income test. *Cf.* 11 U.S.C. § 303(a). If section 303(a) were a net income test Rep. Synar would have been correct in asserting that only few farmers would qualify for immunity from involuntary bankruptcies.

263. H.R. 2211, 99th Cong., 1st Sess. § 1 (1985).

264. *Id.* § 2(2).

265. *Id.* § 5(a).

266. *Id.* § 7(b).

267. *Id.* § 8.

268. *Id.* § 4(a).

269. *Id.* § 3. The bill would not have applied to existing bankruptcy cases. *Id.* at § 10.

publicly traded.[270] The maximum period of time for a family farmer chapter 13 plan was changed from seven to ten years to allow for greater repayment of unsecured claims.[271] In the floor debate Representative Williams recounted how farmers who had been encouraged by federal agricultural officials and farm lenders to expand their operations during the 1960s and 1970s were now facing financial ruin because they had followed such advice, and then encountered low crop prices, high interest rates, and falling land values.[272] Representative Synar acknowledged that the bill would not solve the farm crisis, and would only help those family farmers with sufficient financial vitality able to successfully reorganize under the new bankruptcy provisions.[273] Representative Synar also suggested that the bill would benefit farm lenders as they would receive more under a successful reorganization than they would under liquidation.[274] Representative Moorhead quoted hearings testimony to the effect that a longer period for family farmer chapter 13 plans would increase repayment of unsecured creditors,[275] while the longer period for filing a family farm chapter 11 plan would allow debtors to more accurately evaluate the results of the next harvest.[276] The committee bill was passed by the House on June 24, 1985.[277]

H.R. 2211 would have provided substantial bankruptcy relief to family farmers. The absence of the chapter 11 elements styming farm reorganizations—the adequate protection requirement, creditor approval of the farm reorganization plan, and the absolute priority rule—would have significantly enhanced the possibility of a successful farm reorganization. At the same time, the extended ten year period for a family farmer chapter 13 reorganization plan would have increased the eventual recovery of unsecured claimants to the extent farmers realized disposable income, balancing somewhat the significant advantages afforded to family farmers at the expense of their creditors. However, the possibility of the chapter 13 family farmer debtor receiving either a hardship discharge or a super discharge suggested that creditors would have run the significant risk of not receiving the liquidated value of their claims, let alone any additional

270. H.R. Rep. No. 178 99th Cong., 1st Sess. 1, *reprinted in* June 18.1(a) Bankr. L. Rep. CCCH No. 152 (June 27, 1985).
271. *Id.* § 7(b). *See*, 131 CONG.REC. H4770 (daily ed. June 24, 1985) (statement of Rep. Moorhead).
272. 131 CONG. REC. H4774-75 (daily ed. June 24, 1985) (Statement of Rep. Williams).
273. *Id.* at H4769.
274. *Id.* at H4470. Presumably this assertion took into account the expanded payments to unsecured claimants that would occur with a ten year family farmer chapter 13 plan.
275. *Id.* One bankruptcy judge suggested that higher repayment of unsecured debts would allow family farmers to retain more dignity and self respect. *Id.*
276. *Id.* at H4771.
277. *Id.* at H4775.

repayment. Therefore, despite the ten year term of the family farmer chapter 13 plan, creditors would have run a substantial risk of receiving less then they would have in immediate liquidation.

In the Senate, Senator Grassley introduced S. 2249, the Family Farm Reorganization Act of 1986, on March 26, 1986.[278] The bill proposed a new chapter 12 of the Bankruptcy Code which combined elements of chapter 11 and chapter 13. Family farmer eligibility requirements were similar to those of H.R. 2211 except that the debt ceiling was increased from $1 million to $1.5 million.[279] A trustee would be appointed for all chapter 12 cases similar to chapter 13.[280] The farm debtor would operate the farm as a debtor in possession with authorities similar to a chapter 11 debtor in possession.[281] A creditor's committee would have been established similar to chapter 11 with similar authorities.[282] The debtor in possession would have been removed on the same general bases as a chapter 11 debtor in possession.[283] The chapter 12 debtor would have had an exclusive right to file a reorganization plan within 240 days after filing, with an additional 60 days to have the plan approved by creditors.[284] The proposed confirmation standard was similar to chapter 11.[285] The bill's chapter 12 adequate protection requirements were significantly different from those of chapter 11. Section 361, including the indubitable equivalent requirement, would not have applied in the proposed chapter 12. Instead, reasonable customary rental payments would have been required for use of farmland, in addition to the chapter 11 periodic cash payments, replacement liens, and other relief.[286] Farmland or farm equipment could have been sold by the trustee free of creditors's interests.[287] A special provision would have allowed obtaining credit on an expedited basis to provide emergency livestock care.[288] The new chapter 12 would have had a five year life.[289] In his introductory remarks

278. Cosponsors included the late Sen. Zorinsky of Nebraska. Other Senate farm bankruptcy proposals included S. 1342, and S. 1516. *See* 132 CONG.REC. S5556 (daily ed. May 7, 1986).
279. S. 2249 99th Cong., 2d Sess. § 2 (1986) (proposed § 1201).
280. *Id.* (proposed § 1203).
281. *Id.* (proposed §§ 1204, 1205).
282. *Id.* (proposed §§ 1206, 1207).
283. *Id.* (proposed § 1209).
284. *Id.* (proposed § 1211). Creditors could have filed a plan if the debtor were removed as debtor in possession, if the debtor in possession did not file a plan within 240 days, or did not have the plan approved by creditors. *Id.* The contents of the debtor's plan would have been similar to those of a chapter 11 plan. *Id.* (proposed § 1211). A disclosure statement, creditor solicitation, and creditor voting would have been required similar to chapter 11. *Id.* (proposed § 1212).
285. *Id.* (proposed §§ 1216-18).
286. *Id.* (proposed § 1222).
287. *Id.* (proposed §§ 1223).
288. *Id.* (proposed § 1225).
289. *Id.* § 6.

Senator Grassley noted that the bill would eliminate the need for farmers to provide creditors with lost opportunity cost, and that the farmland adequate protection requirements reflected what creditors would realistically have received if they had foreclosed on the farmland.[290] Senator Grassley also acknowledged that the proposed chapter 12 would not solve the farm crisis, but stated that the current bankruptcy statutes inhibited farmer reorganizations.

S. 2249 was subsequently added as an amendment to S. 1923, a bill to increase the number of bankruptcy judgeships.[291] In proposing the amendment Senator Grassley noted that the proposed chapter 12 would have four significant differences relative to chapter 11: modified adequate protection requirements, authorized sales free of liens, elimination of the absolute priority rule, and extention of the time for filing a debtor's plan of reorganization.[292] The Senate adopted an amendment offered by Senator McConnell which added a 50% farm income requirement for family farmers.[293] Senator Grassley noted a change he made to his amendment from its original introduction which would require chapter 12 debtors to make periodic reports during the period the debtor in possession is preparing his reorganization plan.[294] Senator Helms voiced the only opposition to the new chapter 12 in the record of the legislative debate, stating that it would result in reduced credit to farmers.[295] Senator Harkin voiced support for chapter 12, but expressed concerns regarding the five year sunset provision and the chapter 12 creditor's committee.[296]

The Conference Committee adopted the Senate version with modifications.[297] The creditor's committee provisions were deleted, the period for filing a chapter 12 reorganization plan was reduced from 240 to 90 days, the confirmation hearing was required to be held within 45 days of plan submission, and the sunset provision was increased from five to seven years. The Conferees stated that the purpose of the bill was "to give family farmers facing bankruptcy a fighting chance to reorganize their debts and keep their land. The bill offers family farmers the important protection that bankruptcy provides while, at the same time, preventing abuse of the system and ensuring that farm

290. 132 CONG.REC. S3529 (daily ed. Mar 26, 1986)(Statement of Sen. Grassley). Sen. Grassley argued that if the lender had foreclosed on the land it would have bid the debt at the foreclosure sale, obtained the land, probably would not have been able to sell the land, and thus could only rent it.

291. *Id.* at S5619 (daily ed. May 8, 1986).

292. *Id.* at S5555-56 (daily ed. May 7 1986)(Statement of Sen. Grassley). An analysis of the amendment is contained at *id.* at S5556-58.

293. *Id.* at S5613-15 (daily ed. May 8, 1986).

294. *Id.* at S5614 (Statement of Sen. Grassley).

295. *Id.* at S5618 (Statement of Sen. Helms).

296. *Id.* at S5618-19 (Statement of Sen Harkin).

297. *See* Conference Report of H.R. 5316, 132 CONG.REC. H8986, H8991-94 (daily ed. Oct. 2, 1986).

lenders receive fair repayment."[298] The Conference Report Joint Explanatory Statement stated that farmers had found chapter 11 reorganizations unworkable, and that farmer reorganizations would be easier to accomplish under chapter 12.[299] The Joint Explanatory Statement stated that there was intended to be no routine conversion of chapter 11 or 13 cases to chapter 12, but that bankruptcy courts would in their discretion authorize such conversions on a case by case basis. It was stated that in making that determination the court should consider the likelihood of a successful chapter 12 reorganization.[300] The Joint Explanatory Statement also noted the substantial changes in adequate protection requirements.

In the House debate on the Conference Report Representative Synar stated that the new chapter 12 would give farmers the same opportunity to reorganize in bankruptcy that individuals and small businesses already had. This would benefit creditors, who would recover more than they would in liquidation, while other farmers who would be protected from a further decline in land values resulting from additional foreclosures.[301] In the Senate Senator Thurmond stated that chapter 12 is intended to help those farmers with true potential to reorganize and yet allow such farmers to make reasonable payments to creditors given the current agricultural situation. The conferees intended chapter 12 to maintain a balance between farm debtors and creditors. Senator Thurmond warned that bankruptcy courts should strive to maintain equity between debtors and creditors, realizing the possible harm to creditors of providing financial relief to farmers. Senator Thurmond also stated that Congress should move quickly to correct serious problems in chapter 12 if they developed, including a possible repeal before the seven year sunset.[302] A letter from the American Banking Association stated that the Association withdrew its objections to the chapter 12 because of the additional bankruptcy judges the bill would authorize, the 90 day requirement for filing a reorganization plan, the seven year sunset provision, and the assurance that any major inequities would be addressed in the following Congress.[303] Senator Grassley's statement focused on the

298. *Id.* at H8999. *Cf.* Rep. Synar's statement *supra* note 263.

299. *Id.* at H8998-99.

300. *Id.* at H8999. Other considerations favoring conversion included whether the bankruptcy petition was recently filed but no further action was taken. Considerations against allowing conversion included whether a reorganization plan has been filed or confirmed, or whether the parties had substantially relied on pre-chapter 12 law. *Id.*

301. 132 CONG.REC. H9001 (daily ed. Oct. 2, 1986). These statements ignore that secured claimants may lose in chapter 12 if the reorganization is ultimately unsuccessful and collateral values decline after plan confirmation.

302. *Id.* at S15075 (daily ed. Oct. 3, 1986).

303. *Id.*

speed with which chapter 12 cases would be required to proceed.[304] Senator Deconcini, while supporting chapter 12, correctly suggested that it could work a hardship on agricultural lenders to write off debt with no opportunity under the section 111(b) election to recover the deficiencies when the farm crisis ends and asset values recover. Senator Deconcini suggested that any farmer with an undersecured loan would take advantage of chapter 12's debt write down provisions, regardless of his financial status.[305] Senator Deconcini argued that the provisions favoring farm debtors would reduce the likelihood of voluntary workouts in favor of chapter 12.[306] The Senator suggested that the effects of chapter 12 be closely monitored and that any inequities be promptly remedied.

The Conference Report was adopted by the House on October 2, 1986, and the Senate the following day.[307] The bill was signed by President Reagan on October 27, 1986.[308]

V. CHAPTER 12[309]

Chapter 12 allows qualifying family farmers an attractive opportunity to reorganize their finances. Insolvent debtors can reduce debt to the value of their nonexempt assets. High interest rates may be reduced to market levels. Secured debt may be restructured over a longer period of time, lowering payment requirements. A chapter 12 debtor is subject to the best interests of creditor rule, but is not subject to the absolute priority rule or the section 1111(b)(2) election and enjoys more lenient adequate protection requirements. Chapter 12 is a short proceeding, which will shorten most farm bankruptcy proceedings. However, the short time period, which may be as short as 45 days for the well prepared chapter 12 debtor, give creditors little time to respond or marshall their case. This may hamper creditors in objecting to asset valuation, reorganization plans and debt discharge, as

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304. *Id.* at S15075-76 (Statement of Sen. Grassley).

305. *Id.* at S15092. However, debt can be written down only to the extent that the farmer is actually insolvent. Thus a solvent farmer cannot write down debt in chapter 12 even though a particular loan may be undersecured. *See infra* text accompanying notes 479-86.

306. 132 CONG. REC. S15092 (daily ed. Oct. 3, 1986). This argument ignores the strong tradition of self reliance and nearly universal farmer aversion to bankruptcy. If anything chapter 12 has increased the possibility of debt workouts by making lenders more willing to accept debt write downs than they were when the farmer's only reorganization option was chapter 11. *See infra* § VI.

307. 132 CONG.REC. H9002; (daily ed. Oct. 2, 1986); *id.* (daily ed. Oct. 3, 1986).

308. Bankruptcy Judges, United States Trustees, and Family Farmers Bankruptcy Act of 1986, Pub. L. No. 99-554, 100 Stat. 3088 (1986).

309. Regarding chapter 12, *see* Wilson, *Chapter 12: Family Farm Reorganization*, 8 J.AGRIC. TAX'N & L. 299 (1987); Armstrong, *The Family Farmer Bankruptcy Act of 1986: An Analysis for Farm Lenders*, 104 BANKING L.J. 189 (1987); J. Anderson & J. Morris, *supra* note 6.

well as pursuing preferences and fraudulent conveyances. While chapter 12 debtors must devote all disposable income to repayment of objecting unsecured claim holders, creditors will be required to carefully monitor the debtor's income and expenditures to insure compliance with this requirement. Most insolvent farmers will be required to pay unsecured claim holders little, if anything, in chapter 12, perhaps hampering their chances for needed post-confirmation credit. While the best interests of creditors test insures in theory that creditors will receive at least the liquidated value of their claim, secured claimants will ultimately lose if the reorganization attempt is unsuccessful and collateral values decline after confirmation. Because of the advantages it provides qualifying farm debtors, chapter 12 may result in more voluntary farm debt workouts.

A. Eligibility.

Chapter 12 is available only to family farmers with regular annual income.[310] Individuals, including spouses, are family farmers if they are engaged in a farming operation with aggregate debts of up to $1.5 million, 80% of which arises from the farming operation, and if at least 50% of their gross income for the prior taxable year is from farming.[311] A corporation or partnership qualifies as a family farmer if at least 50% of its outstanding stock or equity owned by a single family, it is engaged in a farming operation conducted by a family member, it has aggregate debts of up to $1.5 million, at least 80% of which arises from the farming operation, at least 80% of its assets relate to the farming operation, and any corporate stock is not publicly traded.[312] Corporate or partnership family farmers are not subject to the 50% gross farm income requirement.[313] Family farmers are exempted

310. 11 U.S.C.A. § 109(f) (West Supp. 1987). A family farmer with regular annual income is defined as one whose income is sufficiently stable and regular to enable the family farmer to make payments under a chapter 12 plan. *Id.* § 101(18).

311. *Id.* § 101(17)(A). The debt on the family farmer's principal residence is excluded from the 80% farm debt limitation unless such debt arises from the farming operation. *Id*; *In re* Henderson Ranches, 75 Bankr. 225 (Bankr. D. Idaho 1987). The $1.5 million debt limitation is as of the date the bankruptcy petition is filed. 11 U.S.C.A. § 101(17)(A) (West Supp. 1987); *In re* Labig, 74 Bankr. 507 (Bankr. S.D. Ohio 1987). *See also* Matter of Rinker, 75 Bankr. 65 (Bankr. S.D. Iowa 1987).

312. 11 U.S.C.A. § 101(17)(B) (West Supp. 1987). The debt on the family's principal residence is excluded from the $1.5 million limitation unless such debt arises from the farming operation. *Id.*

313. One court has declined to address the constitutionality of not establishing a 50% gross income test for family farm corporations or partnerships as not constituting a "core" bankruptcy proceeding. *In re* Lawless, 74 Bankr. 54 (Bankr. W.D. Mo. 1987). Regarding core bankruptcy proceedings see 28 U.S.C. § 157(b)(2); Marrion, *Core Proceedings and the "New" Bankruptcy Jurisdiction*, 35 DEPAUL L.REV. 675 (1987).

from involuntary chapter 7 or 11 bankruptcy cases.[314]

Because chapter 12 offers farm debtors significant advantages over chapter 11, litigation is likely regarding whether farm debtors in fact qualify for chapter 12. One issue already raised is whether a debtor is engaged in farming. Farming is not defined by the Code, but 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."[315] Section 109(f) does not specify when the debtor must be engaged in farming in order to qualify for chapter 12. Some bankruptcy courts have held the farming requirement must be met when the chapter 12 petition is filed.[316] This is likely to be an issue where the debtor either has rented out the farm, probably because of inability of obtain operating financing, or where the debtor is liquidating. Thus far the cases indicate that the farmer is not engaged in farming in either case.[317] Given the congressional intent to help farmers stay on the farm, this interpretation seems appropriate.[318]

A related issue is whether at least 50% of the farmer's gross income is farm income. Thus far bankruptcy courts are divided regarding whether cash rent income is farm income, although the Bankruptcy Court for the District of Nebraska has ruled in the negative.[319] Income sources (other than direct farm earnings) which have qualified as farm income include the sale of farm equipment and land,[320] cattle hauling for other farmers,[321] and federal farm program payments.[322] An individual retirement account distribution has been determined to constitute non-farm income, even though the IRA was funded with farm earnings.[323] Courts have split regarding whether income tax principles should govern in determining whether income is farm in-

314. 11 U.S.C.A. § 303(a) (West Supp. 1987).

315. *Id.* § 101(20).

316. *In re* Labig, 74 Bankr. 507 (Bankr. S.D. Ohio 1987); *In re* Tim Wargo & Songs, Inc., 74 Bankr. 469 (Bankr. E.D. Ark. 1987); *In re* Mikkelsen Farms, Inc., 74 Bankr. 280 (Bankr. D. Or. 1987); *In re* Tart, 73 Bankr. 78 (Bankr. E.D. N.C. 1987).

317. *In re* Labig, 74 Bankr. 507 (Bankr. S.D. Ohio 1987); *In re* Tim Wargo & Sons, Inc., 74 Bankr. 469 (Bankr. E.D. Ark. 1987) (landlord not engaged in farming); *In re* Mikkelsen Farms, Inc., 74 Bankr. 280 (Bankr. D. Or. 1987) (landlord not engaged in farming); *In re* Tart, 73 Bankr. 78, 80 (Bankr. E.D.N.C. 1987).

318. 132 CONG.REC. H8999 (daily ed. Oct. 2, 1986).

319. *In re* Haschke, 77 Bankr. 223 (Bankr. D. Neb. 1987), citing Matter of Armstrong, 812 F.2d 1024 (7th Cir. 1987); *In re* Mary Freese Farms, Inc., 73 Bankr. 508 (Bankr. N.D. Iowa 1987); *In re* Welch, 74 Bankr. 401, 404 (Bankr. S.D. Ohio 1987); *Contra In re* Rott, 73 Bankr. 366 (Bankr. D.N.D. 1987).

320. *In re* Shepherd, 75 Bankr. 501 (Bankr. N.D. Ohio 1987); *In re* Rott, 73 Bankr. 366 (Bankr. D.N.D. 1987); *In re* Armstrong, 812 F.2d 1024 (7th Cir. 1987).

321. *In re* Guinnane, 73 Bankr. 129 (Bankr. D. Mont. 1987).

322. *In re* Shepherd, 75 Bankr. 501 (Bankr. N.D. Ohio 1987).

323. *In re* Nelson, 73 Bankr. 363 (Bankr. D. Kan. 1987).

come for purposes of chapter 12.[324] One may expect amended tax returns and similar prefiling activity as farm debtors seek to restructure their income to qualify for chapter 12. Whether such activities will be successful remains to be seen.

Finally, some of the early chapter 12 litigation has addressed the $1.5 million debt limitation. In *In re Johnson* the bankruptcy court ruled that spouses could not simply sever joint debts to avoid the $1.5 million debt limitation in order to qualify for separate chapter 12 cases.[325] In *In re Labig*, the bankruptcy court ruled that an assignee's postpetition willingness to forego claims against the farm debtor could not be used to reduce debtor's indebtedness below the $1.5 million limit.[326] Similarly, future litigation can be expected as to whether prepetition debt repayment to qualify for chapter 12 constitutes a preference or bad faith filing.

B. Conversion or Dismissal.

Bankruptcy cases filed after November 26, 1986 may be converted to chapter 12.[327] Whether bankruptcy cases filed before chapter 12's effective date may be similarly converted is unclear, and has generated most of the early chapter 12 litigation. Section 302(c)(1) of the 1986 bankruptcy act states that the chapter 12 amendments do not apply to cases filed before the act's effective date of November 26, 1986. However, the legislative history clearly indicates that the conferees intended bankruptcy courts to allow conversion of existing farm bankruptcy cases to chapter 12 in their equitable discretion.[328] The failure of the statute to comport with the legislative history is doubtless a drafting error which will prevent many family farmers from converting their existing bankruptcy case to chapter 12. Of the reported cases, a majority do not allow conversion[329] while a substantial minor-

324. Court will not look behind filed income tax return regarding the 50% gross farm income requirement. *In re* Nelson, 73 Bankr. 363, 365 (Bankr. D. Kan. 1987). *Contra, In re* Rott, 73 Bankr. 366 (Bankr. D.N.D. 1987) (debt forgiveness income not included in gross income calculations even though constituted taxable income).

325. 73 Bankr. 107 (Bankr. S.D. Ohio 1987). The court also found that the petitions were not filed in good faith and did not allow conversion to chapter 11.

326. 74 Bankr. 507 (Bankr. S.D. Ohio 1987).

327. 11 U.S.C.A. §§ 706, 1112, 1307 (West Supp. 1987). To convert from chapter 11 to chapter 12 the conversion must be equitable. *Id.* § 1112(d)(3). The motion to convert must include the debtor's proposed chapter 12 plan. Local R. Bankr. 12-1(2) (D. Neb., proposed Nov. 26, 1986).

328. *See* text accompanying note 300, *supra*.

329. *In re* Solomon, 72 Bankr. 506 (Bankr. E.D. Ark. 1987); *In re* Keinath Bros. Dairy Farm, 71 Bankr. 993 (Bankr. E.D. Mich. 1987); *In re* Evans, 72 Bankr. 21 (Bankr. D. Or. 1987); *In re* Rossman, 70 Bankr. 985 (Bankr. W.D. Mich. 1987) *In re* McDonald, 72 Bankr. 227 (Bankr. D.S.C. 1987); *In re* Ray, 70 Bankr. 431 (Bankr. E.D. Mo. 1987); *In re* Hughes, 70 Bankr. 66 (Bankr. W.D. Va. 1987); *In re* Glazier, 69

ity do.[330] The first district court opinion on the issue follows the minority approach.[331] While the Bankruptcy Court for the District of Nebraska has not directly ruled on the issue, it has allowed a chapter 13 debtor to file a chapter 12 case and then to dismiss its chapter 13 case.[332] The interim chapter 12 rules for the District of Nebraska treat a motion to convert a pre-chapter 12 farm bankruptcy case to a new chapter 12 case as a motion to dismiss,[333] inviting the debtor to file a new chapter 12.

The debtor may convert the chapter 12 case to a chapter 7 case at any time.[334] The debtor might elect to do so if his liquidation analysis indicated that reorganization was not financially feasible.[335] If a case has not already been converted from chapter 7 or 11 to chapter 12, the debtor may at any time request the court to dismiss the case.[336] The court may dismiss a chapter 12 case for a variety of reasons, including the debtor's unreasonable delay or gross mismanagement prejudicial to creditors,[337] failure to timely file a reorganization plan,[338] failure to make timely payments or material default under a confirmed plan,[339] denial of confirmation and denial of the time to file an additional plan,[340] revocation of confirmation and the debtor's failure to obtain

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Bankr. 666 (Bankr. W.D. Okla. 1987); *In re* Lindsey, 69 Bankr. 632 (Bankr. C.D. Ill. 1987); *In re* Barclay, 69 Bankr. 552 (Bankr. C.D. Ill. 1987); *In re* Spears, 69 Bankr. 511 (Bankr. S.D. Iowa 1987); *In re* Litteral, 74 Bankr. 14 (Bankr. W.D. La. 1987); *In re* Petty, 69 Bankr. 412 (Bankr. N.D. Ala. 1987); *In re* Albertson, 68 Bankr. 1017 (Bankr. W.D. Mo. 1987); *In re* Groth, 69 Bankr. 90 (Bankr. D. Minn. 1987); *In re* Fischer, 72 Bankr. 634 (Bankr. D. Kan. 1987); *In re* Council, 70 Bankr. 20 (Bankr. W.D. Tenn. 1987); *In re* B.A.V., Inc., 68 Bankr. 411 (Bankr. D. Colo. 1986); *In re* Tomlin Farms, Inc. 68 Bankr. 41 (Bankr. D.N.D. 1986); *In re* Calif. Land & Equip. Leasing Co. Inc., 72 Bankr. 1 (Bankr. E.D. Calif. 1984).

330. *In re* Nelson, 73 Bankr. 363 (Bankr. D. Kan. 1987); *In re* Gamble, 72 Bankr. 75 (Bankr. D. Idaho 1987); *In re* Orr, 71 Bankr. 639 (Bankr. E.D.N.C. 1987); *In re* Anderson, 70 Bankr. 883 (Bankr. D. Utah 1987); *In re* Woloschaak Farms, 70 Bankr. 498 (Bankr. N.D. Ohio 1987); *In re* Mason, 70 Bankr. 753 (Bankr. W.D.N.Y. 1987); *In re* Henderson, 69 Bankr. 982 (Bankr. N.D. Ala. 1987); *In re* Big Dry Angus Ranch, Inc., 69 Bankr. 695 (Bankr. D. Mont. 1987); *In re* Fischer, 72 Bankr. 634 (Bankr. D. Kan. 1987); *In re* Erickson Partnership, 68 Bankr. 819 (Bankr. D.S.D. 1987), *aff'd* 74 Bankr. 670 (S.D.S.D. 1987); *accord* J. Anderson & J. Morris, *supra* note 6, §§ 3.09 at 3-45 to - 54.
331. *In re* Erickson Partnership, 74 Bankr. 670 (S.D.S.D. 1987), *aff'g* 68 Bankr. 819 (Bankr. D.S.D. 1987).
332. *In re* Frederick, BK87-898 (Bankr. D. Neb. 1987) *Accord In re* Woloschaak Farms, 70 Bankr. 498 (Bankr. N.D. Ohio 1987); *In re* Gamble, 72 Bankr. 75 (Bankr. D. Idaho 1987).
333. Local R. Bankr. 12-1(1) (D. Neb., proposed Nov. 26, 1986).
334. 11 U.S.C.A. § 1208(a) (West Supp. 1987).
335. *See* text accompanying notes 475-84, *infra*.
336. 11 U.S.C.A. § 1208(b) (West Supp. 1987).
337. *Id.* § 1208(c)(1).
338. *Id.* § 1208(c)(3).
339. *Id.* §§ 1208(c)(4), 1208(c)6).
340. *Id.* § 1208(c)(5).

confirmation of a modified plan,[341] and continuing loss or diminution of the estate and lack of a reasonable likelihood of rehabilitation.[342] The court may dismiss or convert to chapter 7 if the debtor has committed fraud in connection with the case.[343]

There is no specific provision authorizing conversion from chapter 12 to chapter 11 or 13.[344] At least one bankruptcy court has denied conversion from chapter 12 to chapter 11.[345]

C. Case Administration.

Case administration in chapter 12 will be an interesting mixture of chapters 11 and 13. The deadlines are short, similar to chapter 13, but opportunities for litigation (and preconfirmation negotiation and compromise) abound. In most cases the short time period for filing claims, objections, etc. and the local rules encouraging negotiation and compromise will minimize litigation. Where large amounts are at stake, however, and no clear precedent has been established, litigation will probably be undertaken.

The major items of chapter 12 case administration include the chapter 12 trustee's authorities, the chapter 12 debtor's authorities, and adequate protection requirements.

Filings and Notices. The chapter 12 filing fee is $200.[346] Schedules of assets, liabilities and creditors must be filed within 15 days of filing or the case will be dismissed for cause.[347] Within 10 days of filing the schedules, the debtor must serve notice of the initial meeting of the creditors to all parties.[348] The initial notice must contain the date the schedules were filed, the date for the meeting of the creditors (section 341 hearing), a statement that objections to discharge must be filed within 60 days of the section 341 hearing, and a statement that creditor claims must be filed within 30 days of the filing of the schedules.[349] If a plan was filed with the petition, as is likely to be common practice unless the bankruptcy petition is an emergency filing, the notice must list the confirmation hearing date (not later than 45 days after filing the plan[350]) and must include a copy of the plan.[351] Otherwise, the notice must include a statement that the debtor will serve all parties

341. *Id.* § 1208(c)(7).
342. *Id.* § 1208(c)(9).
343. *Id.* § 1208(d).
344. *In re* Orr, 71 Bankr. 639 (Bankr. E.D.N.C. 1987).
345. *In re* Lawless, 74 Bankr. 54-55 (Bankr. W.D. Mo. 1987).
346. 28 U.S.C.A. § 1930(a)(5) (West Supp 1987).
347. Local R. Bankr. 12-2(2) (D. Neb., proposed Nov. 26, 1986).
348. *Id.* 12-2(3). The parties include all creditors, the U.S. Attorney, the chapter 12 trustee, and any other entity requesting notice. *Id.*
349. *Id.* 12-3(1).
350. 11 U.S.C.A. § 1224 (West Supp. 1987).
351. Local R. Bankr. 12-3(1)(g) (D. Neb., proposed Nov. 26, 1986).

with a copy of the plan when it is filed, and provide notice of the confirmation hearing date.

Claims and Objections. Creditors's proofs of claims must be filed within 30 days of the order for relief if the schedules are filed with the petition; otherwise within 45 days of the order for relief.[352] Objections to creditors's claims must be filed at least ten days prior to the confirmation hearing. Claims not timely filed will be allowed or disallowed as shown on the debtor's schedules.

Chapter 12 Trustee. A trustee will be appointed in each chapter 12 case.[353] In districts, such as Nebraska, where the U.S. Trustee system has not yet been implemented, a standing trustee will be appointed by the bankruptcy court.[354] The chapter 12 trustee has many but not all the duties of a chapter 7 or 11 trustee, including: examining and objecting to proofs of claim, opposing discharge, furnishing information regarding the estate and estate administration to a party in interest, and investigating the debtor's financial condition and business operation.[355] Given the short duration of the chapter 12 case, between 45 and 135 days,[356] the trustee is unlikely to have time to investigate the debtor's farm operations except in unusual cases. The trustee must also appear and be heard at all valuation hearings, confirmation hearings, postconfirmation plan modification hearings, and sales of estate property.[357] The trustee must approve section 1206 sales of farmland and farm equipment.[358] The trustee will monitor the debtor's performance of the plan,[359] and if the debtor is removed as debtor in possession, administer the property of the estate.[360] However, the trustee is not authorized to file a reorganization plan.[361] The trustee must file any required state or local income tax return for the estate.[362] The trustee's will have more of an arm's length relationship with a chapter 12 debtor than a chapter 13 debtor, similar to chapter 11.

The chapter 12 trustee's fees can significantly affect the ultimate cost of a chapter 12 reorganization to debtors. For cases filed before November 26, 1989 or thirty days after the U.S. trustee's program is extended to Nebraska, the trustee is entitled to a fee of up to 10% of

352. *Id.* 12-4.
353. 11 U.S.C.A. § 1202(a) (West Supp. 1987).
354. A standing Chapter 12 Trustee has been appointed for the District of Nebraska. *See* Local Bankr. Rules 3 (D. Neb., proposed Nov. 26, 1986).
355. 11 U.S.C.§§ 704(5)-(7), 1106(a)(3) (1982); 11 U.S.C.A. § 1202 (b)(1)-(2) (West Supp. 1987).
356. The plan must be filed within 90 days of the petition, while the confirmation hearing must be held within 45 days of the plan's filing. *Id.* §§ 1221, 1224.
357. *Id.* § 1202(b)(3).
358. *See infra* note 378 and accompanying text.
359. 11 U.S.C.A. § 1202(b)(4) (West Supp. 1987).
360. *Id.* §§ 1202(b)(5), 1203.
361. *Id.* § 1221.
362. *Id.* § 1231(b).

all payments made under a confirmed chapter 12 plan up to $450,000, and 3% of all additional payments.[363] When the U.S. trustee's program is implemented in Nebraska, the chapter 12 trustee fee standard will be the same, although such fees will be established by the U.S. Attorney General rather than by the individual bankruptcy court.[364] Currently U.S. trustees are charging the full 10% fee.[365] Some debtors have unsuccessfully sought to avoid paying trustee's fees by making payments to secured creditors directly rather than through the trustee.[366] Until the U.S. trustee's program is implemented in Nebraska trustee's fees are likely to be substantially less than 10%. This could change when the U.S. trustee program is implemented. Imposing the maximum trustee's fee could significantly raise the cost of chapter 12 to debtors, and reduce its attractiveness.

Chapter 12 Debtor. The chapter 12 debtor is a debtor in possession, and enjoys virtually the same powers as a chapter 11 debtor in possession.[367] The debtor may use, sell or lease property of the estate other than in the ordinary course of business,[368] obtain operating credit,[369] reject, affirm or assign executory contracts and unexpired leases,[370] avoid judicial liens and unperfected liens,[371] avoid certain statutory liens,[372] avoid fraudulent conveyances,[373] avoid preferential transfers,[374] abandon property of the estate,[375] operate the farm,[376] and exercise the exclusive right to file a chapter 12 reorganization plan.[377] After notice and hearing, the debtor may, with the approval of the trustee, sell farmland or farm equipment free of liens and without creditors's approval, although sale proceeds are subject to the lien.[378]

363. *Id.* § 1202(d)(1)(B); Pub. L. No. 94-554, §§ 302(c), 302(d)(2)(A), 302(d)(2)(B)(xi).
364. 28 U.S.C. § 586(e)(1)(B) (1982).
365. *See In re* Citrowske, 72 Bankr. 613, 615 (Bankr. D. Minn. 1987).
366. *See Id.*; *In re* Rott, 73 B.R. 366 (Bankr. D.N.D. 1987); *In re* Meyer, 73 Bankr. 457 (Bankr. E.D. Mo. 1987); *In re* Centineo, 4 Bankr. 654 (Bankr. D. Neb. 1980). Trustee fees are based on plan payments, not farm income. *In re* Janssen Charlais Ranch, Inc., 73 Bankr. 125 (Bankr. D. Mont. 1987).
367. 11 U.S.C.A. § 1203 (West Supp. 1987). The chapter 11 debtor in possession's authorities include all those of a chapter 11 trustee. 11 U.S.C. 1107(a) (1982). Those duties include most of the duties of a chapter 7 trustee, *id.* § 1106(a)(1), in addition to the general estate administration authorities granted a trustee under titles 3 and 5.
368. 11 U.S.C. § 363(b) (Supp. III 1985). If collateral is sold, the sale is subject to the creditor's approval. *Id.* at § 363(f).
369. *Id.* § 364 (1982).
370. *Id.* § 365 (1982 & Supp. III 1985).
371. *Id.* § 544 (1982).
372. *Id.* § 545.
373. *Id.* §§ 544; 548 (1982 & Supp. III 1985).
374. *Id.* § 547 (1982).
375. *Id.* § 544.
376. *Id.* § 1203 (West Supp. 1987).
377. *Id.* § 1221.
378. *Id.* § 1206. This section authorizes the trustee to make such sales. As a practical

This new authority to sell property free of liens allows the farmer to downsize his operation and use the proceeds to operate, providing lienholders with substitute collateral on a future crop.[379]

The debtor in possession may be removed for prepetition and postpetition fraud, dishonesty, incompetence or gross management.[380] In such a case the trustee may assume operation of the case, although the more likely result is dismissal.[381]

Property of the Estate. Property of the estate includes postpetition property and earnings, similar to chapter 13.[382]

Automatic Stay and Adequate Protection. In addition to the section 362 automatic stay, chapter 12 establishes a special co-debtor stay for persons guaranteeing consumer (but not business) debts.[383] To use property of the estate (including cash collateral) in preconfirmation farming operations, the chapter 12 debtor must provide adequate protection to secured creditors. However, section 361 and its indubitable equivalent standard do not apply in chapter 12 cases.[384] Thus, one of the major obstacles to successful chapter 11 farm reorganizations has been removed from chapter 12.[385] Adequate protection may be provided by making cash payments or giving a replacement lien reflecting collateral depreciation from use,[386] by paying customary farmland rental payments, based on the land's rental value, net income, and earning capacity,[387] or by the court's providing such other relief as will

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matter the trustee will do so only when so requested by the debtor. Thus the practical effect of § 1206 is to authorize the debtor to sell farmland and equipment without creditors's consent if the trustee approves.

379. This is possible because section 361 and its indubitable equivalence standard do not apply to chapter 12. *Id.* at § 1205(a) *See also infra* text at notes 430-36.

380. *Id.* § 1204(a). The debtor in possession may be reinstated by the court. *Id.* at § 1204(b).

381. *Id.* § 1208(c)(1),(d).

382. *Id.* § 1207(a). *Cf. id.* § 1306.

383. *Id.* § 1201. *Cf.* 11 U.S.C. § 1301 (1982 & Supp. III 1985). *See In re* Bigtalk, 75 Bankr. 561 (Bankr. D. Minn. 1987); *In re* Circle Five, Inc., 75 Bankr. 686 (Bankr. D. Idaho 1987). A chapter 12 plan proposing to release non-consumer co-debtors could not be confirmed over creditors's objections. *In re* Robinson Ranch, Inc., 75 Bankr. 606 (Bankr. D. Mont. 1987).

384. 11 U.S.C.A. § 1205(a) (West Supp. 1987). Chapter 12 debtor not required to pay postpetition interest as adequate protection to undersecured creditor. *In re* Rennich, 70 Bankr. 69 (Bankr. D. S.D. 1987).

385. *See supra* text at notes 149-66.

386. 11 U.S.C.A. § 1205(b)(1)(2), (West Supp. 1987). Adequate protection is not required for real estate value declines. *In re* Raylyn AG Inc., 72 Bankr. 523 (Bankr. S.D. Iowa 1987).

387. 11 U.S.C.A. § 1205(b)(3) (West Supp. 1987). Chapter 12 debtors may argue that adequate protection payments are not required until the creditor could have obtained clear title to the collateral through foreclosure, adopting the approach of *In re* Ahlers, 794 F.2d 388 (8th Cir. 1986), *cert. granted*, 55 U.S.L.W. 3852 (1987). *See supra* text accompanying notes 149-66. However the *Ahlers* court's reasoning was significantly based on § 361, which does not apply to chapter 12. Thus the

adequately protect collateral value or an ownership interest.[388]

The local bankruptcy rules for the District of Nebraska encourage negotiation and settlement of adequate protection disputes. Creditors who have farmland for collateral and request relief from the automatic stay must state whether the parties have an agreement from the farm debtor agreeing to pay 1205(b)(3) fair rental value, whether the debtor's offer is inadequate, the position of the parties relative to the motion, and a statement that the parties have been unable to reach an agreement or compromise.[389] If the collateral at issue is personal property, the creditor's motion must specify the contacts the creditor made with debtor's counsel regarding adequate protection, any offer of adequate protection made by the debtor, the reason such offer was rejected, and the creditor's demand of adequate protection with justification.[390] In either case no relief from the stay shall be granted if the creditor has failed to attempt to resolve the matter with debtor's counsel prior to the hearing.[391]

D. Chapter 12 Farm Reorganization Plan Requirements

The chapter 12 plan is the heart of the chapter 12 reorganization. In the plan the insolvent debtor can write down debt to the value of assets (net of exemptions), discharging loan deficiencies. Debt repayment can be extended, and high interest rates can be reduced to current market levels. After acquired property clauses generally are cut off in bankruptcy, giving the farm debtor an opportunity to use future crops to finance current operations or repay other creditors. Default can be cured and foreclosures avoided. For many farmers the reduced debt may make the operation financially viable.

The purpose of chapter 12, like chapter 13, is confirmation of a reorganization plan. Creditors do not vote on a plan, and a reorganization plan can be crammed down dissenting creditors. The 1111(b) election is not available, nor is the absolute priority rule, making a confirmable farm reorganization plan the rule rather than the exception.

Despite the many advantages provided debtors in chapter 12, creditors are still able to object to asset valuation, interest rates, repayment terms, and plan feasibility. Thus, preconfirmation negotiation and litigation will be the norm. The short time available to creditors to oppose a plan, however, means that strategies that are successful in

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Ahlers' rationale regarding when adequate protection payments are required may not apply in chapter 12.

388. 11 U.S.C.A. § 1205(b)(4) (West Supp. 1987).

389. Local R. Bankr. 12-7(1) (D. Neb., proposed Nov. 26, 1986).

390. *Id.* at 12-7(2).

391. *Id.* at 12-7(3). The motion will be heard on the affidavits and argument of counsel only. *Id.*

chapter 11 will not necessarily succeed in chapter 12. This section will examine the formal requirements, including confirmation requirements, for a chapter 12 plan. The next section will analyze the considerations for formulating an acceptable chapter 12 plan which meets these requirements.

Plan Filing. The debtor has the exclusive right to file a chapter 12 plan; neither creditors nor the trustee can do so.[392] The plan must be filed within 90 days of the petition unless time is extended by the court.[393] Most plans will be filed with the petition to shorten the period of the bankruptcy proceeding. Failure to file a timely plan is grounds for dismissal.[394]

Plan Contents. The chapter 12 plan has mandatory and discretionary components, and is modeled after the chapter 13 plan content requirements.[395] The plan must provide for the submission of all or as much of debtor's future earnings and income to the trustee as is needed to implement the plan.[396] All priority claims must be paid in full either in cash or in deferred payments unless the holder agrees to a different treatment.[397] If the plan classifies claims each claim in a particular class must be the same unless a claim holder agrees to less favorable treatment.[398] In addition to these mandatory provisions, the plan may contain other discretionary provisions which provide the real reorganization opportunities. The plan may modify the rights of secured and unsecured claims, which provides the opportunity to reduce loan balances due, as well as to modify loan terms, substitute collateral, etc.[399] The plan may provide for the curing or waiving of any

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392. 11 U.S.C.A. § 1221 (West Supp. 1987).

393. Filing plan one day late excused by court where there was no intent by the debtor to delay the proceedings. *In re* Raylyn AG, Inc., 72 Bankr. 523 (Bankr. S.D. Iowa 1987).

394. 11 U.S.C.A. § 1208(c)(3) (West Supp. 1987); *In re* Lawless, 74 Bankr. 54 (Bankr. W.D. Mo. 1987).

395. 11 U.S.C.A. § 1222 (West Supp. 1987). *Cf. id.* at § 1322.

396. *Id.* § 1222(a)(1).

397. *Id.* § 1222(a)(2). *See supra* text accompanying notes 76-79. Administrative expenses may be paid on deferred basis, in contrast to chapter 11, where administrative expenses must be paid in full on the effect date of the plan. *In re* Citrowske, 72 Bankr. 613, 617 (Bankr. D. Minn. 1987).

398. 11 U.S.C.A. § 1222(a)(3) (West Supp. 1987) A bankruptcy court had occasion to discuss the nature of claim classification in a chapter 12 case that apparently was debtor counsel's first bankruptcy case. The court stated that (1) claims in the same class should be substantially similar, (2) secured claims are almost never substantially similar and should be in separate classes, (3) secured and unsecured claims should be segregated into separate classes, even if the creditor is the same, and (4) unsecured creditors have special objection rights, and segregation of a claim into secured and unsecured components is not a mere formality. *In re* Citrowske, 72 Bankr. 613, 616 (Bankr. D. Minn. 1987).

399. 11 U.S.C.A. § 1222(b)(2) (West Supp. 1987). In *In re* O'Farrell, 74 Bankr. 421 (Bankr. N.D. Fla. 1987) the court approved a plan with a mortgage with the repayment term rewritten to 30 years.

prepetition default,[400] including default on long term debt exceeding the term of the plan,[401] giving the debtor the opportunity to decelerate any accelerated loans. Unsecured claims may be paid concurrently with secured claims, allowing unsecured claimants to receive some payment before secured claimants have been paid in full.[402] The plan may provide for the assumption, rejection, or assignment of any executory contract or unexpired lease.[403] This is in addition to the section 1203 authority to do so as a debtor in possession. The plan may provide for payment of all or part of a claim with property of the estate, including exempt property.[404] The plan may provide for the sale of property of the estate or the distribution of property of the estate,[405] which would allow downsizing the farming operation as part of the plan. Secured claims may be paid over a longer period than the period of the plan.[406] This allows debtors to reamortize secured long and medium term debt over longer periods, reducing payment requirements. The plan may provide for vesting of the property of the estate in the debtor or other entity at confirmation or at a later time (e.g. regarding long term debt).[407] Finally, any other provision not inconsistent with the Code may be included in a reorganization plan, giving full rein to the ingenuity of counsel in developing creative financing alternatives and compromises.[408] The latter provision might allow, e.g. payment of interest only for a term and then payment of interest and principle when priority claims have been satisfied; or repayment over a thirty year reamortization schedule with a five year balloon payment. The plan cannot exceed three years (except for payments on long term secured debt), although the court may approve a plan of up to five years.[409]

Plan Confirmation Criteria. The plan must comply with all provisions of chapter 12 and all applicable provisions of the Bankruptcy Code.[410] This includes the section 1222(a) mandatory plan content

400. 11 U.S.C.A. § 1222(b)(3) (West Supp. 1987).
401. *Id.* § 1222(b)(5). Default may be cured within a reasonable time under the plan. *Id.*
402. *Id.* § 1222(b)(4); 5 W. COLLIER, COLLIER ON BANKRUPTCY ¶ 1222.03 at 1222-4 (15th Ed. 1987).
403. 11 U.S.C.A. § 1222(b)(6) (West Supp. 1987).
404. *Id.* § 1222(b)(7). In *In re* Massengill, 73 Bankr. 1008, 1013 (Bankr. E.D.N.C. 1987) the court approved debtor's returning Production Credit Association stock and Federal Land Bank stock to the PCA and Land Bank, respectively, over their objection in partial payment at face value.
405. 11 U.S.C.A. § 1222(b)(8) (West Supp. 1987).
406. *Id.* § 1222(b)(9).
407. *Id.* § 1222(b)(10).
408. *Id.* § 1222(b)(11).
409. Id. § 1222(c). No separate motion is needed to have a five year term approved; it is merely part of confirmation process. *In re* Citrowske, 72 Bankr. 613, 617 (Bankr. D. Minn. 1987).
410. 11 U.S.C.A. § 1225(a)(1) (West Supp. 1987).

requirements. The debtor must have paid the chapter 12 filing fee plus any amounts required in the plan to have been paid prior to confirmation.[411] The plan must have been proposed in good faith, an issue that is likely to result in substantial chapter 12 litigation.[412] In an early chapter 12 case the bankruptcy court ruled that there is no good faith requirement that nondischargeable debts be treated differently under the plan. Instead, if the creditor is successful in objecting to discharge, the debt is not discharged as per section 1228(a).[413] In the first chapter 12 bankruptcy court decision in the District of Nebraska on good faith, the court ruled that income from a $138,000 exempt annuity must be devoted to the chapter 12 plan to meet the section 1225(a)(4) good faith requirement.[414] Zero payment plans, i.e. plans proposing to make no payment to unsecured creditors are likely to be found not in bad faith, so long as the debtor proposes to distribute all disposable income (if any) to unsecured claimants for the term of the plan.[415]

The plan must propose to distribute to unsecured claimants at least the liquidated value of their claim as of the date of confirmation, i.e., at least the amount unsecured claimants would have received in chapter 7 liquidation.[416] This familiar best interests of creditors test is a common feature of reorganization bankruptcy, and is the reason that a liquidation analysis is a common feature of chapter 12 bankruptcy planning.[417] The debtor has three options regarding treatment of secured claims under the chapter 12 plan. First, the secured holder may accept the plan, i.e., accept its treatment under the plan.[418] Alternatively, the debtor may turn the collateral over to the secured claim holder.[419] The cramdown alternative is that the dissenting secured claim holder retains its lien, and the value of the property to be dis-

411. *Id.* at § 1225(a)(2); 28 U.S.C.A. § 1930(a)(5) (West Supp. 1987) *See* 5 W. COLLIER, COLLIER ON BANKRUPTCY ¶ 1225.02, at 1225-3 (15th ed. 1987).

412. 11 U.S.C.A. § 1225(a)(3) (West Supp. 1987). Regarding good faith litigation in chapters 11 and 13, see 5 W. COLLIER, COLLIER ON BANKRUPTCY ¶¶ 1129.02[3], 1325.04 (15th ed. 1987).

413. *In re* Citrowske, 72 Bankr. 613, 617 (Bankr. D. Minn. 1987). The court noted that the automatic stay preludes creditors from pursuing a non,dischargeable claim. However, once the plan has been completed and a discharge entered, the automatic stay is terminated and the creditor may then legally pursue its nondischargeable claim. *Id.* at 618.

414. *In re* McKeag, 77 Bankr. 716 (Bankr. D. Neb. 1987). Now annuity exemptions are limited to $10,000. NEB.REV.STAT. § 44-371(2) (Supp. 1987).

415. This approach has been followed in chapter 13 cases. A chapter 13 plan to pay only 18% of disposable income to creditors was not proposed in good faith. *In re* Faust, 12 Bankr. 679, 681 (Bankr. D. Neb. 1981). *Cf.* 11 U.S.C.A. § 1225(b)(1)(B) (West Supp. 1987).

416. *Id.* § 1225(a)(4) (West Supp. 1987).

417. *Cf. id.* at §§ 1124(3)(A), 1325(a)(4), 1325(a)(5)(B).

418. *Id.* § 1225(a)(5)(A).

419. *Id.* § 1225(a)(5)(C).

tributed to the secured claim holder (including deferred payments) is the allowed amount of the claim.[420] This is likely to be the most frequently litigated issue in chapter 12 cases, and deserves additional discussion. The major issues include realty collateral valuation, adequate protection of personalty collateral, and the appropriate interest rate.

The issue with the greatest potential for disagreement and litigation is farmland valuation under the plan. Farmland is likely to constitute the majority of the farmer's assets and loan collateral.[421] The higher the valuation, the greater portion of an undersecured lender's claim will be secured and the smaller proportion unsecured.[422] The higher the valuation the higher the debt repayment requirements in the typical chapter 12 case, and the reduced likelihood that the plan will be financially feasible. Debtors then will prefer lower valuations while secured creditors will prefer higher valuations. The official valuation date is the effective date of the plan,[423] although most valuations will be conducted prior to that time. In the first reported chapter 12 case considering the problems of valuing farm real estate relative to plan confirmation, the bankruptcy court refused to limit itself to a consideration of the farmland's rental value despite Congress' use of rental value in section 1205 adequate protection determinations.[424] The court also considered comparable sales and capitalized income. The bankruptcy court for the district of Nebraska has followed a capitalized earnings test rather than a comparable sales test, although generalizing from only one case may be inappropriate.[425] Any outstanding real estate taxes would be subtracted from the value of an undersecured lender's claim as a prior lien,[426] as would any property exemption.[427]

The local bankruptcy rules for the District of Nebraska will encourage compromise of differences in farmland valuation. The rules state that objections to real estate valuation will not be sustained unless the objecting party has consulted with a *pro se* debtor or debtor's counsel regarding valuation.[428] The objecting party's motion must include an affidavit stating that the parties are unable to reach a valuation compromise, provide the parties' respective good faith estimates

420. *Id.* §§ 1225(a)(5)(B), 1222(b)(9).
421. *See infra* note 7.
422. 11 U.S.C. § 506(a) (1982).
423. 11 U.S.C.A. § 1225(a)(5)(B)(ii) (West Supp. 1987) *See In re* Statmore, 22 Bankr. 37 (Bankr. D. Neb. 1982). Other things being equal, a court is likely to favor a later property valuation.
424. *In re* Beyer, 72 Bankr. 525, 527-28 (Bankr. D. Colo. 1987).
425. *In re* McKeag, 77 Bankr. 716 (Bankr. D. Neb. 1987).
426. *In re* Edwardson, 74 Bankr. 831, 835 (Bankr. D.N.D. 1987). *Cf.* NEB.REV.STAT. § 77-203 (1986).
427. *In re* Brown, 22 Bankr. 363 (Bankr. D. Neb. 1982). *See supra* text accompanying notes 44-54.
428. LOCAL R. BANKR. 12-5(1) (D. Neb., proposed Nov. 26, 1986).

of value, and state whether either estimates are supported by a qualified appraisal conducted within 90 days of filing the affidavit. The costs of any hearing on objections to the plan may be taxed "proportionate to the value determined at said hearing."[429] This last provision should help keep the parties' farmland valuations more realistic.

Where collateral is personal property rather than realty, an important issue is whether an after acquired property clause has been cut off by the bankruptcy petition. The automatic stay does not cut off an after acquired property clause in postpetition proceeds, offspring, rents or profits.[430] Thus, if the collateral is farm equipment, the after acquired property clause in the security agreement would be cut off except with regards to proceeds. With regard to annual crops, the after acquired property clause is cut off with regard to crops planted after the petition was filed, but crops planted prepetition are subject to the security interest even if they are harvested postpetition unless the court orders otherwise.[431] Regarding perennial crops, all postpetition crops are subject to the prepetition security interest after acquired property clause,[432] as are postpetition livestock offspring.[433] The livestock issue was considered in an early chapter 12 decision of the bankruptcy court for the District of Nebraska regarding plan confirmation. The debtor proposed to sell feeder pigs and cull sows in the ordinary course of business and sell them free of the creditor's security interest.[434] The creditor objected on the basis that this would violate its section 552 postpetition security interest, which it is would be allowed to retain under section 1225(a)(5)(B)(i).[435] The court analyzed these sections, and correctly concluded that if it prohibited livestock operators from selling offspring it would doom any such farm reorganization plans. Thus, the court allowed the debtor to sell postpetition livestock offspring in order to fund its chapter 12 plan so long as it adequately protected the creditor's prepetition security interest by maintaining the hog herd at 110% of the remaining balance of the creditor's secured claim.[436] As the loan balance is reduced, the size of herd subject to lien would be reduced accordingly.

The final issue regarding treatment of secured claims under the chapter 12 plan is the appropriate interest rate for deferred payments. Creditors are entitled to the present value of their secured claim,

429. *Id.* 12-5(5).
430. 11 U.S.C. 552(b) (Supp. III 1985).
431. *See* Kunkel et al., *supra* note 39.
432. *In re* Beck, 61 Bankr. 671 (Bankr. D. Neb. 1985).
433. *In re* Wobig, 73 Bankr. 292 (Bankr. D. Neb. 1987).
434. *Id.* at 293.
435. *Id.* at 293-94.
436. *Id.* at 294-95. The court also required that the debtor pay any disposable income to unsecured claims for at least three years, and that the unsecured portion of the creditor's livestock lien not be discharged for that three year period. *Id.* at 295-96.

which includes interest if the claim is not immediately paid in full.[437] The appropriate interest rate to apply in the chapter 12 cramdown has already been established by the bankruptcy court for the District of Nebraska. In *In re Wichmann* the court ruled that the appropriate market interest rate is the treasury bond yield with a remaining maturity equal to the average loan amount outstanding plus a 2% risk factor.[438] The court in *Wichmann* followed *In re Doud*,[439] the first reported chapter 12 decision dealing with the appropriate chapter 12 interest rate in some detail. The *Doud* court noted the different approaches followed in determining the appropriate interest rate, and stated that the Eight Circuit has adopted a market interest rate standard.[440] In implementing this market interest rate approach, the *Doud* court used treasury bonds as the appropriate measure of an interest rate free of risk.[441] The court selected treasury bonds over treasury bills used by other courts because treasury bond terms can be matched to chapter 12 repayment terms, whereas treasury bills have a 52 week term. Selecting the appropriate term for a treasury bond requires some special calculations. Interest on treasury bills is not paid until the end of the treasury bond term, whereas interest and principal on a debt would be paid at least annually. To compensate for this difference the *Doud* court matched the average percentage outstanding during the repayment period of the chapter 12 debt with the treasury bond term.[442] This may be best illustrated by an example. If the debt is $12,000 to be repaid in six equal annual principal payments of $2,000, the average balance due equals $7,000. This is the total of the annual loan balances ($12,000 + $10,000 + $8000 + $6000 + $4000 + $2000 = $42,000) divided by the loan term of six years ($42,000/6 = $7000). The average balance due divided by the total balance due is $7000/12,000 or 58.33%. Thus, the treasury bond term will be 58.33% of the bankruptcy debt six year repayment period or three and one

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437. 11 U.S.C.A. § 1225(a)(5)((B)(ii) (West Supp. 1987). *See* 5 W. COLLIER, COLLIER ON BANKRUPTCY ¶ 1129.03, at 1129-62 (15th ed. 1986); Carbiener, *Present Value in Bankruptcy: The Search For An Appropriate Cramdown Discount Rate*, 32 S.D.L. REV. 42, 59-60 (1987).

438. *In re* Wichmann, 77 Bankr. 718 (Bankr. D. Neb. 1987).

439. *In re*, Doud, 74 Bankr. 865 (Bankr. S.D. Iowa 1987).

440. *Id.* at 867, citing *In re* Monnier Bros., 755 F.2d 1336 (8th Cir. 1985); and United States v. Neal Pharmacal Co., 789 F.2d 1283 (8th Cir. 1986).

441. *In re* Doud, 74 Bankr. 865, 868 (Bankr. S.D. Iowa 1987).

442. *Id.* citing Carbiener, *supra* note 437, at 64. Carbiener gives a more precise definition: "the rate paid to the bankruptcy creditor should be based on a government security with a duration equal to the same percentage of the repayment period as the average percentage of the claim outstanding. For example, if the average percentage of the creditor's claim outstanding during the repayment period is sixty percent, and the repayment period is ten years, the discount rate should be based on a government security with a duration of sixty percent of ten years, or six years." Carbiener, *supra* note 437, at 65.

half years.[443] The *Doud* court added a two percent risk factor to this basic treasury bond rate to account for reorganization risks and the inherent risks in farming.[444] The *Doud* court did not discuss on what date the bond rate should be established. The bankruptcy court for the District of Nebraska adopted the *Doud* analysis in *Wichmann*, including the two percent risk premium.[445] The court stated that it would consider evidence regarding special circumstances rendering its discount rate calculations inapplicable, but indicated generally that it would follow the *Doud* approach.[446] The *Wichmann* court also did not discuss what date would be used to establish the treasury bond rate.

The final general confirmation standard for a chapter 12 reorganization plan is a plan feasibility test, which is also likely to give rise to significant litigation.[447] Under the test, creditors will be able to challenge the financial viability of the farming operation, including the farmer's past production record and whether the farmer's income will fall due to scheduled farm program payment reductions.[448] Interestingly, the local bankruptcy rules for the District of Nebraska require the farmer only to submit a one year cash flow plan.[449] Creditors may argue that a one year cash flow projection is inadequate where a farmer is proposing a three to five year plan. The justification for a one year cash flow is that annual changes in government farm programs, in addition to normal crop and livestock market fluctuations, make precise prediction of future farm prices difficult. The counter argument is, at least for cash grain farmers heavily dependent on farm program payments, that a one year cash flow projection probably overstates future farm income in light of scheduled reductions of farm program payments.

The last special confirmation standard likely to be invoked in most chapter 12 cases is the unsecured claim holder cramdown standard. If either the trustee or an unsecured claim holder objects to confirmation, the plan must propose either to pay all unsecured claims in full, or else to devote all disposable income to payment of unsecured claims during the life of the plan for a minimum of three years.[450] Disposa-

443. *Cf. In re* Doud, 74 Bankr. 865, 868 nn. 1-2 (Bankr. S.D. Iowa 1987). Generally treasury bond interest rates increase with the bond term.

444. *Id.* at 869. Carbiener recommended a one percent risk factor. Carbiener, *supra* note 437, at 65. However, the additional risk attendant in chapter 12 farm reorganizations not present in the typical chapter 11 and 13 non-farm reorganizations would seem to justify the additional risk premium.

445. *In re* Wichmann, 77 Bankr. 718 (Bankr. D. Neb. 1987).

446. *Id.* at 722.

447. 11 U.S.C.A. § 1225(a)(6) (West Supp. 1987). *See In re* Monnier Bros., 755 F.2d 1336 (8th Cir. 1985).

448. *See supra* text accompanying note 2.

449. LOCAL R. BANKR. 12-6(1)(b) (D. Neb., proposed Nov. 26, 1986).

450. 11 U.S.C.A. § 1225(b)(1) (West Supp. 1987). Although the statute does not so

ble income is income received by the debtor less reasonably necessary family support and reasonably necessary expenses to continue, preserve and operate the debtor's business.[451] As most chapter 12 debtors are likely to be insolvent, and as unsecured claim holders are likely to object to plan confirmation, a standard feature of the typical chapter 12 plan will be to pay all disposable income to unsecured claim holders for three years or any longer plan term.[452]

The local bankruptcy rules for the District of Nebraska suggest some further chapter 12 plan confirmation requirements. The plan must include (1) a summary of the debtor's assets and liabilities; (2) a one year cash flow projection including all income sources and the assumptions upon which the income projection is based; (3) the historical or other data justifying the cash flow assumptions (i.e. prior farm production and marketing records); (4) farm income and expense information for the last four years;[453] (5) projected administrative expenses, including attorney fees; (6) schedules showing the dates and amounts of payments to be made, including those outside the plan; (7) the tax consequences of any sale of assets;[454] (8) the basis for property valuations, including a statement of whether the debtor's valuation varies from the creditor's valuation; (9) a justification for any payment of secured debts over a term exceeding three years; and (10) an itemization, valuation, and basis therefor of any encumbered property proposed to be retained by the debtor.[455]

The debtor may modify the plan prior to confirmation.[456] This would allow the debtor, *inter alia*, to modify the plan to reflect negotiations with creditors. If the plan is confirmed by the bankruptcy court, it is binding on the debtor and all creditors, even if the creditor is not provided for in the plan, or has rejected the plan.[457] If the plan is not confirmed, at least one court has ruled that the debtor may file a new plan.[458] Confirmation may be revoked for fraud if a creditor objects within 180 days of confirmation.[459] All property of the estate

state, the clear intent is that disposable income be paid to unsecured claim holders. *In re* Citrowske, 72 Bankr. 613, 616 (Bankr. D. Minn. 1987).

451. 11 U.S.C.A. § 1225(b)(2) (West Supp. 1987).

452. *See In re* Wobig, 73 Bankr. 292, 295-96 (Bankr. D. Neb. 1987).

453. The rules suggest that the information could be taken from the schedule F from the farmer's last four federal income tax returns. LOCAL R. BANKR. 12-6(1)(d) (D. Neb., proposed Nov. 26, 1986).

454. Taxes from the sale of appreciated assets must be paid by the debtor, whereas income resulting from debt discharge is not taxable. *See supra* text accompanying notes 91-95.

455. LOCAL R. BANKR. 12-6(1) (D. Neb., proposed Nov. 26, 1986).

456. 11 U.S.C.A. § 1223 (West Supp. 1987).

457. *Id.* § 1227(a).

458. *In re* Bentson, 74 Bankr. 56, 58 (Bankr. D. Minn. 1987).

459. 11 U.S.C.A. § 1230(a) (West Supp. 1987). The court may dismiss the case pursuant to section 1208 (erroneously referred to in section 1230(b) as section 1207) unless

vests in the debtor upon confirmation except as otherwise provided in the plan or confirmation order.[460] The property vests free of creditor's claims except for debts not discharged, or as otherwise provided in the plan or confirmation order.[461] The chapter 12 discharge is received when all payments under the plan are completed, except for payments exceeding the term of the plan.[462] Debts not discharged include those for which no proof of claim was filed,[463] long term debts being repaid over a period longer than the period of the plan,[464] and debts defined by the Code as nondischargeable.[465] A hardship discharge may be granted by the court if the debtor is unable to make plan payments and if such failure is beyond the debtor's control, creditors have received at least the liquidation value of their claim, and postconfirmation plan modification is not practicable.[466] A creditor may object to discharge on the basis of the debtor's fraud if the creditor did not know of such fraud until after discharge was granted.[467]

An additional confirmation issue that may result in litigation is postconfirmation modification of the chapter 12 plan. After confirmation but before payments have been completed, the plan may be modified to increase or decrease payments on claims of a particular class, extend or reduce the time of such payments (subject to the five year plan term limitation), or alter the distribution to a particular creditor based on payments made outside the plan if such modification is requested by the debtor, trustee, or unsecured claim holder.[468] Anderson and Morris suggest several circumstances that might lead to postconfirmation plan modification.[469] If the debtor's income is less than expected, the debtor could petition the court to reduce payments to unsecured claim holders. If the debtor's income increased or the debtor obtained additional assets, unsecured claim holders could petition the court for increased payments during the life of the plan. If the debtor were unable to make payments on secured claims, the debtor could petition the court to modify the plan or surrender the

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the debtor proposes to modify the plan and the modified plan is confirmed. *Id.* § 1230(b).

460. *Id.* § 1227(b).

461. *Id.* § 1227(c).

462. *Id.* § 1228(a).

463. *Id.* §§ 1228(a)(1); 523(a)(3).

464. *Id.* §§ 1228(a)(1), 1222(b)(5), (10) (West Supp. 1987).

465. *Id.* § 1228(a)(2); 11 U.S.C. § 523(a) (1982 & Supp. III 1985). Regarding nondischargeable debts, *see supra* text accompanying notes 83-90.

466. 11 U.S.C.A. § 1228(b) (West Supp. 1987).

467. *Id.* § 1228(d).

468. *Id.* § 1229(a),(c). Payments outside the plan could include payments by third parties (e.g., relatives or guarantors). J. ANDERSON & J. MORRIS, *supra* note 6, § 9.03, at 9-11.

469. J. ANDERSON & J. MORRIS, *supra* note 6, § 9.03, at 9-11 to 9-13.

collateral to the secured claim holder.[470] The modified plan may distribute to unsecured claim holders less than the liquidated value of their claim.[471] Anderson and Morris take a contrary position, arguing that unsecured holders must receive the liquidated value of their claims, citing the section 1228(b) hardship discharge requirements.[472] However, the postconfirmation plan modification confirmation requirements omit the section 1225(b) unsecured holder cramdown criterion. This suggests that a section 1228(a) regular discharge could be obtained under the modified plan without obtaining a section 1225(b) hardship discharge. The postconfirmation plan modification becomes the plan unless disapproved by the court.[473] Thus, the modified plan would be the plan under which the debtor would be required to make all plan payments to receive a section 1225(a) discharge.

One issue which individuals who are counselling debtors considering chapter 12 should be aware of is the effect of an unsuccessful chapter 12 on subsequent bankruptcies, particularly a subsequent chapter 7. An earlier chapter 12 discharge does not bar a subsequent chapter 7 discharge within six years of the commencement of the chapter 12 case, if the debtor paid 100% of the unsecured claims; or if the debtor paid 70% of the unsecured claims, the plan was proposed in good faith, and was the debtor's best effort.[474] This provision has different effects depending on whether the plan failed, or whether the debtor is unable to pay long term secured debts after the plan has been completed and discharge has been granted. If the plan fails before it has been completed, generally the debtor will have received no debt discharge (unless debts were discharged in the plan). If there was no debt discharge there is no bar to a chapter 7 discharge. If, however, the plan has been completed and discharge has occurred, the debtor could qualify for a subsequent chapter 7 discharge only if the debtor has paid all unsecured claims or met the section 727(a)(9) best efforts discharge test. In most cases the chapter 12 discharge would have discharged much if not all of the debt exceeding current asset values. Thus, the inability of the unsuccessful chapter 12 debtor to repay long term debt would probably not result in the high income taxes that would have occurred in the absence of a bankruptcy liquidation or debt discharge. If the debtor cannot meet one of the hardship discharge requirements, the debtor will be denied a chapter 7 discharge for six years after the chapter 12 petition was filed. The undischarged debts remaining at

470. Note, however, that secured claimants may not petition the court for postconfirmation plan modification. An interesting, and to this point unanswered, question is whether a undersecured creditor may petition the court as an unsecured holder for modification of the plan's treatment of its secured claim.

471. 11 U.S.C.A. § 1229(b)(1) (West Supp. 1987). *Cf. id.* at § 1225(b).

472. J. ANDERSON & J. MORRIS, *supra* note 6, § 9.03, at 9-12 to 9-13.

473. 11 U.S.C.A. § 1229(b) (West Supp. 1987).

474. 11 U.S.C. § 727(a)(9)(1982).

this point, aside from nondischargeable debts, would be the long-term secured debts (but not the loan deficiencies). As these debts are likely to constitute most of the chapter 12 debtor's remaining debts, those debts would not be discharged in a subsequent chapter 11. Assuming the unsecured loan deficiencies have been discharged, little debt forgiveness income would be realized in a subsequent non-bankruptcy liquidation. Thus, most chapter 12 debtors will not be significantly penalized if they fail to qualify for a subsequent chapter 7 bankruptcy, absent special considerations.

E. Chapter 12 Plan Preparation

This section deals with the two most important elements of the chapter 12 plan: debt writedown and postpetition financing.[475] After the assets and liabilities have been scheduled, the most important part of the plan will be a liquidation analysis, i.e. an analysis of the value of each claim as if the farmer were liquidated in chapter 7 rather than reorganized in chapter 12. The initial liquidation analysis will indicate whether reorganization is feasible or not. In simple terms, insolvent debtors will be able to write debt down to the value of their assets, less any exemptions. If the debtor needs further debt writedown to make his reorganization feasible, he probably will not be able to have his plan confirmed. From the creditor's perspective, the liquidation analysis depends on whether the creditor is oversecured, undersecured, priority, or unsecured.

Secured claims. If the creditor is oversecured it will receive full payment under the chapter 12 plan. It will also receive interest at the contract rate up to the date of confirmation, and at the market rate approved in the plan thereafter.[476] The loan term may be extended under the plan to help the debtor's cash flow position, although any disposable income will in virtually every case be paid to unsecured claim holders. The equity cushion in collateral pledged to an oversecured creditor is the value that will be applied against unsecured claims, as discussed below. If the creditor is undersecured, it will have two claims, secured and unsecured. Property valuation will be critical as it will determine how much of the creditor's claim is secured and how much is unsecured.[477] Secured claims must be paid in full whereas in many cases unsecured claims will receive little or no payment. Normally each secured creditor, whether oversecured or undersecured, will be placed in a separate class in the plan.

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475. For a sample chapter 12 plan, *see* J. ANDERSON & J. MORRIS, *supra* note 6, at F-94 -153.

476. *In re* Lenz, 74 Bankr. 413 (Bankr. C.D. Ill. 1987).

477. Property is valued for purposes of § 1225(a)(5)(B) plan confirmation as of the effective date of the plan. *In re* Mikkelsen Farms, Inc., 74 Bankr. 280, 289 (Bankr. D. Or. 1987).

Unsecured claims. The plan must deal with all unsecured claims, including those of unsecured creditors and the deficiency claims of secured creditors. The debtor can place consumer claims into a separate category and propose a different treatment of those claims.[478] A more significant issue is whether the debtor's plan can discriminate in favor of creditors essential to the debtor's future operations. In *In re Wobig* the bankruptcy court for the District of Nebraska approved the special treatment of "necessary creditors" without discussion, suggesting that the court is at least receptive to this approach.[479] The limits to which chapter 12 debtors may go in proposing special treatment for necessary creditors has not yet been established.

The minimum required payment to unsecured claim holders is the liquidated value of their claim. There are two possible sources of value in the farm assets that must be paid out to unsecured claim holders: unencumbered nonexempt assets and any equity in encumbered nonexempt assets.[480] Unsecured claim holders then have an interest in asset valuation similar to that of secured claim holders: the higher the asset valuation, the higher the liquidation value of unsecured claims is likely to be. If the chapter 12 debtor is insolvent, has no unencumbered nonexempt property, and has no equity in encumbered property, the liquidated value of unsecured claims will be zero. Many, if not most, chapter 12 plans will be "zero plans" in that unsecured claims will have no liquidation value and the plan will propose no payment to unsecured claim holders. In such a case the court is likely to require that all disposable income be paid against unsecured claims for three years, assuming that either the trustee or an unsecured creditor objects to confirmation. Chapter 12 plans may propose to pay the three year's disposable income to unsecured claim holders even if the claims have no liquidated value to speed confirmation. In this regard an issue likely to be litigated is how disposable income is calculated. In an early chapter 12 case one court has ruled that the inclusion of a "reserve account" in the farm budget (probably similar to a depreciation expense) was a reasonable business expense and did not violate the section 1225(b)(2)(B) disposable income requirement.[481] In that case unsecured creditors were paid in full; a different result might have obtained if the plan had been a zero plan.

Operating financing. An important component of the reorganization plan is operating financing. In most cases unsold crops or livestock and government farm program payments will constitute the

478. 11 U.S.C. § 1222(b)(1).

479. 73 Bankr. 292, 293 (Bankr. D. Neb. 1987).

480. Recall that oversecured creditors are entitled to postpetition interest up to confirmation. *See supra* text accompanying notes 31-32. Thus any equity in encumbered assets must be in excess of these required interest payments.

481. *In re* Janssen Charolais Ranch, Inc., 73 Bankr. 125, 128 (Bankr. D. Mont. 1987).

bulk of the debtor's cash collateral. Typically, the debtor will propose to use cash collateral as operating capital and offer replacement liens in future crops, program payments, etc.[482] A major issue will be the validity of prepetition after acquired property clauses. Crops planted postpetition are clearly not subject to prepetition after acquired property clauses, and a debtor will be free to pledge those postpetition crops as substitute collateral for secured debt where the collateral is proposed to be sold to provide operating financing, or to provide collateral for postpetition operating financing. For example, if the PCA has a lien on the crop which has been harvested and stored, the debtor can propose to sell that stored crop, use the proceeds for the next season's operating financing, and give the PCA a lien on the future crop. Because of the uncertainty regarding a future crop, bankruptcy courts are likely to require crop insurance as a condition of approving such collateral substitutions.[483] As the secured loan is paid down, the portion of future crops that is continued to be repledged as substitute collateral will decrease over time.[484]

VI. CONCLUSION

Chapter 12 has revolutionized farm bankruptcies and indirectly farm credit workout negotiations. Prior to chapter 12, chapter 11 reorganization was not a realistic option for farmers. Whether the *Ahlers* decision will change this as a practical matter remains to be seen. Unless the farmer could qualify for chapter 13, he had little realistic likelihood of a successful bankruptcy reorganization. This gave lenders little legal incentive to negotiate farm debt workouts. The farmer's main negotiating point was the real estate mortgage foreclosure delays and delays associated with a bankruptcy filing. However, lenders would face the possibilities of these same delays if the workout failed, so the threat was not that effective.

Chapter 12 has changed this by giving farmers a realistic bankruptcy reorganization option. Most insolvent farmers will be able to have a chapter 12 plan confirmed by writing debt down to asset values, unless the farmer has a poor production history. This may make lenders more willing to negotiate workouts, including accepting debt writedowns, to avoid having to participate in bankruptcy proceedings. Most financially troubled farmers would probably be willing to accept workout terms less generous than they could obtain in chapter 12 simply to avoid the stigma of bankruptcy. However, some lenders may be unwilling to negotiate workouts outside of chapter 12 because they

482. *See, e.g.*, *In re* Beyer, 72 B.R. 523 (Bankr. S.D. Colo. 1987).

483. *See supra* text accompanying notes 172-177.

484. For a similar analysis of encumbered livestock, *see supra* text accompanying notes 434-36.

perceive it as being inequitable regarding their other farm borrowers. If a lender's farm borrowers who are current on their loans learn of favorable treatment given to a delinquent farmer to avoid bankruptcy, the current customer may expect similar treatment and request debt writedown and reduced interest rates. The lender can save face by in effect agreeing to a workout in chapter 12 rather than outside of bankruptcy. Using this stategy, the lender will have had no "choice" in the matter and will have no public relations problem with other farm borrowers.

Will farmers in fact be able to successfully reorganize in chapter 12? The answer depends not only on how chapter 12 is interpreted but perhaps more significantly on the weather, crop prices, the federal farm program, and the chapter 12 debtor's management ability. The prospect of reduced federal farm payments and the possibility of lower crop prices resulting from biotechnological changes in agriculture do not bode well for the highly leveraged farmer. However, chapter 12 will give insolvent farmers an opportunity to reduce their debt load down to asset values. If these farmers can generate sufficient farm income to service these reduced debts, many will have an opportunity to survive in what promises to be a continually changing agricultural economy.