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**Protecting America's Farmers under State
Mediation Laws and Chapter 12:
Who's Being Protected?**

by

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PROTECTING AMERICA'S FARMERS UNDER STATE MEDIATION LAWS AND CHAPTER 12: WHO'S BEING PROTECTED?

“Worm or beetle — drought or tempest —
on a farmer's land may fall,
Each is loaded full o' ruin,
but a mortgage beats 'em all.”¹

I. INTRODUCTION

The measure of the crisis in American agriculture has been depicted by staggering statistics. The farm crisis of the 1980's resulted from several underlying economic forces which developed primarily during the 1970's, including inflationary spirals, a rise in interest rates, increasing reliance on debt, and a dramatic upswing in farmland values. Of these forces, two major trends significantly impacted on agricultural lenders supplying credit to the farm industry — increasing reliance on debt and the dramatic upswing in farmland values.²

Increasing reliance on debt to finance continuing farm operations and expansion changed the nature of the farm balance sheet. This reliance caused a deterioration in net income as farmers struggled to meet interest commitments in the slower economy of the 1980's. Farm debt rose from \$53 billion at the beginning of 1972 to \$150 billion at the beginning of 1980 and increased further to a cyclical peak approaching \$200 billion in the summer of 1984.³

The dramatic upswing in farm land values in the 1970's and subsequent dramatic decline also contributed to the farm problems. Most of the rise and fall in the total value of farm assets consisted of changes in the price of farmland.⁴ Measured in 1986 dollars, real capital gains on farm land during the 1970's totaled about \$500 billion.⁵ Real capital losses from 1980 to 1986 mirrored the dramatic gains at about \$450 billion.⁶ This dramatic

1. J. BARTLETT, *BARTLETT'S FAMILIAR QUOTATIONS* 808 (14th ed. 1968) (quoting W. CARLETON, *THE TRAMP'S STORY*).

2. For a detailed discussion regarding the extent of the farm debt, see Melichar, *Turning the Corner on Troubled Farm Debt*, 73 *FED. RESERVE BULL.* 523 (July, 1987); see also Harl, *Section One: The Land Debt Crisis and Agricultural Finance Reform*, 34 *U. KAN. L. REV.* 425 (1986); U.S. Dept. of Agriculture, *ECONOMIC INDICATORS OF THE FARM SECTOR: NATIONAL FINANCIAL SUMMARY* 1985 (1986).

3. Melichar, *supra* note 2, at 526-27.

4. *Id.*

5. *Id.*

6. *Id.*

drop in asset values exhausted the equity of many of the more heavily indebted farmers, and as the crisis continued, agricultural lenders could not recover the full amount of funds loaned to those farmers.⁷

The extent of the crisis in American agriculture, however, cannot be measured solely by cold numbers on a page.⁸ Rather, it is to be measured "in terms of the human tragedy, the disruption of lives, and the despair of being a middle-aged farmer suddenly told to find another livelihood to support a family."⁹ The human dimension of the farm crisis in America, as described by a farmer, represents the feelings shared by many fellow farmers:

It is waking up every morning to know your interest bill has increased \$100 during the night.

It is having your children become strangers because you are working to [sic] hard.

It is watching your neighbors [sic] farm equipment being auctioned off.

It is watching something you really care for slowly slipping away like sand through an hour glass.

It is knowing salvation through people who love you.

It is praying that you will give yourself to those who can silently and patiently wait.¹⁰

This Comment discusses the state and federal response to the crisis in American agriculture. An examination of eligibility under Chapter 12, a new bankruptcy chapter designed to provide financial relief to American farmers, will follow. Finally, this Comment discusses the impact of Chapter 12, focusing upon the number of filings and its derivative effects upon American agriculture.

7. *Id.* at 528.

8. 132 CONG. REC. S15,075 (daily ed. Oct. 3, 1986) (statement of Sen. Grassley).

9. *Id.*

10. INTERCHURCH MINISTRIES OF NEBRASKA FARM CRISIS HOTLINE RESPONSE, RURAL NEBRASKANS AT RISK: THREE STUDIES ON UNMET EMOTIONAL, HUNGER, AND LEGAL NEEDS 4 (Summer 1987). "One phenomena of the farm crisis has been the development and growth of a number of farm crisis support groups." *Id.* at 19. In fact, this author's parents were instrumental in establishing such a group of farmers in southeastern Minnesota. Their group, known as Concerned Farmers, has established a network designed to meet the informational and emotional needs of farmers.

II. PROTECTIONS FOR AMERICA'S FARMERS — STATE AND FEDERAL RESPONSES TO THE FARM CRISIS

A. *The State Response — Mediation Laws*

In the wake of extreme economic hardship, farmers sought protection at the state and federal levels. At the state level, the passage of mandatory (Minnesota¹¹ and Iowa¹²) or voluntary (Wisconsin¹³ and North Dakota¹⁴) mediation laws exemplified states' attempts to respond to the farm crisis. Mediation laws were primarily designed as a mechanism to resolve disputes between farmer-debtors and agricultural lenders regarding the collection of farm credit in a mutually beneficial manner.¹⁵

In order to be entitled to protection provided by mediation statutes, eligibility generally depends upon minimum acreage requirements and minimum income requirements.¹⁶ Only a few state courts have construed their state farm mediation laws. In *Krueger v. Washington Federal Savings Bank*

11. See Minnesota Farmer-Lender Mediation Act, MINN. STAT. ANN. §§ 583.20-.32 (West 1988).

12. See Farm Mediation, IOWA CODE ANN. § 654A (West Supp. 1988).

13. See Farm Mediation and Arbitration Program, WIS. STAT. § 93.50 (1987-88).

14. See Assistance for Financially Distressed Farmers and Small Business Persons, N.D. CENT. CODE § 6.09.10 (1987).

15. Myers, *The Role of the Bar in Troubled Times — A Minnesota Perspective*, 38 ALA. L. REV. 637, 638 (1987).

16. The scope of the Minnesota Farmer-Lender Mediation Act defines its scope:

Except as provided in paragraph (b) the farmer-lender mediation act applies to a debtor who is:

- (1) a person operating a family farm as defined in section 500.24, subdivision 2;
- (2) a family farm corporation as defined in section 500.24, subdivision 2; or
- (3) an authorized farm corporation as defined in section 500.24, subdivision 2.

MINN. STAT. ANN. § 583.24(2)(a) (West 1988). However, "[t]he farmer-lender mediation act does not apply to a debtor who owns and leases less than 60 acres with less than \$20,000 in gross sales of agricultural products the preceding year." *Id.* at § 583.24(2)(b).

The scope of the Iowa Farm-Mediation Act is defined in IOWA CODE ANN. § 654A.4 (West Supp. 1988), which provides:

1. This chapter applies to all creditors of a borrower described under subsection 2 with a secured debt against the borrower of twenty thousand dollars or more.
2. This chapter applies to a borrower who is any of the following:
 - a. An individual operating a farm.
 - b. A family farm corporation as defined in section 172C.1.
 - c. An authorized farm corporation as defined in section 172C.1.

The scope of the Wisconsin Act is defined in WIS. STAT. § 93.50(3) (1987-88):

- (a) A farmer or creditor wishing to resolve a dispute between them involving the farmer's agricultural property and the creditor's claim affecting the agricultural property, either before an action has been initiated to which they are parties or after entry of a suspension order in an action to which they are parties under sub. (2m), may participate in mediation under this section in accordance with this subsection.

See also WIS. STAT. § 93.50(1) (1987-88), which provides:

of *Montevideo*,¹⁷ *Northern State Bank of Thief River Falls v. Efteland*,¹⁸ and *Rengstorf v. Richards*,¹⁹ the Minnesota Court of Appeals routinely held that failure to meet the eligibility requirements of the farm mediation law resulted in denial of mediation.

On the one hand, under mandatory mediation, certain legal proceedings against a farmer-debtor by agricultural lenders are suspended. The Minnesota and Iowa mandatory mediation laws similarly require creditors desiring to terminate a contract for deed, garnish, levy on, execute on, seize, or attach agricultural property, to first serve notice on the debtor of the right to mandatory mediation.²⁰ On the other hand, under voluntary mediation, farmer-debtors and agricultural lenders are encouraged, but not required, to resolve farm credit disputes outside of court.²¹ The different mediation

(am) "Agricultural property" means real property that is used principally for farming, real property that is a farmer's principal residence and any land contiguous to the residence, personal property that is used as security to finance farming or personal property that is used for farming.

....

(d) "Farmer" means a farmer, as defined in S. 102.04(3), who owns or leases a total of 60 acres or more of land that is agricultural property and whose gross sales of farm products for the preceding year equaled \$20,000 or more.

The scope of the North Dakota Act is defined in N.D. CENT. CODE §§ 6-08.3 to -09.10 (1987):

1. An eligible farmer means a farmer who has a debt to asset ratio of greater than fifty percent and is unable to pay for legal or tax assistance without impairing funds needed for necessary family living and farm operating expenses.

17. 406 N.W.2d 543 (Minn. Ct. App. 1987).

18. 409 N.W.2d 541 (Minn. Ct. App. 1987).

19. 417 N.W.2d 138 (Minn. Ct. App. 1987). Interestingly, current policy responses to the farm crisis have mirrored similar policy developments during the Great Depression. In 1933, Minnesota was the first state to pass a law providing moratoria on farm mortgages and, in some cases, home mortgages as well. L. CHANDLER, *AMERICA'S GREATEST DEPRESSION: 1929-1941* 65 (1970). By the end of 1933, most other significant agricultural states had adopted similar legislation. *Id.* "In various ways, these laws prevented foreclosures, or at least inhibited them: they introduced more complex and time-consuming foreclosure procedures; provided arrangements for scaling down principal, or interest, or both; outrightly suspended foreclosures for stated periods, usually at least two years; and prohibited deficiency judgments against farmers." *Id.*

20. MINN. STAT. ANN. § 583.26 (West 1988). Minnesota's farm credit mediation law is a "mandatory prerequisite to the institution of certain adverse actions by creditors who have a security interest in agricultural property in excess of 5000 dollars." Myers, *supra* note 15, at 639. As stated therein,

[t]hese adverse actions are: (1) actions to replevy agricultural personal property subject to a security interest, including a personal property lease that is not a true lease; (2) actions to terminate a contract to purchase agricultural real property (K4D); (3) actions to foreclose a mortgage on agricultural property; and (4) actions to enforce a judgment lien on either real or personal agricultural property.

Id. (footnotes omitted); see also IOWA CODE ANN. § 654A.6 (West Supp. 1988).

21. See WIS. STAT. § 93.50 (1985-86); see also N.D. CENT. CODE § 6-09.10 (1987).

laws enacted illustrate the lack of uniformity in the states' response to the farm crisis. While some states responded to the farm crisis with vigor, others have not acted.²²

B. *The Federal Response — Chapter 12*

Given the extent of the nationwide farm crisis,²³ the sporadic response among the states was generally inadequate and lacked uniformity. Those farmers unable to mediate credit disputes were forced to file bankruptcy under the then existing Bankruptcy Code, which failed to address the reorganizational needs of American farmers.²⁴ On October 27, 1986, Congress enacted a separate bankruptcy chapter, Chapter 12, known as "Adjustment of Debts of a Family Farmer With Regular Annual Income."²⁵ Chapter 12 was particularly structured for those family farmers who wanted to survive the farm crisis and *continue* their operations.²⁶

The extraordinary response to the farm crisis has not been without the support of the American public. In a recent survey, over eighty percent of those surveyed agreed that "[t]he family farm must be preserved because it is a vital part of our heritage."²⁷ The survey results also indicated that seventy percent of those surveyed believe most farmers today are in financial trouble and the "government should have a special policy to ensure that family farms survive."²⁸ Thus, "[t]he symbol of the family farm, bastion of

22. At the present time, at least one state legislature is considering mediation legislation. LB 664, 90th Leg., 1st Sess., 1988 Nebraska Laws; see also *infra* notes 151-52 and accompanying text. As explored in Section IV of this Comment, the presence of state mediation laws, coupled with the enactment of Chapter 12, has produced significant results in terms of filing ratios. See *infra* notes 139-66 and accompanying text.

23. See 132 CONG. REC. H9001 (daily ed. Oct. 2, 1986).

24. See *infra* notes 33-37 and accompanying text.

25. 11 U.S.C. §§ 1201-31 (Supp. V 1987). The family farm amendments took effect 30 days after the date of enactment, November 26, 1986.

26. The enactment of a separate bankruptcy chapter to address the ills of American farmers has historical precedence. As part of Congress' legislative response to the agricultural crisis during the Great Depression, Congress added section 75 to the Bankruptcy Code in 1933. For a discussion of the historical antecedents of Chapter 12, see Note, *An Analysis of the Family Farmer Bankruptcy Act of 1986*, 15 HOFSTRA L. REV. 353 (1987); see also Anderson & Rainach, *Farmer Reorganizations Under the New Bankruptcy Code*, 28 LOY. L. REV. 439, 447 (1982). For a discussion of section 75, see 3 W. NORTON, JR., *NORTON BANKRUPTCY LAW AND PRACTICE* § 80.07, 8-10 (1987). For an excellent historical discussion, see Anderson, *An Analysis of Pending Bills to Provide Farm Debtor Relief Under the Bankruptcy Code*, reprinted in 132 CONG. REC. S15076 (daily ed. Oct. 3, 1986).

27. Survey conducted by Luther Tweeten, Oklahoma State University. *Beliefs Bound to the Land Hold Firm as Times Change*, 3 INSIGHT 10 (Dec. 7, 1987).

28. *Id.*

Jeffersonian democracy, is deeply embedded in the American consciousness."²⁹

III. RATIONALE FOR ENACTING CHAPTER 12

A. *Shortcomings of the Existing Chapters to Adequately Address the Needs of Farmers*

Prior to the enactment of Chapter 12, family farmers could file for relief under Chapters 7, 11, and 13 of the Bankruptcy Code.³⁰ Proponents believed a separate bankruptcy chapter was necessary for farm reorganizations in order to allow family farmers to continue their farming operations. Chapter 12 was drafted in response to the tremendous hardship afflicting many segments of the farm community which has resulted in a large number of bankruptcies. It was concluded that the present structure of the Bankruptcy Code simply did not fit the special economic circumstances attending the family farmer.³¹

Congressional conferees, urging the adoption of Chapter 12, described the shortcomings of existing bankruptcy chapters and the inability under current law to adequately address the needs of financially distressed family farmers as follows:

Under current law, family farmers in need of financial rehabilitation may proceed under either Chapter 11 or Chapter 13 of the Bankruptcy Code. Most family farmers have too much debt to qualify as debtors under Chapter 13 and are thus limited to relief under Chapter 11. Unfortunately, family farmers have found Chapter 11 needlessly complicated, unduly time-consuming, inordinately expensive and, in too many cases, unworkable.

Accordingly, this subtitle creates a new chapter of the Code — Chapter 12 — to be used only by family farmers. It is designed to give family farmers facing bankruptcy a fighting chance to reorganize their debts and keep their land. It offers family farmers the important protection from creditors that bankruptcy provides while, at the same time, preventing abuse of the system and ensuring that farm lenders receive a fair repayment.

This new chapter is closely modeled after existing Chapter 13. At the same time, however, the new chapter alters those provisions that are inappropriate for family farmers — the requirement that the plan be filed within 15 days of the petition; the requirement that plan

29. *Id.*

30. C. Grassley, *Some Questions and Answers Concerning Chapter 12* (after November 26, 1986) (available from Senator Grassley, Senator for the State of Iowa).

31. 132 CONG. REC. S15, 091-92 (daily ed. Oct. 3, 1986) (statement of Sen. DeConcini).

payments start within 30 days of the plan confirmation; and the low debt limits found in Chapter 13.

Under this new chapter, it will be easier for a family farmer to confirm a plan of reorganization.³²

The shortcomings of these bankruptcy chapters as they relate to family farmers may be briefly summarized as follows:

1) Chapter 7, a liquidation chapter, would not have saved the family farm. Chapter 7 contained no provisions which would have allowed a farmer to modify secured debts.³³

2) Chapter 13 was not available for most farmers because they typically had too much debt.³⁴ The relatively low debt ceilings assigned to Chapter 13 of \$100,000 in unsecured debt and \$350,000 in secured debt³⁵ prohibited most family farmers from being eligible for relief under Chapter 13. Thus, prior to Chapter 12, most farmers were limited to relief under Chapter 11.

But, even for those farmers who do qualify, Chapter 13 has its disadvantages — the plan must be filed within 15 days after the petition, the plan is limited to 3 to 5 years, and the plan may not modify secured claims secured only by the debtor's residence.³⁶

32. OVERVIEW OF THE FAMILY FARM SUBTITLE OF THE CONFERENCE REPORTS, 132 CONG. REC. H8,998-99 (daily ed. Oct. 2, 1986) [hereinafter Overview]. For a detailed discussion regarding the inadequacy of the Bankruptcy Code to respond to the needs of farmers, see Note, *supra* note 26; see also Anderson, *supra* note 26; Comment, *Bankruptcy Chapter 12: How Many Family Farms Can it Salvage?*, 55 UMKC L. REV. 639 (1987).

33. C. Grassley, *supra* note 30, at 1. For a detailed discussion of Chapter 7 as it relates to farmers, see 3 W. NORTON, JR., *supra* note 26, § 80.03, at 3-4; see also CENTER FOR RURAL AFFAIRS, REBUILDING FAMILY FARMS THROUGH BANKRUPTCY: A GUIDE TO CHAPTER 12 BANKRUPTCY 7 (Feb. 1987) [hereinafter CENTER FOR RURAL AFFAIRS].

Chapter 7 bankruptcy . . . is referred to as "straight bankruptcy" or "liquidation bankruptcy." In Chapter 7, the assets are liquidated (sold at a sale or 'abandoned' to the debtor) and the farm debtor is typically only allowed to keep certain exempted property. It is possible to use Chapter 7 for rebuilding a farm operation by a careful use of exemption laws so as to exclude key farming assets from liquidation. Even though bankruptcy is a federal proceeding, in most states, the exemptions used by the bankruptcy court are determined by state exemption and redemption law. As a result, the use of Chapter 7 as a tool for rebuilding will depend on how extensive state law is in this area. For financially distressed farmers leaving or retiring from agriculture, Chapter 7 might be the best bankruptcy option.

Id.

34. C. Grassley, *supra* note 30, at 1. For a detailed discussion of Chapter 13 as it relates to farmers, see 3 W. Norton, Jr., *supra* note 26, § 80.04, at 4-5.

35. Note, *supra* note 26, at 362 (citing Kotis, *Chapter 13 and the Family Farm*, 3 BANKR. DEV. J. 599, 622 (1986)).

36. C. Grassley, *supra* note 30, at 1; see also, CENTER FOR RURAL AFFAIRS, *supra* note 33, at 7.

Chapter 13 was originally designed for individual wage earners or businesses with fairly low debts. It cannot be used by corporations. While Chapter 13 is a quick procedure, and

3) Chapter 11 was designed for large corporate debtors and contemplated a large number of different classes of creditors. It also provided creditors with considerable control over the debtor's future plan of operations. Thus, for farmers filing under Chapter 11, it was difficult to get confirmation of a Chapter 11 reorganization plan which impaired the interests of a creditor.³⁷

B. Purpose of Chapter 12

Specifically designed to meet the needs of financially distressed family farmers, the primary purpose of Chapter 12 is "to give family farmers facing bankruptcy a fighting chance to reorganize their debts and keep their land."³⁸ Chapter 12 was "meant to assist those farmers who have the true potential to reorganize and to allow them relief from heavy debt burden and yet allow farmers to repay creditors what is reasonable under today's difficult economic situation."³⁹

One proponent of Chapter 12 described its purpose as follows:

The new provisions for the family farmer will aid in the preservation of the family farm while maintain [sic] at the same time the integrity of the bankruptcy system and meeting the needs of bona fide farm creditors. It also enables a family farm in trouble to undergo a reorganization without going under financially.⁴⁰

Many farmers, operating under times of extreme economic hardship, witnessed the value of their collateral shrink significantly below their loans. Responding to the major economic forces that have impacted on farming, Chapter 12 was designed to allow farmers to reorganize their debts instead of going into foreclosure. Chapter 12 permits farmers to extend payments on secured debt over a longer period and reduce unsecured debt by payment

has been used by some farm operations in the past, debt level restrictions and the prohibition against corporations eliminates many currently distressed farmers.

Id.

37. CENTER FOR RURAL AFFAIRS, *supra* note 33, at 7.

38. Overview, *supra* note 32, at H8,998-99.

39. 132 CONG. REC. S15,075 (daily ed. Oct. 3, 1986) (statement of Sen. Thurmond). Sen. Thurmond continues:

When administering this chapter 12, the courts should strive to preserve this equity balance between creditors' and debtors' rights. They should appreciate the possibility of harsh consequences to secured and unsecured creditors in providing financial relief to farmers. Attempting to balance the conflicting objectives of the farmer debtors and agricultural creditors has been a monumental task at best.

Id.

40. 132 CONG. REC. S15,092 (daily ed. Oct. 3, 1986) (statement of Sen. Hatch).

of a percentage of the amount due and/or by payment over a three-to-five year period.⁴¹

Chapter 12 has induced the sharing of losses between farmer-debtors and agricultural lenders.⁴² This sharing of losses, however, has been sharply criticized as placing an even greater burden on agricultural lenders, particularly since the experience of many agricultural lenders has mirrored financial developments in the farm economy. To attest to this fact, more than 200 agricultural banks have failed since the onset of farm loan problems.⁴³ Although the agricultural lending community took a neutral position regarding the adoption of Chapter 12,⁴⁴ one critic's pronouncement during congressional debates reflected the fears of many lenders surrounding the adoption of Chapter 12.

I am very worried that the extremely debtor oriented-provisions of this chapter may force our farm lender to write off hundreds of millions of dollars of farm debt with no hope of recovering this debt when the farm crisis ends. Can our credit community afford this? Can our rural banks, teetering now, take another hit? Can the Farmer Credit System take yet another significant economic reversal? Is it fair to ask the creditor to absorb the huge losses that can

41. See 11 U.S.C. § 1222(c) (Supp. V 1987); see also KING, CHAPTER 12 BANKRUPTCY, A LEGAL GUIDE FOR WISCONSIN FARMERS 29 (1987). "A debt is secured to the extent of the value of the collateral. For example, if the FMHA is owed \$500,000 and their collateral — the land — is worth \$300,000, FMHA has a secured claim to the extent of \$300,000 and an unsecured claim to the extent of \$200,000." *Id.* For a detailed discussion regarding the treatment of mortgages under Chapter 12, see White, *Taking From Farm Lenders and Farm Debtors: Chapter 12 of the Bankruptcy Code*, 13 J. CORP. L. 1 (1987); see also Bauer, *Where You Stand Depends on Where You Sit: A Response to Professor White's Sortie Against Chapter 12*, 13 J. CORP. L. 33 (1987).

42. Bahls, *Working It Out: A Report on the First Year of Chapter 12 Bankruptcy Farmfutures* (1987); see also Faiferlick and Harl, *The Chapter 12 Bankruptcy Experience in Iowa*, 9 J. AGRIC. TAX'N & L. 302, 303 (1988).

43. Melichar, *supra* note 2 at 526; see also Melichar, *Agricultural Banks Under Stress*, 72 FED. RESERVE BULL. 437 (1986).

44. See generally 132 CONG. REC. S15,075 (daily ed. Oct. 3, 1986) (Letter from Edward L. Yingling, American Bankers Association dated Oct. 3, 1986, contained therein) [hereinafter ABA letter]. Mr. Yingling states:

As you know, earlier in this Congress, we testified in opposition to proposed farm bankruptcy legislation. Under your leadership, a number of key conference improvements were made to the legislation which we believe improves the balance between the concerns of agricultural creditors and farm debtors. Specifically, we strongly support the 52 additional bankruptcy judges, limitations to 90 days for debtors filing a plan, and the 7 year sunset of farm bankruptcy section.

Because of your assurances and that [sic] of Senator Grassley and Senator DeConcini to monitor closely the effects of this experimental legislation and assurances that you will address any major inequities in the next Congress, I wish to inform you that ABA does not oppose this legislation.

reasonably be expected to result from this bill? Will there be credit available for farmers in the future, or will this bill result in a shut-down of credit in the agricultural area?

These are serious and far reaching questions to which I do not have the answer, but I fear we have tilted the pendulum too far in the direction of the financially troubled farmer. The result may well be that [sic] domino effect will occur that in the long run will prove detrimental to the farm sector.

....

Mr. President, I don't want to be a "pollyanna" crying "wolf" needlessly, but it is my most sincere fear that we may regret our actions tonight.⁴⁵

In an effort to address creditors' concerns, Congress inserted a sunset provision as a means of compromise.⁴⁶ Since Chapter 12 was "aimed at a specific class of debtors,"⁴⁷ specifically, financially distressed family farmers, it was thereby limited to a seven-year life. The limited life reflects the basic purpose of responding to what is hopefully a temporary farm crisis.⁴⁸

Chapter 12's seven-year sunset provision was further intended as a mechanism to ensure that Congress reevaluated whether the chapter had been serving its purpose and whether there was a continuing need for a special chapter designed only for family farmers.⁴⁹ Thus, with the inclusion of a sunset clause, Congress will be compelled to evaluate Chapter 12's effectiveness.⁵⁰

IV. PROTECTING AMERICA'S FARMERS UNDER CHAPTER 12: WHO QUALIFIES FOR PROTECTION AS A FAMILY FARMER?

Concerned that nonfarmers would seek the protection provided by Chapter 12, Congress intentionally limited Chapter 12 for use by family farmers, their corporations and partnerships.⁵¹ Under Chapter 12, only a family farmer with regular income may qualify as a debtor for purposes of

45. 132 CONG. REC. S15092 (daily ed. October 3, 1986) (statement of Sen. DeConcini). See generally Armstrong, *The Family Farmer Bankruptcy Act of 1986: An Analysis for Farm Lenders*, 104 BANKING L.J. 189 (1987).

46. ABA Letter, *supra* note 44.

47. Overview, *supra* note 32, at H8999.

48. See also Sen. Grassley's statement regarding the 7-year sunset. "The subtitle also contains a 7-year sunset, ensuring that Congress will reevaluate its effectiveness in allowing farmers to rehabilitate themselves." 132 CONG. REC. S15,076 (daily ed. Oct. 3, 1986).

49. Overview, *supra* note 32, at H8,999.

50. *Id.*

51. Senator Grassley, sponsor of the bill, stated that the purpose of this limiting provision was "to give family farmers a fighting chance to reorganize their debts, [thus], the provisions ensure that only family farmers — not tax shelters or large corporate entities — will benefit." 132 CONG.

Chapter 12.⁵² Under Section 101(18) of Title 11 of the United States Code,⁵³ the family farmer must have an annual income "sufficiently stable and regular to enable such family farmer to make payments under a plan under Chapter 12 of this title."⁵⁴

An individual or an individual and spouse engaged in a farming operation⁵⁵ may be a "family farmer" if three criteria are met:

(1) the aggregate debts of the individual, or of the individual and spouse, must not exceed \$1.5 million;⁵⁶

(2) not less than eighty percent of the aggregate, noncontingent, liquidated debts (excluding debts for the principal residence not arising from a farming operation) must arise out of a farming operation owned or operated by such individual or such individual and spouse;⁵⁷ and

(3) more than fifty percent of the individual's, or the individual's and spouse's, gross income for the taxable year immediately preceding the filing for bankruptcy must have been generated from farming.⁵⁸

REC. S15076 (daily ed. Oct. 3, 1986); see 3 W. NORTON, JR., *supra* note 26, § 81.01, at 1. The rationale for limiting its application to family farmers was aptly described by Senator McConnell:

My intent is to see that only family farmers can take advantage of this provision. One of the biggest criticisms that I hear from Kentucky farmers is that nonfarmers who are only in farming to offset income from some other source are distorting agriculture. My proposal would provide a definition of what constitutes a family farm that I believe is consistent with the overall intent of this legislation. . . . The important change that I propose involves the very definition of "family farmer" in section 1201 of the original Grassley bill. In the original bill, a doctor or lawyer who is using farm losses to protect off-farm income could have debts up to \$1.5 million, with 80 percent of the debt arising from the farm, and still be eligible to file for bankruptcy under Chapter 12. Clearly, anyone who can service a \$1.5 million debt doesn't meet my definition of family farmer.

The language that I propose to add to Senator Grassley's bill would establish more reasonable guidelines to insure that the use of Chapter 12 bankruptcy is restricted for family farms and corporations, not for corporations involved in farming just for the tax shelter that farming has provided in the past. There would be a requirement added to the definition of "family farmer" that requires that, for the purposes of this definition, that a farmer must receive at least 50 percent of his gross income from farming. In addition, a corporation who seeks to file under Chapter 12 must have 50 percent of its stock or equity owned by a person who is actually farming.

132 CONG. REC. S5614 (daily ed. May 8, 1986) (statement of Sen. McConnell).

52. See 11 U.S.C. § 109(f) (Supp. V 1987).

53. See 11 U.S.C. § 101(18) (Supp. V 1987).

54. *Id.*

55. 11 U.S.C. § 101(20) (Supp. V. 1987) defines a "farming operation" as including "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.*

56. See 11 U.S.C. § 101(17)(A) (Supp. V 1987).

57. *Id.*

58. *Id.*

Similarly, a corporation or partnership in which more than fifty percent of the outstanding stock or equity is held by one family, or by one family and its relatives, and the family or its relatives conduct the farming operation, may be a "family farmer" if three criteria based primarily upon farm assets and debts are met:⁵⁹

(1) more than eighty percent of the value of the corporation's or partnership's assets consists of assets related to the farming operation;⁶⁰

(2) the corporation's or partnership's aggregate debts do not exceed \$1.5 million, and not less than eighty percent of its aggregate, noncontingent, liquidated debts (excluding a debt for one dwelling which is owned by such corporation or partnership and which a shareholder or partner maintains as a principal residence, unless such debt arises out of a farming operation), on the date the case is filed, arises out of the farming operation owned or operated by such corporation or such partnership,⁶¹ and

(3) if such corporation issues stock, such stock is not publicly traded.⁶²

The Chapter 12 safety net was intended to provide protection to a limited group of debtors, namely family farmers. The eligibility requirements of Chapter 12 have, however, precluded some farmer-debtors from receiving the protection offered by Chapter 12. The issue of who qualifies as a "family farmer" within the context of Chapter 12 has resulted in numerous motions for dismissal by creditors and attempts to convert to other bankruptcy chapters by debtors. Case law thus far identifies five issues construing eligibility requirements. This Comment analyzes each of these issues and their impact upon eligibility under Chapter 12.

A. What Constitutes a "Farming Operation" Within the Context of "Family Farmer"?

Since the term "farming operation" was incorporated into the definition of "family farmer," the determination of who qualifies as a family farmer has necessarily involved an assessment of what constitutes a "farming operation" in the context of Congress' intent to provide relief for a limited group of farmers.⁶³ Under Title 11, Section 101(20) of the United States Code ("Section 101(20)"), Congress has defined a farming operation as "includ[ing] farming, tillage of the soil, dairy farming, ranching, production or raising of crops, poultry, or livestock, and production of poultry or live-

59. 11 U.S.C. § 101(17)(B) (Supp. V 1987).

60. *Id.*

61. *Id.*

62. *Id.*

63. See *In re Tim Wargo & Sons, Inc.*, 74 Bankr. 469, 472 (E.D. Ark. 1987).

stock products in an unmanufactured state."⁶⁴ The definition has existed since the Code was originally adopted. However, the adoption of Chapter 12 did not alter that definition.⁶⁵

A number of courts construing the term "farming operation," as used in Section 101(20), have endorsed a liberal construction.⁶⁶ The definition has been construed as containing *examples* of the types of activities intended to be encompassed.⁶⁷ That list has been held to be inclusive, not exclusive.⁶⁸ Most courts have been reluctant to confine their interpretation of a farming operation to a natural, traditional, or even a dictionary definition of "farming operation" in determining whether debtors who had filed under Chapter 12 were qualified as family farmers.⁶⁹

As case law has indicated, the examination of a debtor's "farming operation" in any context constitutes a question of fact. Court decisions examining the meaning of "farming operation" have fallen along two lines.⁷⁰ A majority of courts have endorsed a broad interpretation based upon the "totality of circumstances" approach promulgated by the dissent in *In re Armstrong*.⁷¹ Another view, however, questions whether the debtor's activity under consideration exposes the debtor to the risks inherent in agriculture based upon the majority position in *In re Armstrong*.⁷²

An examination of cases endorsing the totality of circumstances test reveals the difficulty courts have encountered in its application. In *In re Wolline*,⁷³ the debtor operated an eighty-acre farm in conjunction with maintaining horses used for riding and leasing. Although the debtor described his principal business as "recreational," and his principal business code as "horse trail rides" on Schedule C of his 1985 federal income tax

64. 11 U.S.C. § 101(20) (Supp. V 1987).

65. *Wargo*, 74 Bankr. at 472.

66. *In re Wolline*, 74 Bankr. 208, 210 (E.D. Wis. 1987) (citing *In re Blanton Smith Corp.*, 7 Bankr. 410 (M.D. Tenn. 1980)); see also *In re Armstrong*, 812 F.2d 1024, 1028 (7th Cir. 1987) (wherein the Seventh Circuit also advocated *Blanton Smith*).

67. *Wolline*, 74 Bankr. at 210.

68. *Id.*; see also *In re Maike*, 77 Bankr. 832, 835 (D. Kan. 1987) (wherein the court held that while some of the more traditional farming operations are listed, other activities may be considered farming operations).

69. *In re McKillips*, 72 Bankr. 565, 568 (N.D. Ill. 1987); see also *Maike*, 77 Bankr. at 838 (wherein the court held that nontraditional enterprises have not been barred from being considered a farming operation in an appropriate context).

70. *In re Burke*, 81 Bankr. 971 (S.D. Iowa 1987); see also *In re Schafroth*, 81 Bankr. 509 (S.D. Iowa 1987).

71. 812 F.2d 1024, 1031 (7th Cir. 1987) (Cudahy, J., concurring in part, dissenting in part); see also *Burke*, 81 Bankr. 971; *Schafroth*, 81 Bankr. 509; *Wolline*, 74 Bankr. 208; *Maike*, 77 Bankr. 832.

72. 812 F.2d at 1028; see also *In re McKillips*, 72 Bankr. 565; *Wargo*, 74 Bankr. 469.

73. *Wolline*, 74 Bankr. 208.

returns, the court held that “[i]t is the nature of his activities, rather than any labels which may have been placed upon them, which is important.”⁷⁴ Since all of the debtor’s activities were inextricably intertwined and dependent upon each other, the court held that the debtor was a farmer and therefore entitled to protection under Chapter 12.⁷⁵

In *In re Maike*,⁷⁶ the court has perhaps overextended the interpretation of a “farming operation” for purposes of eligibility under Chapter 12. In granting the debtor’s petition to proceed under Chapter 12, the court held that “[n]ontraditional enterprises are not barred from being considered ‘farming’ in an appropriate context.”⁷⁷ The facts in *Maike*, however, do not present an appropriate context. The debtors’ nontraditional enterprise consisted of a 2,365.5 acre game farm devoted to the breeding and raising of pheasants. In addition, the debtors operated a kennel enterprise, marketing nearly 7000 dogs per year.

Under the totality of circumstances test, as applied by the *Maike* court, the debtors’ operation constituted a “farming operation” so that the debtors were eligible for Chapter 12 relief.⁷⁸ The *Maike* court apparently recognized the criticism it might receive as a result of this holding, indicating that:

Holding dogs to be “livestock” merely to bring this case within a superficial interpretation of the statute would unnecessarily broaden the definition of farming operation to cover virtually any zoo or amusement park. Likewise to declare the debtors [as] “farmers” merely because they reside in the country would be too broad a construction of the statute.⁷⁹

While the *Maike* court suggested that there was some business risk to the operation,⁸⁰ the court failed to assess whether the kennel operation in particular was subject to the risks normally attendant with a *traditional* farming operation, i.e. inclement weather, insect infestation, disease, and the like.⁸¹

The court’s argument regarding nontraditional enterprises in *Maike* is not without merit, however, and may constitute a strong argument in the

74. *Id.* at 210.

75. *Id.* at 211.

76. 77 Bankr. 832 (D. Kan. 1987).

77. *Id.* at 838.

78. *Id.* at 839.

79. *Id.* at 835.

80. *Id.* at 839.

81. See *Armstrong*, 812 F.2d at 1028.

appropriate context. Thus, the definition of "farming operation" for Chapter 12 purposes:

should not be limited to products and produce which are traditionally associated with farming in the state of the court's location. In an effort to find a legally and profitably marketable product, many farmers are seeking to grow crops not traditionally associated with farming. They should not be denied the protection of the Bankruptcy Code merely because their endeavors are not found in the laundry list of Old McDonald's farm.⁸²

In the wake of financial difficulties, the *Maike* court suggested that many farmers have experimented in nontraditional farming methods in pursuit of profitability. "Christmas trees, catfish, and even wine grapes are now raised on 'farms' in Kansas. Farmer status should not depend on the court's recognition of the debtor's enterprise as a traditional farming enterprise."⁸³

Perhaps the greatest contribution of *Maike*, however, centers on the factors to consider in determining whether an enterprise is a "farming operation" for purposes of determining eligibility under Chapter 12. These factors include whether location would be considered a farm under the traditional definition, the enterprise conducted at the location, the type of product and its eventual market, and the debtor's role in the process.⁸⁴

On the other hand, cases endorsing the narrower interpretation, which focus upon the risks inherent in a farming operation, also reveal the difficulty courts have encountered in application. In a well-reasoned opinion, the court in *In re McKillips*⁸⁵ held that the debtors involved in horse breeding, training, and showing operations were not family farmers within the context of Chapter 12. The court dismissed the debtor's main occupation and held that the training and showing of horses, as essentially a service corporation, was not the production of agricultural goods for consumption.⁸⁶ In so holding, the court reasoned that none of the risks normally attendant with a farming operation were present in the debtors' operation.⁸⁷

82. *Maike*, 77 Bankr. at 839.

83. *Id.* at 835.

84. *Id.* at 839.

85. 72 Bankr. 565 (N.D. Ill. 1987).

86. *Id.* at 568.

87. *Id.*; see also *Armstrong v. Corn Belt Bank*, 55 Bankr. 755 (C.D. Ill. 1985). In reaching its decision, the *McKillips* court relied upon earlier interpretations of "farmer" and "farming operation" as interpreted in relation to Section 303(a) of the Bankruptcy Code, which prohibits filing an involuntary petition against a farmer and Section 1112(c) of the Bankruptcy Code, which prevents the conversion of a farmer-debtor's case from Chapter 11 to Chapter 7. "The only difference between the definition of 'family farmer' and 'farmer' is the difference between the percentage of income earned from the 'farming operation.'" *McKillips*, 72 Bankr. at 567. The definition of "farmer" requires that 80 percent of the person's income result from farming operations under

The inquiry into what constitutes a farming operation was similarly narrowed in scope in *In re Tim Wargo & Sons, Inc.*,⁸⁸ wherein the court held that the mere receipt of rental income from farmland did not establish that a "farming operation" was being conducted. As a result, the lessor (debtor) was ineligible for protection under Chapter 12. While the lessor's (debtor's) expectation for payment from the tenant was subject to the same inherent risks faced by the tenant, this factor alone did not transform the receipt of rental payments into a "farming operation."⁸⁹ The court, concerned about the extension of Chapter 12 to all debtors engaged in agricultural related businesses, held that:

Many nonfarm businesses face the risks of inclement weather and unstable markets for their products. Other businesses, particularly farm implement dealers and suppliers and agricultural lenders have the same risk of nonpayment as the lessors of farmland. Obviously, it would unreasonably expand the definition of a farming operation to afford chapter [sic] 12 protection to entities engaged in these types of nonfarming activities.⁹⁰

The courts must be cautious, however, not "[t]o engage in a narrowly focused inquiry [which] would result in excluding some debtors whom Congress sought to protect."⁹¹

These cases have illustrated the difficulty in determining what constitutes a "farming operation" within the context of Chapter 12. Indeed, the question of what constitutes a "farming operation . . . allows no neat distinctions."⁹² Given the heterogeneous nature of American agriculture, broad interpretations of what constitutes a "farming operation" for purposes of qualifying as a debtor under Chapter 12 represents an appropriate response consistent with the diversity present in agriculture.

Broad interpretations of a farming operation have, for the most part, been consistent with the Supreme Court mandate set forth in *Wright v. Union Central Life Insurance Co.*⁹³ In interpreting the farmer relief statute under the old Act (Section 75),⁹⁴ the *Wright* court stated:

Section 101(19), whereas the definition of "family farmer" requires that only 50 percent of the person's income result from farming operations. *Id.* Therefore, as suggested in *McKillips*, the court may look to cases interpreting Sections 303(a) and 1112(c) of the Bankruptcy Code in determining whether a debtor qualifies as a family farmer within the meaning of the Code. *Id.*

88. 74 Bankr. 469 (E.D. Ark. 1987).

89. *Id.* at 474.

90. *Id.*

91. *Burke*, 81 Bankr. at 976.

92. *Armstrong*, 812 F.2d at 1031 (Cudahy, J., concurring in part, dissenting in part); see also *Burke*, 81 Bankr. at 976.

93. 311 U.S. 273 (1940).

94. See *supra* note 26 and accompanying text.

This Act provided a procedure to effectuate a broad program of rehabilitation of distressed farmers faced with the disaster of forced sales and an oppressive burden of debt. . . . [S]o long as that right [to the value of its collateral] is protected the creditor certainly is in no position to insist that doubts or ambiguities in the Act be resolved in its favor and against the debtor. Rather, the Act must be *liberally construed* to give the debtor the full measure of the relief afforded by Congress, lest its benefits be frittered away by narrow formalistic interpretations which disregard the spirit and the letter of the Act.⁹⁵

However, in order to give effect to Congress' intent of limiting Chapter 12 for use by family farmers only, the courts must be cautious so as not to interpret the term "farming operation" too broadly. Given the extraordinary enactment of Chapter 12 in response to a farming crisis, it is appropriate that the courts try to draw realistic distinctions, on a case-by-case basis. In limiting eligibility, the courts may find it necessary to focus on whether the farming operation reflects the presence of traditional farming risks normally attendant with farming,⁹⁶ such as risks of cyclical and unpredictable income, and risks of nature, such as hail or drought.

B. What is the Relevant Time Period During Which a Debtor Must be Engaged in a Farming Operation?

Due to Congress' failure to specify the relevant time period during which a debtor must be engaged in a farming operation for purposes of eligibility under Chapter 12,⁹⁷ the courts have been compelled to interpret the statute "in a manner which gives effect to [the] overall purpose of the legislation."⁹⁸

95. *Wright*, 311 U.S. at 278-79 (emphasis added) (citations omitted); see also ANDERSON & MORRIS, CHAPTER 12 FARM REORGANIZATIONS § 2.11, 2-47-48 (June 1987).

96. See *McKillips*, 72 Bankr. at 569.

97. *In re Tart*, 73 Bankr. 78, 80-81 (E.D. N.C. 1987).

98. *Id.* at 81. The court continued:

In order to give effect to the legislative intent, it may be necessary for a court to look beyond the literal language of the statute. *In re Ganzer*, 54 Bankr. 75, 77 (D. Minn. 1985). For instance, it could be argued that, read literally, the definition of "family farmer" would preclude from Chapter 12 eligibility a hog farmer who filed for relief after his stock had been wiped out in a natural disaster and who was awaiting insurance compensation before obtaining new pigs. Similarly, it could be argued that Chapter 12 relief is not available to a farmer who files in the dead of winter when he has no crops in the ground because he was not, at the time of filing, "engaged in a farming operation." The court believes that such a literal reading of the definition of "family farmer" would be inconsistent with the broad purpose of Chapter 12.

Id. at n.2.

The timing of a debtor's petition may be crucial to protection under Chapter 12. Unfortunately, the protections of Chapter 12 were too late for some petitioners who had been forced to sell all of their farmland in the year prior to filing. The court in *In re Tart*⁹⁹ construed the term "farming operation" by examining the debtors' activities as of the petition date. Emphasizing that the primary purpose of Chapter 12 was to help family farmers *continue* farming, the court denied the debtors' petition for relief under Chapter 12. In so holding, the court stated that the debtors, who were "only minimally engaged in farming during the taxable year preceding the taxable year in which their petition was filed, who had sold all their farmland prior to the filing of their petition, and did not intend to resume any farming operations,"¹⁰⁰ were precluded from relief under Chapter 12.

Similarly, in *Wargo*,¹⁰¹ the debtor's petition for relief under Chapter 12 was dismissed. The court, upon examination of the debtor's activities as of the petition date, determined that while the debtor's shareholders personally conducted a farming operation in the traditional sense in previous years, their farming operation had ceased in 1985.¹⁰²

However, in *In re Indreland*,¹⁰³ the debtor was not precluded from protection under Chapter 12, even though he elected to scale down his farming operation and derive a greater portion of income from nonfarm sources. The court emphasized that "the important inquiry is whether the Debtor can feasibly rehabilitate his farming operation through debt restructure so as to maintain a farming operation."¹⁰⁴

These cases illustrate that to the extent the debtor continues to own and manage the farm, even though the farm is scaled down or income is derived from nonfarm sources, a debtor is a family farmer engaged in a farming operation and is entitled to the benefits of Chapter 12. For the farmer who elects to sell his farmland and has no intention of resuming any farming operations, the door to protection under Chapter 12 has been closed.

C. *What Is the Operative Date for Determining the Debt Limitation of \$1.5 Million?*

While the Code is silent as to *when* the debt limitation must be met, the cases thus far have held that the date of filing the petition is the operative

99. 73 Bankr. 78 (E.D. N.C. 1987).

100. *Id.* at 82.

101. 74 Bankr. 469.

102. *Id.* at 472.

103. 77 Bankr. 268 (D. Mont. 1987).

104. *Id.* at 271.

date.¹⁰⁵ Also, family farmers who were husband and wife, and whose joint and several obligations totaled more than \$1.5 million, could not file separate petitions in order to circumvent the debt limit of Chapter 12.¹⁰⁶ Thus, in cases where the debtors are husband and wife, the \$1.5 million limit is not doubled.

The courts have stringently enforced the debt limitation of \$1.5 million. In *In re Stedman*,¹⁰⁷ the court held that the debtors' indebtedness, which was \$1,544,103.43 as of the date of their Chapter 12 petition, exceeded the \$1.5 million limit and the debtors were thereby ineligible for Chapter 12 relief at that time.¹⁰⁸ The court, however, instructed the debtors that should their indebtedness fall below the \$1.5 million limitation, they were not precluded from refiling.¹⁰⁹

Similarly, in *In re Labig*,¹¹⁰ the debtors' aggregate debts exceeded the \$1.5 million debt limitation. The debtors disputed a number of their debts and understated their total liabilities by at least \$556,074.¹¹¹ While the Chapter 12 debtors' schedules created a rebuttable presumption regarding the amount of debt owed by the debtors, the creditors in *Labig* successfully rebutted the presumption.¹¹² The court, in determining that the debtors were ineligible for Chapter 12 relief, held that "[c]learly, a debtor may not shoehorn himself into chapter 12 . . . merely by listing debts as 'disputed.'"¹¹³

At least one court has suggested that a debtor may nevertheless challenge the characterization of his debts to remain within the jurisdictional amount under Chapter 12.¹¹⁴ However, debtors who file under Chapter 12 knowing that their aggregate debts exceed the \$1.5 million limit, may jeop-

105. *In re Orr*, 71 Bankr. 639 (E.D. N.C. 1987); *In re Stedman*, 72 Bankr. 49 (D. N.D. 1987); *In re Labig*, 74 Bankr. 507 (S.D. Ohio 1987).

106. *In re Johnson*, 73 Bankr. 107 (S.D. Ohio 1987).

107. *Stedman*, 72 Bankr. 49 (N.D. 1987).

108. *Id.* at 54.

109. *Id.* Interestingly, in determining the indebtedness of petitioners to the Federal Land Bank ("FLB"), the court would not deduct the value of the debtors' stock in FLB, although arguably the stock represented an equity interest. Also, the court found that the debtors' indebtedness to the Commodity Credit Corporation ("CCC") constituted a debtor-creditor relationship. Although the debtors had delivered grain in order to pay off their loan with CCC, and checks had in fact been issued by local elevators as of the date of the bankruptcy petition in consequence of these deliveries, the court applied the strict letter of the law. The court held that until the CCC actually received payment for the sale of the grain under loan to it, the obligations to the CCC were not discharged. *Id.* at 53-54.

110. *Labig*, 74 Bankr. at 510.

111. *Id.* at 509.

112. *Id.*

113. *Id.* at 510.

114. *Whaley v. U.S.*, 76 Bankr. 95 (N.D. Miss. 1987).

ardize their filing. "[T]here is authority that if a debtor files a petition under a chapter for which the debtor does not qualify, the filing is a 'nullity' and there is no case to convert to another chapter."¹¹⁵

As these cases illustrate, the debt limitation requirement has created some confusion at the commencement of some Chapter 12 cases in determining the debtor's eligibility for relief. Given the stringent enforcement of this limitation, this requirement may be particularly important in selecting Chapter 12.¹¹⁶

D. Whether the Debtor's Aggregate Noncontingent, Liquidated Debts Arose Out of a Farming Operation for Purposes of Eligibility Under Chapter 12.

Pursuant to Title 11, Section 101(17)(A),¹¹⁷ not less than eighty percent of the debt must arise out of the farming operation. Motions to dismiss Chapter 12 petitions challenging whether the debts arose out of the farming operation have been denied in two similar holdings. In *In re Rinker*,¹¹⁸ the court held that debts arising out of settlement of a lawsuit which involved 400 acres of land were attributable to the debtor's farming operation.¹¹⁹ The court relied upon *In re Armstrong*,¹²⁰ wherein that court focused on the nature of the questioned activity and its relation to farming.¹²¹ Consistent with the rationale adopted in *Armstrong*, the *Rinker* court made a more searching inquiry. Rather than focusing only peripherally on the fact that the debts resulted from settlement of a lawsuit, the court focused upon the "heart" of the resultant lawsuit, the land, in holding that the debts were attributable to the debtor's farming operation.¹²²

115. *Orr*, 71 Bankr. at 642.

116. ANDERSON & MORRIS, *supra* note 95, § 2.11, at 2-61; *see also Orr*, 71 Bankr. 639.

117. *See also* 11 U.S.C. § 101(18)(B)(ii) (Supp. V 1987). For a discussion of what constitutes a farming operation, *see* 11 U.S.C. § 101(17)(A) (Supp. V 1987).

118. 75 Bankr. 65 (Bankr. S.D. Iowa 1987).

119. *Id.* at 68.

120. 812 F.2d 1024.

121. In *Armstrong*, the questioned activity involved cash rent received from rented farmland, which the court held was not income derived from a "farming operation." The *Armstrong* court distinguished its facts on the basis that "[h]ad disease or bad weather ravaged Hanlon's [the renter's] crops, Armstrong would have had his rent money regardless. There was no risk involved. Armstrong was insulated from the traditional risks of farming." *Id.* at 1028.

122. *Rinker*, 75 Bankr. at 68. The court stated:

It was the land over which the litigants [children of the Perry and Daisy Rinker estate] fought and it was the land that was the subject of the settlement. Land is also the *sine qua non* of a crop production enterprise. Tillage of the land fits precisely into the definition of "farming operation" under section 101(20). It is undisputed that the Rinkers' purpose in settling the case was to preserve their farming operation. Without the land, the Rinkers would have no farm. It is this direct link between the basis of the lawsuit and settlement

Similarly, in *In re Roberts*,¹²³ the court held that the payment of estate taxes (which had been reduced to tax liens) which related to land that the debtor inherited from her mother, were "inescapably interwoven" within the farming operation for purposes of Sections 101(17)(A) and 101(20). In both *Rinker* and *Roberts*, the debts were farm-related debts and rightfully attributable to the debtor's farming operation. Thus, whether a debt arose out of the farming operation may be a difficult determination and must be critically analyzed on a case-by-case basis.

E. What Constitutes Income for Purposes of Meeting the Fifty Percent Gross Income Test of 11 U.S.C. § 101(17)(A)?

The requirement that fifty percent of the debtor's gross income for the taxable year in which the Chapter 12 filing occurred¹²⁴ has presented difficulties in application. For purposes of meeting the fifty percent gross income test, the courts have decided to focus upon whether certain types of income have satisfied this test, including rental income from agricultural land,¹²⁵ income from rent or sale of farm machinery,¹²⁶ income from trucking of cattle,¹²⁷ and income from settlement related to crop damage.¹²⁸

A controversial area construing the fifty percent gross income test has centered on whether cash rent from agricultural land satisfies the fifty percent test. Case law reflects significant controversy surrounding this issue, which has led to inconsistent results. One line of cases, following the majority in *In re Armstrong*,¹²⁹ applies a rather mechanical test which holds that rental income received from rented farmland was *not* income derived from a "farming operation."¹³⁰ Another line of cases rejects the proposi-

and the farming activity that leads this court to conclude that the debts in question arise out of a "farming operation." The mere fact that a debt arises from a settlement of a lawsuit does not mean the requirements of section 101(20) cannot be met.

Id.

123. 78 Bankr. 536 (C.D. Ill. 1987).

124. See 11 U.S.C. § 101(17)(A).

125. See *Armstrong*, 812 F.2d 1024; *Wargo*, 74 Bankr. 469; *In re Mary Freese Farms, Inc.*, 73 Bankr. 508 (N.D. Iowa 1987); *In re Seabloom*, 78 Bankr. 543 (C.D. Ill. 1987); *In re Rott*, 73 Bankr. 366 (D.N.D. 1987).

126. See *Armstrong*, 812 F.2d 1024; *Rott*, 73 Bankr. 366 (D.N.D. 1987).

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

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

129. 812 F.2d 1024 (7th Cir. 1987).

130. See *Mary Freese Farms*, 73 Bankr. 508 (wherein the court held that a family farm corporation which only negotiates leases and accepts rent payments does not conduct a farming operation as required in § 101(17)(B) of the Bankruptcy Code); see also *Wargo*, 74 Bankr. 469 (wherein the court held that mere ownership of land did not constitute a farming operation).

tion that cash rent constitutes "per se" nonfarm income.¹³¹ Rather, this line of cases suggests that each case be evaluated on its own merits, taking into consideration the totality of circumstances.¹³² This approach is represented by the dissent in *Armstrong*.¹³³ Given the extensive controversy in this area, Congress may be called upon to review the cash rent issue and to provide guidance to the courts.

Although an individual or an individual and a spouse engaged in a farming operation are required to meet the fifty percent income test,¹³⁴ there is no requirement with respect to corporations and partnerships. "The fact that corporations or partnerships need not fulfill that requirement (11 U.S.C. § 101(17)(B)) is presumably a Congressional drafting glitch — neither the first nor the last — created by that august body in its infinite wisdom in the passage of this legislation."¹³⁵ Individual debtors in *In re Lawless*¹³⁶ who did not meet the fifty percent income test challenged this difference in treatment on constitutional due process grounds. The *Lawless* court, however, declined to reach the constitutional issue. In its holding, the court stated:

[T]his Court [sic] is not convinced that Congress cannot set different standards for different types of entities but this Court is convinced that it has no business determining the constitutionality or unconstitutionality of any such Congressional mandate. Such matters are best left to Judges [sic] better trained and situated to determine them.¹³⁷

Thus, this issue remains for constitutional determination.¹³⁸

As the foregoing cases interpreting the eligibility requirements of Chapter 12 have illustrated, the key to protection under Chapter 12 depends upon meeting the eligibility criteria. Whether a debtor meets the eligibility criteria defining a "family farmer" within the context of Chapter 12 has resulted in numerous motions to dismiss by creditors or conversion to other bankruptcy chapters by debtors.

131. See *In re Easton*, 79 Bankr. 836, 838 (N.D. Iowa 1987).

132. *Id.*

133. 812 F.2d 1024 (7th Cir. 1987) (Cudahy, J., concurring in part, dissenting in part); see also *In re Rott*, 73 Bankr. 366, 373 (Bankr. D. N.D. 1987) (the court declined to adopt the *Armstrong* inflexible approach to cash rent); *In re Mikkelsen Farms, Inc.*, 74 Bankr. 280, 285 (D. Or. 1987).

134. See 11 U.S.C. § 101(17)(A).

135. *In re Lawless*, 74 Bankr. 54, 55, *modified*, 79 Bankr. 850 (W.D. Mo. 1987).

136. *Id.*

137. *Id.* For a detailed discussion regarding statutory construction as it relates to interpretation of Chapter 12, see *In re Albertson*, 68 Bankr. 1017 (W.D. Mo. 1987).

138. For a discussion of the impact of Chapter 12, see *infra* notes 139-66.

V. IMPACT OF CHAPTER 12

A. Number of Chapter 12 Filings in the North Central Region Since November 26, 1986

America's bread basket, the North Central Region, has witnessed a significant number of farmers filing for Chapter 12 bankruptcy during its first fourteen months of operation. As of September 30, 1988, there were 4300 filings in twelve North Central states. Table 1 shows four-month intervals through September 30, 1988.¹³⁹

TABLE 1
NUMBER OF CHAPTER 12 FILINGS IN THE NORTH CENTRAL
REGION SINCE NOVEMBER 26, 1986

State	Number As Of 1/31/87	Number As Of 5/31/87	Number As Of 9/30/87	Number As Of 1/31/88	Number As Of 5/31/88	Number As Of 9/30/88
Illinois	46	179	25	301	350	373
Indiana	30	153	216	322	351	376
Iowa	73	264	308	350	379	396
Kansas	59	139	244	299	323	342
Michigan	18	87	148	181	216	232
Minnesota	46	91	126	154	168	180
Missouri	18	172	225	281	332	361
Nebraska	96	409	556	626	704	741
N. Dakota	25	74	113	167	188	209
Ohio	23	142	187	227	267	272*
S. Dakota	106	315	512	502	544	560
Wisconsin	38	129	179	213	241	258
TOTAL	578	2,154	3,064	3,623	4,063	4,300

* Data available only through 6/30/88.

These numbers illustrate the financial distress among many of America's farmers.¹⁴⁰ Also of significance, the data presented in Table 2 indicates that there has been a much higher percentage of Chapter 12 filings in states such as South Dakota and Nebraska, which until recently have had

139. The data was obtained from Iowa State University, Ames, Iowa. This table updates data published in Faiferlich & Harl, *supra* note 42, at 303-04. The data was obtained from the clerks of the bankruptcy courts in the respective districts. *Id.* at 303-04.

140. "The response is not surprising: For many farmers, it's the only way they can pay their debts and still remain in business." Bahls, *supra* note 42, at 26.

no farm credit mediation law to resolve financial disputes between lenders and borrowers outside of court.¹⁴¹ South Dakota's Chapter 12 bankruptcy rate of sixteen filings per thousand farmers is approximately eight times that of its neighboring state, Minnesota, whose mandatory mediation program is often upheld as a model.

TABLE 2
COMPARISON OF CHAPTER 12 FILINGS AND MEDIATION

State	Number of Farms ¹⁴²	Number of Chapter Filings ¹⁴³	Chapter Filings Per Thousand Farmers	Type of Mediation
S. Dakota	35,000	560	16.0	Mandatory ¹⁴⁴
Nebraska	56,000	741	13.2	Voluntary ¹⁴⁵
Wisconsin	80,000	258	3.2	Voluntary ¹⁴⁶
N. Dakota	33,000	209	6.3	Voluntary ¹⁴⁷
Iowa	107,000	396	3.7	Mandatory ¹⁴⁸
Minnesota	92,000	180	1.96	Mandatory ¹⁴⁹

In contrast, states such as Iowa and Minnesota thus far have possessed much lower filing rates, presumably as a result of mandatory farm credit mediation laws which had been in effect since 1986. States with voluntary mediation laws (Wisconsin and North Dakota) also experienced significantly fewer filings under Chapter 12. Thus, the existence of a two-tiered protection system, consisting of state mediation laws and federal bankruptcy Chapter 12, has slowed bankruptcy filing rates in those states.

141. Press release from Center for Rural Affairs (Jan. 5, 1988, Center for Rural Affairs, P.O. Box 405, Walthill, Nebraska 68067) [hereinafter Press Release]; see also *infra* notes 144-45 and accompanying text.

142. U.S. Department of Commerce, Bureau of the Census, *Statistical Abstract of the United States* 609, table 1057 (108th ed. 1988). According to the Census Bureau statistics, there are 2,241,000 farms in the United States. *Id.* at 609, table 1058.

143. Faiferlick and Harl, *supra* note 42, at 304 (statistical information updated by Iowa State University as of January 31, 1988).

144. S.D. CODIFIED LAWS ANN. § 54-13 (Supp. 1988) (effective through December 30, 1990).

145. NEB. REV. STAT. §§ 2-4801 to -4816 (Supp. 1988) (effective July 9, 1988).

146. WIS. STAT. § 93.50 (1987-88) (repealed July 1, 1989).

147. N.D. CENT. CODE § 6-09.10 (1987).

148. IOWA CODE ANN. § 654A (West Supp. 1988) (effective May 30, 1986).

149. MINN. STAT. ANN. §§ 583.20-32 (West 1988).

Having recognized the significantly higher number of Chapter 12 filings due to the absence of state mediation laws¹⁵⁰ in states such as South Dakota and Nebraska, the South Dakota and Nebraska legislatures recently enacted state farm mediation programs.¹⁵¹ Statistical significance aside, Congress has also encouraged states to enact mediation laws, and other states are expected to follow this trend. The recent congressional passage of the Agricultural Credit Act of 1987¹⁵² encourages the adoption of state mediation laws. The Act will provide matching funds for the operation and administration of the loan mediation program as approved by the Secretary of Agriculture. Given the existence of a two-tiered protection system, consisting of state mediation laws and federal bankruptcy under Chapter 12, family farmers who want to survive the farm crisis should be able to continue their farming operations.

B. Derivative Effects of Chapter 12

1. Effect of Chapter 12 on the Negotiation Process

Chapter 12 has had a significant effect on debtors' negotiating leverage,¹⁵³ thereby affecting the balance between the rights of debtors and the rights of creditors. It has become evident that this effect is more beneficial to debtors than the balance existing prior to the enactment of Chapter 12.¹⁵⁴

Chapter 12 has not only modified the negotiation process with regard to debtors filing under the Act, but also the negotiation process between lend-

150. See Press Release, *supra* note 141.

151. S.D. CODIFIED LAWS ANN. § 54-13 (Supp. 1988); see also NEB. REV. STAT. §§ 2-4801 to -4816 (Supp. 1988).

152. Agricultural Credit Act of 1987, Pub. L. 100-233, 1988 U.S. CODE & ADMIN. NEWS (101 Stat.) 1568, 1662 (codified in scattered sections of 7 U.S.C., 12 U.S.C., 16 U.S.C. and 31 U.S.C.).

153. Faiferlick and Harl, *supra* note 42, at 332.

154. In a survey conducted at Iowa State University, Ames, Iowa, regarding the Chapter 12 experience in Iowa, Iowa attorneys rated the debtor's bargaining power prior to the enactment of Chapter 12 at 3.90 (on a scale of 0 to 10, 0 meaning no bargaining power and 10 meaning complete control over the bargaining process), which is slightly less than the equal bargaining position of 5. Subsequent to the enactment of Chapter 12, attorneys rated the debtor's negotiating power at 6. "Thus, the attorneys felt, on average, that the debtor's bargaining position improved from a slightly disadvantageous position to a slightly advantageous position." *Id.*; see also Bromley, *The Chapter 12 Family Farm Bankruptcy Law*, 60 WIS. BAR BULL. 18, 20 (Jan. 1987). "It is quite clear that this new balance is more favorable to debtors than the balance existing before Chapter 12's enactment." *Id.*

ers and borrowers *not* in bankruptcy.¹⁵⁵ "Even in its unsettled state, Chapter 12 is changing the relationship between bankers and borrowers."¹⁵⁶

Chapter 12 has thereby served as a negotiating vehicle for all financially distressed farmers, not just those seriously contemplating bankruptcy. "It has done a great deal to keep farmers out of bankruptcy. Farmers who otherwise would have no recourse can use it as a negotiating tool to avoid bankruptcy entirely."¹⁵⁷ As a result, some financially distressed farmers have been able to successfully threaten the petitioning of a Chapter 12 bankruptcy in debt restructuring negotiations, thereby forestalling eventual bankruptcy petitions. "Under threat of the new law, many bankers have halted foreclosure actions because they don't want their secured loans devalued."¹⁵⁸ Thus, Chapter 12 has significantly changed the complexion of negotiations between farmer-debtors and agricultural lenders.

2. Effect of Chapter 12 on Agricultural Lenders

Having mirrored developments in the farm economy, many agricultural lenders have also been in a precarious financial condition. It has been suggested by some critics that Chapter 12 may have extremely adverse long-range effects on farm lenders, thereby potentially increasing the number of bank failures.¹⁵⁹ Since farm lenders will be forced to reduce their secured loans to the currently depressed value of their collateral under Chapter 12, "banks may be faced with a large increase in the total number of their charge-offs, at a time when agricultural lenders can least afford it."¹⁶⁰ As a result, Chapter 12 may have inadvertently disrupted farm lending practices.

There has been controversy, however, surrounding the significance of Chapter 12 upon lenders' policies regarding the extension of credit to farmer-debtors. Some critics have argued that Chapter 12 has changed the complexion of lending and made it more difficult for farmers to currently obtain credit due to tightening by agricultural lenders.¹⁶¹ It has been suggested that the availability of future credit may also have been hampered as a result of Chapter 12. As one critic stated, "[u]nfortunately, Congress's [sic] effort to help family farmers may result in either a wholesale dry-up of

155. Faiferlick and Harl, *supra* note 42, at 333.

156. Bahls, *supra* note 42, at 27.

157. Blodgett, *Saving the Family Farm*, 74 A.B.A. J. 86, 89 (Jan. 1988).

158. Bahls, *supra* note 42, at 27.

159. See *supra* notes 42-45 and accompanying text.

160. Armstrong, *supra* note 45, at 213-14.

161. Bahls, *supra* note 42, at 27; see also *Boom to Bust to Bailout*, 3 INSIGHT 18, 19 (Dec. 7, 1987). Chapter 12 has made it harder for many farmers to get credit. "What Chapter 12 did for us was it scared the hell out of the banks, and they just tightened up tighter than they ever were before." *Id.*

farm credit or increasing the cost of that credit to farmers."¹⁶² Others, however, believe that no such tightening has occurred yet.¹⁶³

The concern regarding the apparent tightening of credit may be tempered due to a change in attitudes among many farmers. An air of caution prevails throughout the farm economy, described as "debt shock," with farmers focusing upon the repayment of debt rather than expansion.¹⁶⁴ "Cost-consciousness and low debt are now prevalent and mutually reinforcing themes among farmers, who are reacting both to the relatively high real cost of borrowing and to the financial misery they have been witnessing."¹⁶⁵ As a result, farmer-debtors and agricultural lenders alike have altered their borrowing and lending practices. The focus has changed from an emphasis upon the farmer-debtor's collateral value to a more conservative lending practice focusing upon a farmer's "cash flow" (or repayment ability). Thus, altered borrowing and lending practices as well as a change in attitudes should ultimately strengthen the state of the farm economy, although relief for American farmers will not occur overnight.

VI. CONCLUSION

Unlike other debtors, the farmer's business is also his or her home, heritage and way of life. Walking away from the family farm has not been a viable option for many family farmers¹⁶⁶ whose lives are financially and emotionally tied to the farm. Recognizing this difference between farm businesses and other businesses resulted in the adoption of state farm mediation laws and Chapter 12.

The adoption of state farm mediation laws addressed the financial distress of farmers. Similarly, the adoption of Chapter 12 addressed the symptoms of the farm crisis through the enactment of a separate chapter to the Bankruptcy Code. The enactment of Chapter 12, however, did not rectify the causes underlying farmer financial failures.¹⁶⁷ As an extraordinary re-

162. Armstrong, *supra* note 45, at 213.

163. Bahls, *supra* note 42, at 27.

164. Pine, *Growing Prudence: As Their Plight Eases, Farmers Pay Off Debt Rather Than Expand*, Wall St. J., July 27, 1987, at 1, col. 1.

165. Melichar, *Turning the Corner on Troubled Farm Debt*, 73 FED. RESERVE BULL. 523, 527 (July 1987).

166. Sweet, *Chapter 11 Bankruptcy*, 1987 LEGAL GUIDE FOR WISCONSIN FARMERS 26, 29.

167. See Anderson, *An Analysis of Pending Bills to Provide Family Farm Debtor Relief Under the Bankruptcy Code*, reprinted in 132 CONG. REC. S15,076-15,091 (daily ed. Oct. 3, 1986) (statement of Senator Grassley). The author writes:

This writer believes that the financial problems of the farmer are actually related to legislation and economic causes which are beyond the realm of the Bankruptcy Code. . . . However, the reader should be aware of the fact that many economic factors, such as over-

sponse to the farming crisis, Chapter 12 attempted to strike a balance in easing the financial burden on family farmers without jeopardizing the solvency of the affected agricultural lending institutions.

The key to protection under state farm mediation laws and Chapter 12 has been dependent upon meeting the eligibility criteria. Failure to meet the eligibility criteria has resulted in denial of protection, as evidenced by early cases interpreting Chapter 12. Whether a debtor meets the eligibility criteria defining a "family farmer" within the context of Chapter 12 has resulted in numerous motions to dismiss by creditors or conversion to other bankruptcy chapters by debtors.

Chapter 12 in particular has had a significant impact, not only in terms of the number of filings, but also in its effects upon negotiations and farm credit lending practices. Farmers in states which offer a farm credit mediation program have benefitted significantly as a result of a two-tiered protection system, consisting of state mediation laws and federal bankruptcy under Chapter 12. Chapter 12 has represented a turning point for many of America's farmers by providing farmers an opportunity to survive the farm crisis and continue their operations.

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production of crops and agricultural legislation promoting such over-production, cause a lack of adequate prices for crops; and these underlying problems have created the farmer crisis. This crisis is enhanced by legislation providing farmers access to borrowings not available to other businessmen, which has encouraged farmers to become over-leveraged. A symptom of this crisis is the failure of the farmer to meet his obligations as they mature, because he cannot get adequate prices for his crops due to overproduction. Because the farmer is encouraged by legislation to borrow money to meet the shortfall in his cash flow created by this over-production, many farmers have become over-leveraged. From this writer's viewpoint, amendments to the Bankruptcy Code can give relief only to the symptoms of the farmer problems, and this action does not rectify the causes underlying farmer financial failures. Until and unless Congress addresses legislation to cure these underlying problems, amendments to the Bankruptcy Code will furnish no real relief to problems inherent in any farming operation.

Id. at \$15,087 n.5; *see also* 132 CONG. REC. S5,555 (daily ed. May 7, 1986) (statement of Sen. Grassley): "To the extent that adjustments are needed in the Code, Congress must be willing to do its part — not as a solution to the farm crisis — but at a minimum, Congress should ensure that farmers have the same opportunity to reorganize that all other businesses and individuals have." *Id.*