A "Fighting Change" Before Sunset: Chapter 12 in the Eastern District

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COMMENTS

A "FIGHTING CHANCE" BEFORE SUNSET: CHAPTER 12 IN THE EASTERN DISTRICT

[A]nd they guarded with guns the land they had stolen. They put up houses and barns, they turned the earth and planted crops. And these things were possession, and possession was ownership . . . . [A]nd their children grew up and had children on the land. And the hunger was gone from them, the feral hunger, the gnawing, tearing hunger for land . . . . These things were lost, and crops were reckoned in dollars, and land was valued by principal plus interest, and crops were bought and sold before they were planted. Then crop failure, drought, and flood were no longer little deaths within life, but simple losses of money. And all their love was thinned with money, and all their fierceness dribbled away in interest until they were no longer farmers at all, but little shopkeepers of crops, little manufacturers who must sell before they can make . . . . No matter how clever, how loving a man might be with the earth and growing things, he could not survive if he were not also a good shopkeeper . . . .

—John Steinbeck
The Grapes of Wrath

INTRODUCTION

The addition of "Chapter 12-Adjustment of Debts of a Family Farmer With Regular Annual Income"[1] to the Bankruptcy Code in October 1986 represents a somewhat novel legislative attempt[2] to alleviate a crisis in the farm economy.[3] Chapter 12 became effective on November

1. Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, §§ 251-257, 100 Stat. 3088, 3104-16, 11 U.S.C. §§ 1201-1231 (Supp. IV 1986).

2. In 1933, Congress added section 75 to the Bankruptcy Act, known as the Frazier-Lemke Act, to aid farmers. Act of March 3, 1933, ch. 204, § 75, Pub. L. No. 63-420, 47 Stat. 1467, 1470 (expired 1949). *See* White, *Taking From Farm Lenders and Farm Debtors: Chapter 12 of the Bankruptcy Code*, 13 J. CORP. L. 1, 1-4 (1987) (discussing the Frazier-Lemke Act as a close analogy to Chapter 12, but one which proponents of it "carefully avoided"). *See also* Letzler, *Bankruptcy Reorganizations for Farmers*, 40 COLUM. L. REV. 1133 (1940).

3. The dimensions of the crisis and its various causes are undoubtedly open to interpretation. However, the dramatic increase in land prices during the 1970's and their subsequent fall beginning in 1981 is generally viewed as the primary cause. *See generally*, Aiken, *Chapter 12 Family Farmer Bankruptcy*, 66 NEB. L. REV. 632 (1987); Flaccus & Dixon, *The New Bankruptcy Chapter 12: A Computer Analysis of If and When a Farmer Can Successfully Reorganize*, 41 ARK. L. REV. 263 (1988); Comment, *Cramdown Under the New Chapter*

26, 1986.[4] It is designed to increase the availability of bankruptcy protection, as well as to simplify the reorganization process for family farmers. Chapter 12 is repealed automatically on October 1, 1993[5] because it is viewed as an emergency measure. This sunset provision, while providing aid and comfort to those wary of or opposed to Chapter 12, is an invitation to supporters to battle for its re-enactment. Likely to be fought in the afternoon before 1993's sunset, that battle provides a backdrop for this comment.

The afternoon of 1992 will find the Democrats choosing a nominee to challenge the incumbent Republican president and congressmen of all stripes seeking re-election.[6] If the farm economy is in recovery, proponents will argue that Chapter 12 was integral to it while opponents will argue that it slowed the recovery by discouraging additional investment. If the farm economy is depressed, Chapter 12—among other things—will be alternatively blamed for the depression or credited with making the fall less harsh. While these political predictions are far from foolproof, it is safe to predict that the decision to extend Chapter 12 or to allow it to sunset will be made in the heat of election year politics.

The role Chapter 12 creates for bankruptcy courts in regulating the farm economy is a question which likely will be unasked in, or remain tangential to, congressional debate. In part, that question springs from the arguments of many commentators,[7] particularly those of Professors

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12 of the Banktuptcy Code: A Boon to the Farmer, A Bust to the Lender?, 23 LAND & WATER L. REV. 227 (1988).

4. Act of October 27, 1986, Pub. L. No. 99-554, tit. III, § 302(a), 100 Stat. 3119 *reprinted at* 28 U.S.C.S. § 581 (Law. Co-op. Supp. 1988).

5. Act of October 27, 1986, Pub. L. No. 99-554, tit. III, § 302(f), 100 Stat. 3124, *reprinted at* 28 U.S.C.S. § 581 (Law. Co-op. Supp. 1988), provides: "Chapter 12 of title 11 of the United States Code is repealed on October 1, 1993. All cases commenced or pending under Chapter 12 . . . shall be conducted and determined under such chapter as if such chapter had not been repealed."

6. While Chapter 12, itself, may not find its way into the Presidential campaign, the concerns of farmers will undoubtedly be heard during the quadrennial trudge through the Iowa snows.

7. Various commentators have expressed concerns that Chapter 12 may have unintended economic side-effects, while others, acknowledging the potential for ill, suggest the benefits outweigh that potential. *See, e.g.*, Aiken, *supra* note 3, (suggesting that the existence of Chapter 12 may increase willingness of lenders to negotiate workouts); Bromley, *The Chapter 12 Family Farm Bankruptcy Law*, 60 WIS. B. BULL. 18 (Jan. 1987) (recognizing the more favorable treatment of debtors but questioning whether the net effect on the rural economy would be positive or negative); Dunn, *Chapter 12 of the U.S. Bankruptcy Code: Recent Issues and Cases*, 76 ILL. B.J. 376 (March 1988) (recognizing that insolvencies will not be prevented by bankruptcy legislation, but that the present economic picture is brighter for farmers); Flaccus & Dixon, *supra* note 3 (suggesting that the potential for successful reorganization into a viable farm under Chapter 12 is not great); Haber, *The New Chapter 12 of the Bankruptcy Code: Special Provisions for Family Farmers*, 56 J. KAN. B. Assoc. 8 (Feb. 1987) (noting that Chapter 12 is a "stop-gap solution" and indicating the likelihood that credit will become less available because the cost of the solution falls heavily on the lending community); Hahn, *Chapter 12—The Long Road Back*, 66 NEB. L. REV. 736 (1987) (noting the ability of the debtor to restructure and deal with all creditors in a single forum); Herbert, *Once More Unto the Breach, Dear Friends: The 1986 Reforms of the Re-*

White and Bauer,[8] regarding the economic effects of Chapter 12. While disagreements abound—from the wisdom of the policy to the factual data underlying it—there is general agreement that Chapter 12 will affect the farm economy in some manner. Thus, it is important to consider whether the courts are the appropriate institution to effectuate a policy intended to rehabilitate the family farmer.

Whether the bankruptcy courts should be charged with regulating the farm economy is, in its broadest sense, a political question.[9] As DeToqueville suggests, however, almost every political question eventually becomes a legal one.[10] And undoubtedly the legal questions, such as the relevant definitions, the filing deadlines, and the advantages and disadvantages of litigating in Chapter 12, are what concern most attorneys. To provide answers to these legal questions and analysis of the underlying political question, this comment considers the significance of Chapter 12 in the Eastern District of North Carolina. Two justifications exist for this narrow focus: First, Judge A. Thomas Small and Judge Thomas M. Moore[11] were the primary authors of Chapter 12;[12] second, focusing on a single judicial district's resolution of practical legal issues during Chapter 12's first two-and-a-half years should highlight the advantages and disad-

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formed Bankruptcy Reform Act, 16 CAP. U.L. REV. 325 (1987) (arguing that concern for agricultural lenders should have been central to the debate over Chapter 12 because of the potential that a substantial reduction in payments to them could result in increased lender failures as well); Tremper, *The Montana Family Farmer Under Chapter 12 Bankruptcy*, 49 MONT. L. REV. 40 (1988) (recognizing the danger to lenders, but expressing the hope that Chapter 12 could "buy time" without "sacrificing the integrity of our agricultural loans"); Comment, *supra* note 3 (suggesting that the victim of Chapter 12 may be the marginal farmer); Comment, *Bankruptcy Chapter 12: How Many Family Farms Can It Salvage?*, 55 UMKC L. REV. 639 (1987) (suggesting that results from Chapter 12 will be ambiguous at best and that legislative resources ought to be focused on a broader resolution of the economic problems of farming).

8. White, *supra* note 2, at 2, argues that the enactment of Chapter 12 was "both wrong and shortsighted" as a redistribution of wealth from mortgagees to mortgagors and as a diminution of the debtors' capacity to buy credit. Professor Bauer responds that the treatment of lenders under Chapter 12 is consistent with their treatment under other Code chapters and the results of Chapter 12 will not be as dire as White suggests. 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).

9. Several commentators suggest that the Supreme Court will not likely hold various provisions of Chapter 12 unconstitutional. *See* White, *supra* note 2, at 1 n.2; Hahn, *supra* note 7, at 727-28. However, the use of the term "political question" here is not intended to invoke the Constitutional political question doctrine. *See, e.g.*, Baker v. Carr, 369 U.S. 186 (1962). Rather, the term is intended to indicate that the decision to allocate power to, or withdraw it from, the bankruptcy courts will undoubtedly occur in the political arena. Further, that decision will likely center on the relative success of the overarching policy of family farmer rehabilitation, rather than on the wisdom of allocating power to courts in the manner of Chapter 12.

10. A. DETOCQUEVILLE, DEMOCRACY IN AMERICA 270 (J.P. Mayer ed., 1969).

11. Hon. A. Thomas Small, Bankruptcy Judge, and Hon. Thomas M. Moore, Chief Bankruptcy Judge, Eastern District of North Carolina.

12. Interview with A. Thomas Small, Bankruptcy Judge, Eastern District of North Carolina, in Raleigh, N.C. (Feb. 8, 1989).

vantages of judicial decision-making in an arena ripe with political and economic combatants.[13]

This comment opens with an outline of Chapter 12 and applicable definitions. Second, Chapter 12 relief is contrasted with the relief available under the other bankruptcy chapters where those differences are significant to farm debtors and lenders. Finally, this comment explores several legal conclusions and some factual data from the Eastern District of North Carolina. In addition to providing information to the practitioner, this presentation indicates areas in which Chapter 12, if re-enacted, could be clarified by amendment and also provides a basis for the argument that the bankruptcy courts can successfully implement economic policy while adjudicating individual cases.

I. CHAPTER 12—ADJUSTMENTS OF DEBTS OF FAMILY FARMERS WITH REGULAR ANNUAL INCOME

While "[l]awyers know that it is dangerous to paraphrase any statute,"[14] a basic outline of Chapter 12's provisions is offered in the next few pages, with the caveat that it should be read with the Bankruptcy Code close at hand.

A. Defining the Family Farmer

The class of debtors who may seek relief under Chapter 12[15] are "family farmers with regular annual income."[16] Generally, a "family farmer"[17] may be either an individual or an individual and spouse en-

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13. Bankruptcy courts almost always resolve disputes between parties involved in economic or political battles. However, Chapter 12's specific application to farmers undoubtedly includes an additional political and economic element not present when farmers are not specifically protected by a legislative scheme.

14. Dunn, *supra* note 7, at 376. This paraphrase and the comparison between Chapter 12 and Chapters 7, 11, 13, *infra* notes 69-112 and accompanying text, are intentionally brief because many other articles cover both in great detail. *See* Aiken, *supra* note 3, at 637-91; Herbert, *supra* note 7, at 336-66. Tremper, *supra* note 7, at 41-55; Comment, *supra* note 3, at 228-35; Comment, *Expanding Bankruptcy Protection to the Individual Businessman: Taking Chapter 12 One Step Further*, 24 SAN DIEGO L. REV. 1201, 1204-19 (1987).

15. 11 U.S.C. § 109(f) (Supp. IV 1986).

16. *Id.* at § 101(18) provides: " 'family farmer with regular annual income' means family farmer whose annual income is sufficiently stable and regular to enable such family farmer to make payments under a plan under Chapter 12 of this title."

17. *Id.* at § 101(17) provides:

"family farmer" means—

(A) individual or individual and spouse engaged in a farming operation* whose aggregate debts do not exceed $1,500,000 and not less than 80 percent of whose aggregate noncontingent, liquidated debts (excluding a debt for the principal residence of such individual or such individual and spouse unless such debt arises out of a farming operation), on the date the case is filed, arise out of a farming operation owned or operated by such individual or such individual and spouse, and such individual or such individual and spouse receive from such farming operation more than 50 percent of such individual's or such individual and spouse's gross income for the taxable year preceeding the taxable year in

gaged in a farming operation in which:

(1) aggregate debts do not exceed $1,500,000;
(2) 80% of the aggregate, noncontingent, liquidated debts arise out of the farming operation; and
(3) more than 50% of the income was received from the farming operation.[18]

A family farmer may also be a corporation or partnership in which:

(1) 50% of the stock is owned by one family;
(2) more than 80% of its assets are related to the farming operation;
(3) its aggregate debt is less than $1,500,000;
(4) 80% of its aggregate, noncontingent, liquidated debts arise out of the farming operation; and
(5) if stock is issued, it is not publicly traded.[19]

A "family farmer" differs from a "farmer"[20] under the Bankruptcy Code in that a "farmer" must earn 80% of his/her income from a farming operation.

B. *Administration of the Estate*

Assuming an individual, individual and spouse, corporation, or partnership qualifies to file a petition under Chapter 12, subchapter I[21] defines the manner in which the estate will be administered. First,

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which the case concerning such individual or such individual and spouse was filed; or

(B) corporation or partnership in which more than 50 percent of the outstanding stock or equity is held by one family, or by one family and the relatives of the members of such family, and such family or such relatives conduct the farming operation; and

(i) more than 80 percent of the value of its assets consists of assets related to the farming operation;

(ii) its aggregate debts do not exceed $1,500,000 and not less than 80 percent of its aggregate noncontingent, liquidated debts (excluding a debt for one dwelling which is owned by such corporation or partnership and which a shareholder or partner maintains as a principal residence, unless such debt arises out of a farming operation), on the date the case is filed, arise out of the farming operation owned or operated by such corporation or such partnership; and

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

*For a discussion of the "engaged in a farming operation" requirement, see *infra* notes 114-46 and accompanying text.

18. *Id.* at § 101(17)(A).

19. *Id.* at § 101(17)(B).

20. *Id.* at § 101(19) provides:

"farmer" means (except when such term appears in the term "family farmer") person that received more than 80 percent of such person's gross income during the taxable year of such person immediately preceding the taxable year of such person during which the case under this title concerning such person was commenced from a farming operation owned or operated by such person.

21. *Id.* at §§ 1201-1208.

codebtors are protected by a stay of actions.[22] Chapter 12 also defines the duties of a trustee appointed under it[23] and provides further that the rights and duties of the debtor in possession are synonymous with those of the trustee.[24] A debtor in possession may be removed for cause.[25] Chapter 12 provides for adequate protection,[26] but specifically prohibits the application of section 361 to cases under it.[27] Property of the estate includes not only section 541 property, but also earnings from services and section 541 property acquired between commencement and closing, conversion or dismissal of the case.[28] Chapter 12 also permits sales by the trustee, upon notice and hearing, free of any interest in such property.[29] A debtor may convert a Chapter 12 case to Chapter 7 at anytime[30] or dismiss at anytime before conversion.[31] Finally, a party in interest may request dismissal for cause,[32] or conversion to Chapter 7 upon a showing of fraud by the debtor.[33]

C. *The Debtor's Plan*

Subchapter II[34] describes the requirements for filing and confirmation of the debtor's plan under Chapter 12. The debtor has 90 days in which to file a plan after the order for relief.[35]

The debtor's plan must provide for payments over a period not exceeding three years unless the court for cause approves a five-year pe-

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22. *Id.* at § 1201(a). The stay may be dissolved upon notice and hearing. *Id.* at § 1201(c).

23. *Id.* at § 1202.

24. *Id.* at § 1203. However, the debtor in possession is not entitled to compensation.

25. *Id.* at § 1204(a). The debtor in possession may also be reinstated. *Id.* at § 1204(b).

26. Adequate protection is a creditor's remedy which relates to the lifting of the automatic stay. To obtain this remedy, the creditor must demonstrate that the stay will result in the deterioration of his/her interest in the property and then request "adequate protection" in some form such as periodic cash payments or a replacement lien. *See* Tremper, *supra* note 7, at 52.

27. 11 U.S.C. § 1205 (Supp. IV 1986). *See also id.* at § 361 (1982 & Supp. IV 1986), which several circuits had held required the adequate protection of lost opportunity costs of creditors. A creditor's lost opportunity cost is the lost interest a creditor could have received if allowed to immediately foreclose and reinvest the proceeds of the sale. Since the bankruptcy stay prevents immediate foreclosure, creditors argued that they were entitled to adequate protection of not only the value of the collateral, but the value of their lost opportunity to reinvest. The Supreme Court rejected this argument in United States Sav. Ass'n of Texas v. Timbers of Inwood Forest Assocs., 484 U.S. 365 (1988), holding that the adequate protection of a creditor's interest did not include lost opportunity costs, and thereby rendered moot the express inapplicability of § 361 to Chapter 12 cases.

28. 11 U.S.C. § 1207 (Supp. IV 1986). *See also id.* at § 541 (1982 & Supp. IV 1986) (defining property of the estate).

29. *Id.* at § 1206.

30. *Id.* at § 1208(a). For a discussion of conversion to Chapter 11, see *infra* notes 147-76 and accompanying text.

31. *Id.* at § 1208(b).

32. *Id.* at § 1208(c).

33. *Id.* at § 1208(d).

34. *Id.* at §§ 1221-1231.

35. *Id.* at § 1221. The period may be extended if substantially justified. *Id.*

riod.[36] Under the plan, the debtor must submit to the trustee future earnings or income necessary for the plan's execution,[37] make full payment of all claims entitled to section 507 priority,[38] and provide for the same treatment of all claims or interests within a particular class if the plan classifies claims and interests.[39]

Additionally, the debtor may, under the plan and subject to the requirements indicated above, classify unsecured claims,[40] modify secured creditor's rights,[41] cure or waive default,[42] pay secured and unsecured claims concurrently,[43] assign any executory contract or unexpired lease subject to section 365,[44] pay claims from the estate's or the debtor's property,[45] sell or distribute the estate's property,[46] extend the three or five year payment period on allowed secured claims so long as the extended payments meet the feasibility requirement of section 1225(a)(5),[47] vest the estate's property in the debtor or any other entity at the time of confirmation or thereafter,[48] and make any payment provision not inconsistent with the Bankruptcy Code.[49]

The debtor may modify the plan before confirmation[50] and any payments received by the trustee shall be retained until the plan is confirmed or denied.[51] The confirmation hearing must be concluded within 45 days of the filing of the plan.[52] To be confirmed, the plan must comply with Chapter 12,[53] pay required fees,[54] be in good faith and not forbidden by law,[55] and pay on unsecured claims an amount not less than what would

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36. *Id.* at § 1222(c). In some circumstances payments may extend beyond the three to five year period. *Id.* at §§ 1222(b)(5), (b)(9). For a disucssion of payments beyond the three to five year period, see *infra* notes, 42, 47, and 102 and accompanying text as well as notes 210-19 and accompanying text.

37. *Id.* at § 1222(a)(1).

38. *Id.* at § 1222(a)(2). *See also id.* at § 507 (1982 & Supp. IV 1986) (priority of claims).

39. *Id.* at § 1222(a)(3).

40. *Id.* at § 1222(b)(1).

41. *Id.* at § 1222(b)(2).

42. *Id.* at § 1222(b)(3). *See also id.* at § 1222(b)(5) which permits the curing of default and the maintenance of payments for a period longer than three to five years if the last payment under the loan would have been due after the end of the period of the plan.

43. *Id.* at § 1222(b)(4).

44. *Id.* at § 1222(b)(6). *See also id.* at § 365 (1982 & Supp. IV 1986) (conditions upon which trustee may assume or reject an executory contract of the debtor).

45. *Id.* at § 1222(b)(7).

46. *Id.* at § 1222(b)(8).

47. *Id.* at § 1222(b)(9). For a discussion of extended payment period, see *infra* note 102 and accompanying text as well as notes 210-19 and accompanying text.

48. *Id.* at § 1222(b)(10).

49. *Id.* at § 1222(b)(11).

50. *Id.* at § 1223(a). A modified plan becomes the plan. *Id.* at § 1223(b).

51. *Id.* at § 1226.

52. *Id.* at § 1224.

53. *Id.* at § 1225(a)(1).

54. *Id.* at § 1225(a)(2). Regarding fees, *see* 28 U.S.C. §§ 1911-1930 (1982 & Supp. IV 1986).

55. 11 U.S.C. § 1225(a)(3) (Supp. IV 1986).

be paid in a Chapter 7 liquidation.[56] Further, if secured holders do not accept the plan, they must retain their securing lien and receive an amount not less than the allowed amount of the claim or the debtor must surrender the security to them.[57] Finally, the debtor must have the ability to make payments under and comply with the plan.[58]

If the trustee or an unsecured creditor files a timely objection to the plan, it will not be confirmed unless the claim is less than or equal to the value of the property to be distributed on account of it[59] or unless all of the debtor's disposable income is to be used to make payments under the plan.[60] A confirmed plan binds the debtor, each creditor, each equity security holder and each general partner in the debtor whether or not the plan provides for a claim of such parties and regardless of their objection to, acceptance, or rejection of the plan.[61]

The confirmed plan may, however, be modified on the request of the debtor, trustee or unsecured creditor unless after notice and hearing the modification is disapproved.[62] Discharge will be granted after completion of payments under the plan.[63] A discharge may also be granted when payments are incomplete after notice and hearing, if the debtor is not accountable for the circumstances which caused the failure to make payments,[64] the value of property distributed under the plan on unsecured claims is not less than the amount that would have been paid under a Chapter 7 liquidation,[65] and modification of the plan is not practicable.[66] The final section of Chapter 12[67] "provides that the Chapter 12 debtor will receive the same state and local tax treatment as a Chapter 11 debtor."[68]

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56. *Id.* at § 1225(a)(4). *See also id.* at §§ 701-766 (1982 & Supp. IV 1986).

57. *Id.* at § 1225(a)(5).

58. *Id.* at § 1225(a)(6).

59. *Id.* at § 1225(b)(1)(A).

60. *Id.* at § 1225(b)(1)(B). "Disposable income" is defined as "income . . . received by the debtor . . . not reasonably necessary . . . for . . . maintenance or support of the debtor or [his/her] dependent . . . or . . . expenditures necessary for the continuation, preservation, and operation of the debtor's business." *Id.* at § 1225(b)(2).

61. *Id.* at § 1227.

62. *Id.* at § 1229. The confirmation order may be revoked within 180 days upon a showing that the order was procured by fraud. *Id.* at § 1230.

63. *Id.* at § 1228(a).

64. *Id.* at § 1228(b)(1).

65. *Id.* at § 1228(b)(2).

66. *Id.* at § 1228(b)(3). Discharge may be revoked within one year due to fraud. *Id.* at § 1228(d).

67. *Id.* at § 1231.

68. Small & Moore, *Chapter 12—Adjustment of Debts of a Family Farmer with Regular Annual Income*, 9TH ANNUAL BANKRUPTCY INSTITUTE, NC BAR FOUNDATION, IV-27 (Dec. 5, 1986).

II. WHY A NEW CHAPTER?

A. *Family Farmer Problems under Chapters 7, 11 and 13*

In attempting to improve bankruptcy relief for the family farmer, the House of Representatives initially sought to allow greater access to Chapter 13 by increasing the debt ceiling of that chapter to $1,000,000.[69] The Senate, however, heard testimony in joint subcommittee hearings that the House bill would not address the main problems of farmers approaching bankruptcy and would be unfair to farm lenders when its provisions were used by large farming operations.[70] Thus, the Senate sought to develop a bankruptcy chapter specifically for family farm debtors.[71] In developing this legislation, both the House and the Senate assumed the Bankruptcy Code was inadequate to protect family farmers attempting to restructure their debt and remain on the farm.[72] Since a family farmer may still file for relief under any of the other chapters, the problems faced by farm debtors under them are considered below.

1. Chapter 7

Chapter 7[73] is the liquidation chapter under the Bankruptcy Code. Thus, the central difficulty for framers under Chapter 7 is that they will lose the farm unless able to purchase at the trustee's or foreclosure sale because the farming operation is liquidated.[74] Further, while Chapter 7 proceedings may be voluntary or involuntary, "farmers"[75] are protected from involuntary proceedings under the Bankruptcy Code.[76] However, the definition of "farmer," which requires higher percentage of income from

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69. H.R. 2211, 99th Cong., 1st Sess. (1985). *See also* Small & Moore, *supra* note 68, at IV-5.

70. Small & Moore, *supra* note 68, at IV-5. *See also Joint Hearings on H.R. 2211 Before the Subcomm. on Administrative Practice and Procedure and the Subcomm. on Courts of the Senate Comm. on the Judiciary*, 99th Cong., 1st Sess. (Nov. 6 & 12, 1985).

71. S. 2249, 99th Cong., 2d Sess., 132 Cong. Rec. S3500 (daily ed. May 26, 1986).

72. Legislative history is sparse, but available. *See* H.R. CONF. REP. No. 958, 99th Cong., 2d Sess. 45 (1986), *reprinted in* 1986 U.S. CODE CONG. & ADMIN. NEWS 5227, 5246-52; 132 CONG. REC. S5556-58 (daily ed. May 7, 1986) (section-by-section analysis of S. 2249); *Joint Hearings on H.R. 2211*, *supra* note 70; *Hearings on H.R. 1397 and H.R. 1399 Before the House Subcomm. on Monopolies and Commercial Law of the House Comm. on the Judiciary*, 99th Cong., 1st Sess. (March 27, 1985) (hearings on two bills which were precursers of H.R. 2211); 132 CONG. REC. S15075-93 (daily ed. Oct. 3, 1986) (floor statements on day bill passed Senate); 132 CONG. REC. S17218 (daily ed. Oct. 17, 1986) (floor statement clarifying typographical error); 132 CONG. REC. H8999-9002 (daily ed. Oct. 2, 1986) (floor statements on day bill passed House); 132 CONG. REC. S3528-29 (daily ed. Mar. 26, 1986), S5555-58 (daily ed. May 7, 1986), S5613-19 (daily ed. May 8, 1987) (floor statements on S. 2249); 131 CONG. REC. H4768-75 (daily ed. June 24, 1985) (floor statements on H.R. 2211).

73. 11 U.S.C. §§ 701-766 (1982 & Supp. IV 1986).

74. Small & Moore, *supra* note 68, at IV-1.

75. 11 U.S.C. § 101(19) (Supp. IV 1986). For a definition of "farmer," see *supra* note 20.

76. *Id.* at § 301 (1982 & Supp. IV 1986). For other Code provisions insuring against involuntary Chapter 7 proceedings, see *infra* note 94.

farming than the definition of "family farmer,"[77] undoubtedly allowed some debtors who could now meet the family farmer definition, to be involuntarily placed in Chapter 7.[78]

2. Chapter 13

Chapter 13[79] is the reorganization chapter for individuals with regular income. Filing for relief in Chapter 13 presents two initial problems for the farm debtor: debt ceiling and time limit for filing a plan. Chapter 13 provides a $100,000 noncontingent, liquidated unsecured debt ceiling and a $350,000 noncontingent, liquidated secured debt ceiling. The debts of most family farmers seeking bankruptcy protection exceed these ceilings.[80] Additionally, the debtor has only 15 days after the petition to file a plan under Chapter 13. This time limitation presents problems for farmers because the uncertainties associated with their income make it difficult for them to predict their ability to comply with a plan. In comparison, it is "wage earners," with their certain incomes, for whom Chapter 13 is most appropriate.[81]

Further, unsecured creditors can require a debtor to pay all their claims in full or a three-year commitment of all the debtor's disposable income to the plan.[82] Moreover, a debtor may not modify any claim secured by the debtor's residence.[83] While Chapter 12 does permit the modification of a claim secured by the debtor's residence, many of its provisions were drawn from Chapter 13.[84]

3. Chapter 11

"[M]ost family farmers, prior to November 26, 1986, sought relief under Chapter 11."[85] However, Chapter 11 was often found to be "needlessly complicated, unduly time-consuming, inordinately expensive, and, in some cases, unworkable . . . . [It] is better suited for corporate reorganization than for the rehabilitation of individuals."[86] Chapter 11 does not usually work for farm debtors, primarily because of high voting requirements, the absolute priority rule, full security election, and creditor's liquidation plans.[87]

A Chapter 11 plan must be approved by two-thirds the amount of

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77. *Compare* 11 U.S.C. § 101(19) (Supp. IV 1986) with *id.* at § 101(17) (1982). For respective definitions, see *supra* notes 17 and 20.

78. *See Aiken*, *supra* note 3, at 666 n.262 (refuting Representative Synar's claim that only 1% of agricultural producers were immune from involuntary liquidation).

79. 11 U.S.C. §§ 1301-1329 (1982 & Supp. IV 1986).

80. Small & Moore, *supra* note 68, at IV-1.

81. Comment, *supra* note 3, at 229.

82. 11 U.S.C. §§ 1322(b)(5), 1322(c) (1982).

83. *Id.* at § 1322(b)(2) (1982 & Supp. IV 1986).

84. Tremper, *supra* note 7, at 47.

85. Small & Moore, *supra* note 68, at IV-2.

86. *Id.*

87. *Id.* at IV-2, IV-3.

creditor claims and one-half the number of class members voting.[88] In many circumstances, a single undersecured creditor's deficiency claim, particularly in a farm economy damaged by falling land values, could dominate the voting in the unsecured class, thereby preventing acceptance by the class.[89] If a plan is confirmed without acceptance (known as cramdown), the absolute priority rule prohibits the debtor from retaining any property unless the non-accepting class claims are paid in full. Farm debtors, generally unable to pay these claims in full, cannot retain the farm or equipment; thus, the absolute priority of the non-accepting creditors prevents the farmer from paying debts through continued operation of the farm—the purpose of Chapter 11 reorganization.[90]

A class of secured creditors may elect to be fully secured despite the value of the collateral in Chapter 11.[91] Such an election limits debtor options and may cause the plan to be unfeasible.[92] Further, a creditor can file a plan of liquidation when a debtor's plan is not confirmed.[93] The effect of such plans is an involuntary Chapter 7-type liquidation, despite insurances in the Code that farmers may not be subjected to involuntary Chapter 7 proceedings.[94]

B. Protections For the Farmer

As previously noted, Chapter 12 is a voluntary chapter in which only the debtor may file a plan.[95] No provision allows an objecting creditor to file a plan and, like Chapter 13, no unsecured creditors may vote on the plan. Rather, if confirmation of a plan is denied, the case is dismissed.[96] Further, conversion to Chapter 7 from Chapter 12 is also voluntary, unless the debtor has committed fraud in connection with the case.[97]

Chapter 12 attempts to resolve the Chapter 13 problems with a higher debt ceiling, longer time to file a plan, and allowing the restructuring of the mortgage on the family farmer's residence. The debt ceiling was increased to $1,500,000 over the $350,000/$100,000 secured/unsecured ceilings in Chapter 13.[98] The time for filing a plan under Chapter 12 is 90

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88. *Id. See also* 11 U.S.C. § 1126(c) (1982).

89. Small & Moore, *supra* note 68, at IV-2.

90. *Id.* at IV-3. *See also* Norwest Bank Worthington v. Ahlers, 485 U.S. 197 (1988) (absolute priority rule prohibited Chapter 11 debtor's retention of equity interest in farm despite debtor's promise of future labor on behalf of enterprise).

91. 11 U.S.C. § 1111(b) (1982).

92. Small & Moore, *supra* note 68, at IV-3.

93. 11 U.S.C. § 1121(c) (1982 & Supp. IV 1986).

94. Small & Moore, *supra* note 68, at IV-3; *See also* 11 U.S.C. §§ 303(a), 1112(c), 1307(e) (1982 & Supp. IV 1986) (provisions in the Bankruptcy Code insuring that farmers will not be subjected to involuntary Chapter 7 proceedings).

95. 11 U.S.C. § 1221 (Supp. IV 1986).

96. *Id.* at § 1208(c).

97. *Id.* at §§ 1208(a), 1208(d). Any waiver of the right to convert or dismiss is unenforceable. *Id.* at §§ 1208(a), 1208(b).

98. *Id.* at § 101(17). For the text of § 101(17), see *supra* note 17. However, it should be noted that the definition of "family farmer" defines debt more broadly than Chapter 13 because the debt ceiling includes "aggregate debts" instead of only "noncontingent liqui-

days as opposed to 15 days under Chapter 13.[99] Also, there is no limitation on the family farmer's plan to "modify the rights of holders of secured claims"[100] like the limitation regarding residential mortgages in Chapter 13.[101] Finally, the payments under the plan may extend beyond the three or five year period in two specific circumstances.[102]

The debtor also has the power to sell farm land and farm equipment free of any interest in that property after notice and hearing.[103] This "expanded" power is significant because "[o]ne of the problems for farm debtors in bankruptcy has been the inability to sell portions of the farm property [not needed for reorganization] free of liens."[104] In other words, the ability to get rid of the farming operation's least productive assets should provide greater flexibility to the debtor and conceivably greater disposable income to the benefit of all creditors.

C. *Creditor Protections*

Chapter 12 does not provide for adequate protection of lost opportunity costs, absolute priority or an opportunity to elect to be fully secured. Instead, adequate protection is provided through the creditor's ability to recover rent from the debtor and the absolute priority rule is replaced with the "best interest of creditors" test.[105] There is no alternative provided for the fully secured election since any election of that nature would undoubtedly render most plans unfeasible.[106]

The inability of farmers to provide adequate protection of the creditor's lost opportunity costs was another of "the farmer's problems in chapter 11."[107] This problem was resolved by eliminating the application of section 361 of the Bankruptcy code to Chapter 12 and replacing it with specific Chapter 12 adequate protection provisions, including the potential for the payment of reasonable rent.[108]

The absolute priority rule—which prohibits a debtor from retaining any property unless all claims are paid in full is unavailable to unsecured

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dated" debts. *Compare* 11 U.S.C. § 101(17) *with* 11 U.S.C. § 109(e) (1982) and 11 U.S.C. § 101(29) (Supp. IV 1986).

99. 11 U.S.C. § 1221 (Supp. IV 1986). In the original Senate proposal, a debtor would have had 240 days to file. S. 2249, 99th Cong., 2d Sess., 132 Cong. Rec. S3500 (daily ed. May 26, 1986). The 90-day time limit may cause feasibility problems. Small & Moore, *supra* note 68, at IV-11.

100. 11 U.S.C. § 1222(b)(2) (Supp. IV 1986).

101. *Id.* at § 1322(b)(2) (1982 & Supp. IV 1986).

102. *Id.* at §§ 1222(b)(5), (b)(9), (c) (Supp. IV 1986).

103. *Id.* at § 1206. This section is an expansion of trustee powers provided under 11 U.S.C. § 363(f) (1982 & Supp. IV 1986). The debtor in possession has this power to make sales free of interests by virtue of 11 U.S.C. § 1203, (Supp. IV 1986), which gives the debtor in possession the powers of the trustee.

104. Small & Moore, *supra* note 68, at IV-14.

105. *Id.* at IV-15, IV-24.

106. *Id.* at IV-24.

107. *Id.* at IV-15.

108. 11 U.S.C. §§ 1205(a), (b)(3) (Supp. IV 1986). For a discussion of the mootness of the adequate protection of lost opportunity costs issue, see *supra* note 27.

creditors in Chapter 12. Instead, under the "best interests of creditors" test, an unsecured creditor must receive value to the extent such creditor would have been paid in a Chapter 7 liquidation.[109]

Chapter 12 does not alter the basic prohibition against the debtor's use of cash collateral, nor does it provide a list of factors to be considered by a court before authorizing such use.[110] This prohibition "may continue to be a serious impediment to the family farmer's reorganization."[111]

Thus, in one sense, Chapter 12 is a hybrid response to the perceived inadequacy of the Bankruptcy Code to offer effective relief to family farmers. In another sense, however, Congress delegated[112] the authority to formulate farm economic policy to the Bankruptcy courts. And it is an implicit recognition that farm policy (at least in the worst case scenario of bankruptcy) may best be developed on a case-by-case basis.

III. CHAPTER 12 IN THE EASTERN DISTRICT

This comment focuses on the decisions and the data from the bankruptcy court in the Eastern District of North Carolina, an area in which there are many farms—not only to answer practical questions regarding definitions, procedural matters and substantive results, but to provide a more in-depth consideration of the decision-making process of a particular bankruptcy court. By examining the manner in which a court answers the practical questions regarding Chapter 12, some insight may be gained into the broader question of whether courts can effectuate economic policy on a case-by-case basis.

Additionally, the judges from the Eastern District were instrumental[113] in the drafting of Chapter 12. Thus, their decisions interpreting the statutory language and its legislative history have been and will continue to be extremely significant to attorneys in this state as well as bankruptcy courts throughout the nation. Those decisions could conceivably become incorporated into, or specifically rejected by, a re-enacted or amended Chapter 12. Finally, the factual data from the Eastern District should aid attorneys representing debtors and creditors when faced with the potential for filing or fighting a Chapter 12 petition or plan.

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109. 11 U.S.C. § 1225(a)(4) (Supp. IV 1986).

110. Small & Moore, *supra* note 68, at IV-14-IV-15.

111. *Id.* at IV-15.

112. It is a delegation in the sense that while Congress could have passed legislation aimed at a more general scheme of debt forgiveness, it chose instead to share power by permitting the courts to forgive debt in specific cases.

113. Hon. A. Thomas Small; Hon. Thomas M. Moore. *See In re* Johnson, 73 Bankr. 107, 109 (Bankr. S.D. Ohio 1987). Judge Small and Judge Moore were primarily responsible for writing the draft of S. 2249, and deeply involved in drafting the compromise which was favorably reported by the Conference Committee. Interview with A. Thomas Small, Bankruptcy Judge, Eastern District of North Carolina, in Raleigh, N.C. (Feb. 8, 1989).

A. *Some Law from the Eastern District*

This section of the comment considers the opinions from the Eastern District (reported as of February 24, 1989) which provide tissue for the statutory skeleton. Additionally, cases from other jurisdictions which explicitly follow or reject those opinions will be considered briefly. Each case reveals the potential for tension in the judicial decision-making process. Specifically, those tensions appear when courts are called upon to clarify definitions through rules or reasons, to exercise discretion without express prohibition or authorization, to justify a choice between conflicting federal laws on grounds of policy or legal authority, or to recognize rights which, if exercised, conflict with express policy goals of Chapter 12. The court's resolution of these tensions in the Chapter 12 cases discussed below suggests that the equities have shifted in favor of farm debtors intent on continuing to farm and that the bankruptcy courts are inclined and able, with some exceptions, to adjudicate Chapter 12 in accordance with its rehabilitative purpose.

1. *Defining the family farmer*

In *In re Tart*,[114] the court held that debtors who had sold their farm land and did not intend to resume farming operations could not qualify for relief under Chapter 12,[115] because they were not "engaged in a farming operation."[116] This issue was ripe because the Bankruptcy Code is silent as to "the time period during which a debtor must be engaged in a farming operation to be eligible for chapter 12."[117] While the court declined to specify the salient time period,[118] the "engaged in" language seems to require at least an intent to continue farming during and after reorganization and an attempt to farm during the year in which the petition is filed.[119] While this conclusion may seem obvious or at least not surprising, both the factual setting of the case and the court's focus on other Code definitions and the broad purpose of Chapter 12 are worthy of some inquiry.

When the debtors' petition was filed on November 26, 1986,[120] they were not planting or harvesting crops. Further, they had sold all their real property, except for their house and lot, prior to the filing of the petition. In 1985, the Tarts earned $23,000 from the sale of farm land, $1,390 in rent payments for land and tobacco allotments, $8,600 in private disability payments, and $9,600 in Social Security disability payments. Mr. Tart "had been a farmer all of his adult life, and all of the Tarts' debts had

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114. 73 Bankr. 78 (Bankr. E.D.N.C. 1987).

115. *Id.* at 81.

116. 11 U.S.C. §§ 101(17)(A), 101(20) (Supp. IV 1986).

117. *Tart*, 73 Bankr. at 80.

118. *Id.* at 82 n.4; *See also id.* at 81 n.2.

119. *Id.* at 80, 82.

120. *Id.* at 79. November 26, 1986 was the first day on which Chapter 12 became available for family farmers facing the prospect of bankruptcy.

arisen from farming,"[121] but because he and his wife were disabled they expressed the intention in their Chapter 12 plan not to continue farming.

The debtors argued that they should be considered family farmers whether or not they were presently engaged in a farming operation if they met the remaining "definitional requirements of § 101(17)(A)."[122] Rejecting this argument, the court distinguished the definitions of "family farmer" and "farmer."[123] Noting both the inapplicability of the definition of farmer to Chapter 12[124] and the absence of the "engaged in a farming operation" language from that definition, the court stated that "[t]he inclusion of this language [in the definition of "family farmer"] suggests that Congress intended to require more than that a 'family farmer' be engaged in a farming operation during the taxable year preceding the year in which the petition was filed . . . . [Otherwise,] the 'engaged in a farming operation' language would be superfluous . . . ."[125]

Having determined that "more" was required but undefined by the statute, the court sought to interpret the language so as to give "effect to the overall purpose of the legislation."[126] In doing so, the court relied on the Conference Report[127] and the statements of the bill's primary sponsors, Representative Synar[128] and Senator Grassley,[129] to find that the "legislative history of Chapter 12 indicates that its primary purpose is to help farmers *continue* farming."[130] Even though "the court sympathize[d] with these debtors, Chapter 12 [came] too late to be of assistance to them"[131] because their minimal farming in 1985, the sale of all their farm land, and their intention not to resume farming removed them from the definitional requirements of a "family farmer."

Other courts have looked to *Tart*[132] for guidance. In *In re Indreland*,[133] the court held that a debtor who was engaged in farming at the time of filing the petition, but who scaled down his farming operation under the five-year plan, was a "family farmer" and thus entitled to

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121. *Tart*, 73 Bankr. at 79.

122. *Id.* at 80.

123. *Id.* at 80-81. The court specifically distinguished Potmesil v. Alexandria Production Credit Ass'n, 42 Bankr. 731 (W.D. La. 1984) (a case arising before the availability of Chapter 12) where the court considered only the debtor's status in the tax year preceding the year in which the petition was filed to determine whether the debtor was a "farmer." *Cf.* 11 U.S.C. § 101(17)(A) and § 101(19) (Supp. IV 1986) (defining "family farmer" and "farmer"). As the court notes, the definition of "farmer" does not require one to be "engaged in a farming operation." *Tart*, 73 Bankr. at 81.

124. *Tart*, 73 Bankr. at 80.

125. *Id.* at 81.

126. *Id.*

127. H.R. CONF. REP. No. 958, 99th Cong. 2d Sess. 45 (1986), *reprinted in* 1986 U.S. CODE CONG. & ADMIN. NEWS 5227, 5246-52.

128. 132 CONG. REC. H9001 (daily ed. Oct. 2, 1986).

129. 132 CONG. REC. S15075 (daily ed. Oct. 3, 1986).

130. *Tart*, 73 Bankr. at 81.

131. *Id.* at 82.

132. 73 Bankr. 78 (Bankr. E.D.N.C. 1987).

133. 77 Bankr. 268 (Bankr. D. Mont. 1987).

Chapter 12 relief. Reaching that conclusion, the court relied on Judge Small's account of Chapter 12 legislative history and then distinguished *Tart* on its facts. A different result was reached in *In re Sohrakoff*[134] where the court was faced with debtors who had sold some, but not all, of their farm land. Holding that the sale of farm land was not income generated from the farming operation,[135] the court dismissed the debtors' petition. Two other cases[136] have considered whether a lessor of farm land is a family farmer—an issue which Judge Small specifically left unaddressed in *Tart*.[137] In *In re Tim Wargo & Sons,Inc.*,[138] the court cited *Tart* for the proposition that "[i]n construing the term 'farming operation,' the Court must examine the debtor's activities as of the petition date"[139] and held that debtors who had formerly farmed their land, but presently rented to others, were not engaged in a farming operation.[140] However, in *Matter of Burke*,[141] another court considered income from the lease of farm land to be farm income.

The *Tart* court's decision—not to develop an unbending rule regarding the time period during which a farmer must be engaged in a farming operation to qualify as a family farmer—may be more indicative of its sympathies than the condolences to the Tarts quoted above.[142] That decision signals the court's willingness to make case-by-case judgments based on a debtor's current activities and apparent future intentions. Those judgments will undoubtedly enable some borderline cases to cross the eligibility hurdle even if they are ultimately unable to formulate a plan meeting the confirmation requirements. At that point, such debtors will be required to choose between conversion to Chapter 7 and dismissal. Other debtors, misjudging the facts of their case, will erroneously file Chapter 12 petitions only to fail on definitional grounds. While the cost of that mistake to the debtor has been mitigated by an earlier decision in the Eastern District,[143] creditors may find more debtors beyond their reach while the eligibility issue is litigated.

At least one court has adopted a rule,[144] and some might suggest an amendment to the definition of "family farmer," specifying the relevant time period as the time the petition is filed. While time of filing is a

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134. 85 Bankr. 848 (Bankr. E.D. Cal. 1988).

135. *Id.* at 849.

136. *See In re* Tim Wargo & Sons, Inc., 74 Bankr. 469 (Bankr. E.D. Ark. 1987), *aff'd sub nom., In re* Tim Wargo & Sons, Inc. v. Equitable Life Assur. Soc., 86 Bankr. 150 (E.D. Ark. 1988), *aff'd, In re* Tim Wargo & Sons, Inc., 869 F.2d 1128 (8th Cir. 1989); Matter of Burke, 81 Bankr. 971 (Bankr. S.D. Iowa 1987).

137. *Tart*, 73 Bankr. at 82 n.3.

138. 74 Bankr. 469 (Bankr. E.D. Ark. 1987).

139. *Id.* at 472. Note that *Tart* did not adopt such a straightforward rule.

140. *Id.* at 474.

141. 81 Bankr. 971 (Bankr. S.D. Iowa 1987).

142. For the court's expression of sympathy, see *supra* text accompanying note 131.

143. For a discussion of conversion from Chapter 12 to Chapter 11, see *infra* notes 147-74 and accompanying text.

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

"good general rule,"[145] without more analysis it creates a brightline, but shortsighted, test: It restricts eligibility inconsistently with the rehabilitative purpose of Chapter 12 by narrowing the court's focus to the present instead of broadening it to include the future. Eligibility should be determined according to the statutory language where that language is specific and in view of the general purpose of the legislation where the language is not. Courts should not engraft additional restrictions on eligibility. Otherwise, they ironically assume the immediate power to legislate from the bench while depriving themselves of discretion in the future.

Certainly courts often find it necessary to adopt a brightline rule. Often, such rules simplify the present decision and decrease the amount of time required to reach similar decisions later. Yet, it is precisely because courts have both the ability and the forum for analyzing credibility and factual circumstances that rules should not replace reasons where statutory silence allows the court to develop one or the other. Rules tend to limit discretion; reasons enhance a court's power.

Eligibility battles in Chapter 12 disclose the tension between rules and reasons in judicial decisionmaking. That tension may help to explain why courts are an appropriate institution to effectuate a particular economic policy. Where the rules exist, courts can be expected to follow them. Where there are no rules or they are unclear, courts in most circumstances can be expected to justify a decision reasonably rather than construct a rule which deprives them of discretion in the next case. Reasons, developed from the facts and circumstances of a case and in light of experience, not only explain the application of a broader policy to a specific situation, but, like rules, govern the conduct of both the parties and similarly situated economic actors. Where the policy is family farmer rehabilitation, debtors should be required to show, and creditors should have the opportunity to dispute, an intention to continue farming. A "time of filing" rule removes this issue from consideration; the reasoning in *In re Tart*[146] requires it.

2. *Conversion from 12 to 11—good faith plus*

In *In re Orr*,[147] the court allowed a debtor who filed for Chapter 12 relief in good faith, but who failed to meet the debt ceiling, to convert the case to Chapter 11 despite the absence of any express statutory authority for such conversions.[148] The conversion issue arose because the Orrs filed a petition in Chapter 12 on January 9, 1987, claiming aggregate debts below the $1,500,000 ceiling.[149] That claim was based primarily upon representations by one of their creditors—Branch Banking & Trust (BB & T)—that the Orrs' outstanding debt to them was no greater than

145. Interview with A. Thomas Small, Bankruptcy Judge, Eastern District of North Carolina, in Raleigh, N.C. (Feb. 8, 1989).

146. For a discussion of *Tart*, see *supra* notes 114-31 and accompanying text.

147. 71 Bankr. 639 (Bankr. E.D.N.C. 1987).

148. *Id.* at 641.

149. *Id.* at 640.

$676,227.52.[150] The bankruptcy court found, however, that the actual amount of the debt to BB & T was $862,612.53—a difference which forced the Orrs' aggregate debts up to $1,641,594.39 and rendered them ineligible for Chapter 12 relief.[151] Having made that determination, the court next considered whether to dismiss or convert the case to Chapter 11.

In reaching the conclusion that conversion should be allowed, the court traveled some fairly treacherous ground. First, while conversion to Chapter 7 is specifically provided for, conversion to Chapter 11 is not.[152] Second, the legislative history indicates that the omission was intended to preclude such conversions.[153] As the court noted:

> It would be entirely unfair to creditors to permit a debtor who was unsuccessful in chapter 12 to start anew in chapter 11 . . . . [Because] chapter 12 is designed to make confirmation of plans easier . . . and, in most cases, it would make no sense to allow a failed chapter 12 debtor to begin again in chapter 11 where confirmation is more difficult.[154]

Third, a provision in the Senate version of Chapter 12 which did not become part of the legislative scheme "would have permitted a person filing a chapter 12 petition in good faith to convert to chapter 7, 11, or 13 if the person was determined . . . not to be a 'family farmer.' "[155] The refusal or failure to adopt such a provision might be read fairly as a further expression of intent not to allow such conversions.[156] Finally, "there 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."[157]

The court's footwork through this maze of authority is surprisingly simple. Situations may arise, like that of the Orrs, "when conversions from Chapter 12 to Chapter 11 or 13 would not be unfair to creditors and the denial of conversion would be inequitable to the debtor."[158] Despite Congress' failure to adopt a "good faith conversion" provision, good faith conversions should not be denied.[159] Further, to require dismissal and subsequent refiling in another chapter is to promote form over substance[160] and might actually prejudice the creditors since refiling would

150. *Id.*

151. *Id.* at 640-41.

152. *Id.* at 641.

153. *Id.*

154. *Id.* at 641-42.

155. *Id.* at 642.

156. *See, e.g., In re* Christy, 80 Bankr. 361, 363 (Bankr. E.D. Va. 1987). For a discussion of cases refusing to allow conversion in any circumstance, see *infra* notes 165-67 and accompanying text.

157. *Orr*, 71 Bankr. at 642. The court cites Matter of Wulf, 62 Bankr. 155 (Bankr. D. Neb. 1986).

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

159. *Id.*

160. *Id.*

alter "the date used in computing the preference period."[161] In response to the "nullity" argument, the court argued that "[t]he Code . . . should not be interpreted so narrowly as to preclude all conversions . . . to Chapter 11."[162] Thus, conversion should be permitted in the court's discretion when the debtor fails to qualify for Chapter 12 relief so long as the petition was filed in good faith, and conversion will not prejudice the creditors or be "otherwise inequitable."[163]

Several other bankruptcy courts have faced the conversion issue discussed in *Orr*.[164] Contrary to Judge Small, Judge Tice, a bankruptcy judge in the Eastern District of Virginia, held that the absence of express statutory language permitting conversion to Chapter 11 precluded such conversions.[165] In reaching that conclusion, the court relied on both the legislative history and the fact that while Chapter 12 only provides for conversion to Chapter 7, "the conversion sections of other chapters specifically allow for extensive conversion."[166] Additionally, "[t]he removal of the good faith conversion provision from the final bill is at least an indication that Congress specifically rejected the concept of allowing a debtor to convert a chapter 12 case to a case under chapter 11."[167] Other courts following *Orr* have dismissed Chapter 12 cases based on lack of good faith or other grounds.[168] In *Matter of Bird*,[169] however, the court permitted conversion relying not only on "the very persuasive and well-reasoned case of *In re Orr*,"[170] but also in the language of section 1208(e).[171] Arguing that the section is "inartfully drafted,"[172] the court stated that "its language should be construed broadly to permit a Chapter 12 debtor to convert to any other chapter under which the debtor is qualified to be a debtor."[173]

In sum, a Chapter 12 debtor may convert to Chapter 7 as a matter of

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161. *Id.* at 643.

162. *Id.* at 642-43.

163. *Id.* at 643.

164. Two cases citing *Orr* did not consider the conversion issue. *See In re* Labig, 74 Bankr. 507, 509 (Bankr. S.D. Ohio 1987) (date of filing petition is date on which to determine amount of debt); Whaley v. United States, 76 Bankr. 95, 96-97 (N.D. Miss. 1987) (factual comparison).

165. *In re* Christy, 80 Bankr. 361, 363 (Bankr. E.D. Va. 1987).

166. *Id.* at 362.

167. *Id.* at 363. *See also* Matter of Roeder Land & Cattle Co., 82 Bankr. 536 (Bankr. D. Neb. 1988) (following *Christy*).

168. *See In re* Johnson, 73 Bankr. 107, 109 (Bankr. S.D. Ohio 1987) (expressly following *Orr*, but finding lack of good faith); *In re* Lawless, 79 Bankr. 850 (W.D. Mo. 1987) (tending to agree with *Orr*, but upholding Bankruptcy Court's exercise of discretion not to permit conversion).

169. 80 Bankr. 861 (Bankr. W.D. Mich. 1987).

170. *Id.* at 863.

171. 11 U.S.C. § 1208(e) (Supp. IV 1986) provides: "Notwithstanding any other provision of this section, a case may not be converted to a case under another chapter of this title unless the debtor may be a debtor under such chapter."

172. *Bird*, 80 Bankr. at 863.

173. *Id.*

right.[174] Some courts, perhaps depending on their perception of the judge's role as equitable or legal, will permit conversion to Chapter 11 or 13 in the presence of debtor good faith and in the absence of harm to creditors. The better rule is for the court to maintain the discretion to permit conversion. Further, if Chapter 12 is re-enacted, Congress should amend the statute in a way expressly authorizing such conversions. Language appropriate for the situation would be as follows:

> If a debtor files a petition under this chapter in good faith but is determined by the court not to be a "family farmer," the court may permit the debtor to convert the case to any chapter under this title so long as the debtor may be a debtor under such chapter and conversion would not harm creditors or be otherwise inequitable.[175]

The disagreement over whether to permit conversion exhibits another tension in judicial decisionmaking: Is discretion an element of judicial power or an element of judicial authority?[176] In context, must the discretion to permit conversion be expressly prohibited or expressly authorized by statute? Given both the emergency and rehabilitative nature of Chapter 12 relief, any limitations in judicial discretion ought to be express. Further, like questions of eligibility, it seems counterproductive for a court to adopt a rule limiting its discretion. Rather, in those circumstances where conversion could potentially injure a creditor, a court should refuse to allow conversion in that case. Where no injury would result, requiring dismissal and refiling promotes form over substance. By using their discretion in light of an underlying statutory purpose, courts can effectively promote a particular economic policy. However, because some judges are unwilling to exercise discretion without express authority, Congress should have granted the authority for good faith conversion and should do so by amendment if Chapter 12 is re-enacted.

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174. 11 U.S.C. § 1208(a) (Supp. IV 1986).

175. S. 2249, 99th Cong., 2d Sess., 132 CONG. REC. S3500 (daily ed. May 26, 1986), contained similar language, which was ultimately deleted.

176. Power is the ability to alter the behavior of another in accordance with one's wishes. Authority is the right to alter the behavior of another in accordance with one's wishes. J.Q. Wilson, A Glossary of Some Terms Used in Government 1500, p.1 (Harvard University, Fall 1986) (unpublished). The easy answer to the question is that discretion is both an element of power and of authority. The point of the question, however, is to suggest that if a court has the power to exercise discretion, then its exercise must be expressly prohibited by legislation. If it is an element of authority, then it should be expressly recognized by legislation. Thus, the view expressed here is that discretion is within the inherent power of the court.

3. *Conflict of Laws—Bankruptcy Code v. Farm Credit Act of 1971*

In *In re Massengill*,[177] the court ruled that two creditors could be required to retire the debtors' stock to reduce their secured claims.[178] The Massengills, who had farmed various crops for over twenty-five years, filed a Chapter 12 petition on November 26, 1986.[179] Their plan, filed on March 24, 1980[180] and subsequently amended on April 20 and orally at the confirmation hearing, provided for the liquidation of their farm land and equipment.[181] Two secured creditors—the Land Bank and the Production Credit Association (PCA)—objected to the debtors' plan insofar as it sought to reduce the secured claims by returning stock.[182] The Land Bank's claim of $88,000 was secured by three tracts of land and by Land Bank stock at a par value of $5,000.[183] PCA's claim of $6,500 was secured by barns, equipment and PCA stock at a par value of $925.[184] Both the Land Bank and PCA stock were purchased as required by the Farm Credit Act of 1971.[185]

Both creditors argued that "the Farm Credit Act vest[ed] the right to retire or cancel Land Bank or PCA stock *solely* in the discretion of the Land Bank or PCA and that that discretion cannot be displaced by the provisions of the Bankruptcy Code."[186] The argument rested on the fact that the statute[187] gives land banks and production credit associations the discretion, to cancel stock upon default, but does not require it to do so.

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177. 73 Bankr. 1008 (Bankr. E.D.N.C. 1987), *rev'd*, No. 87-821-CIV-5, (E.D.N.C. May 23, 1988) (unpublished ORDER by Fox, J.). No further appeal was filed. However, in *In re* FCX, Inc., 853 F.2d 1149 (4th Cir. 1988), *cert. denied*, 109 S. Ct. 1118 (1989), the Court of Appeals affirmed the bankruptcy court's conclusion that a Chapter 11 debtor could release "patronage certificates" in satisfaction of a creditor's claim. The bankruptcy court reached this conclusion by relying on its decision in *Massengill* and the Court of Appeals found "the analysis in *In re Massengill* persuasive." *FCX*, 853 F.2d at 1158.

178. *Massengill*, 73 Bankr. at 1012.

179. *Id.* at 1008.

180. *Id.* The Massengills were granted an extension beyond the 90 day time period because Mr. Massengill suffered a heart attack. *See* 11 U.S.C. at § 1221 (Supp. IV 1986), which allows granting of extensions where "substantially justified."

181. *Massengill*, 73 Bankr. at 1008. Note that the Massengills, unlike the Tarts, intended to continue farming by renting land and equipment. For a discussion of *Tart*, see *supra* notes 114-31 and accompanying text.

182. *Id.* at 1009.

183. *Id.*

184. *Id.*

185. *Id.* at 1009-10. *See also* Farm Credit Act of 1971, 12 U.S.C. §§ 2001 to 2276 (1982 & Supp. IV 1986), particularly §§ 2034(a), 2094(k). For partial text of §§ 2034(a) and 2094(k), see *infra* note 187.

186. *Massengill*, 73 Bankr. at 1010.

187. 12 U.S.C. § 2034(a) (1982 & Supp. IV 1986) provides in part: "Stock shall be retired and paid at book value not to exceed par, as determined by the association, upon the full repayment of the loan and if the loan is in default may be cancelled for application on the loan . . . when approved by the bank."
12 U.S.C. § 2094(k) (Supp. IV 1986) provides in part: "In . . . case . . . the debt . . . is in default, the association may retire all or part of the capital investments in the association held by such debtor . . . in total or partial liquidation of the debt."

Further, the federal regulations[188] indicate that discretion is unfettered. Finally, another bankruptcy court had held that cancellation of stock should not be permitted.[189] Clearly, a strong policy consideration underscores the creditor's claim: land banks and PCAs depend upon their borrowers' ownership of stock for both stability and capital; allowing cancellation could undermine this stability and deplete their capital, impairing their ability to make future loans.[190]

Both the language and this particular policy of the Farm Credit Act conflict with the language of sections 1222(b)(8) and 1225(a)(5)(C)[191]—which authorize the return of such stock—and the policy of the Bankruptcy Code (and particularly Chapter 12)—to rehabilitate particular debtors while protecting the interests of all creditors involved in the case.[192] The return of non-income producing property usually increases the disposable income available to the debtor and, ultimately, to other creditors.[193] Further, the Fourth Circuit Court of Appeals rejected similar policy arguments advanced by creditors and ruled that stock should be offset against a secured creditor's claim, under the Bankruptcy Act of 1898, the Farm Credit Act notwithstanding.[194] Finally, the Supreme Court ruled that express provisions of the Bankruptcy Code are paramount to provisions of the National Labor Relations Act and, perhaps by analogy, to other statutory schemes.[195]

Two courts allowed a surrender of stock to reduce the amount of creditors' claims.[196] However, another court held that a surrender caused the secured creditor to become unsecured as to the par value of the stock, rather than causing the amount of the claim to be reduced.[197]

Most of the economic criticism of Chapter 12 has focused on this type of decision.[198] Simply, a legislative scheme and consequent judicial decisions which encourage bankruptcy by particular economic actors create disincentives to invest in that segment of the economy and drain the

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188. 12 C.F.R. § 615.5260(b) (1988) provides in part: "[T]he bank may, but shall not be required to, retire and cancel all or part of any stock . . . on which the bank has a lien as collateral for the debt . . . ."

189. *Massengill*, 73 Bankr. at 1010 (citing *In re* Walker, 48 Bankr. 668 (Bankr. D.S.D. 1985)).

190. *Massengill*, 73 Bankr. at 1010, 1012.

191. 11 U.S.C. §§ 1222(b)(8) (Supp. IV 1986), *supra* note 46, 1225(a)(5)(C) (Supp. IV 1986).

192. *Massengill*, 73 Bankr. at 1012.

193. *Id.*

194. *Id.* at 1010-11. *See* Columbia Bank for Cooperatives v. Lee, 368 F.2d 934 (4th Cir. 1966) *cert. denied* 386 U.S. 992 (1967).

195. 73 Bankr. at 1012. *See* N.L.R.B. v. Bildisco & Bildisco, 465 U.S. 513 (1984).

196. *In re* Greseth, 78 Bankr. 936 (D. Minn. 1987); *In re* Ivy, 86 Bankr. 623 (Bankr. W.D. Mo. 1988).

197. *In re* Arthur, 86 Bankr. 98 (Bankr. W.D. Mich. 1988).

198. For a list of articles discussing the economic impacts of Chapter 12, see *supra* notes 7 and 8. Professor White focused solely on the effect of Chapter 12 on the value of mortgages on land. White, *supra* note 2. Presumably, his concern would be heightened by the debtor's ability to cancel stock as well.

resources of those creditors who cannot easily exit the market. Further, because courts decide issues of this sort on a case-by-case basis—focusing solely on economic situations of the debtor and creditors involved—the broader economic effects of their legal conclusions may seem insignificant or non-existent to the courts. This potentially narrow focus is one danger of attempting to use courts as instruments of a particular economic policy.

The assumption that courts do not consider the broader effects of their decisions, both economic and legal, may prove too much. Instead, the concern that stock surrender or cancellation would destabilize the capital structure of debtor-owned lending institutions depends upon a credible floodgates argument: that family farmers would opt for bankruptcy solely to divest Land Bank or PCA stock while remaining debtors of those institutions. In order to weigh that argument's credibility, courts must consider not only the interests of the particular debtor and creditors involved, but the desires of similarly situated parties. In the case of the surrender of stock, at least one macro-economic trend weighs heavily against the creditors' fear of destabilization: "Farmers hate bankruptcies."[199] Thus, for the threat to lending institutions to be realistic, holding Land Bank or PCA stock would have to be more distasteful to marginal farmers than bankruptcy. Even farmers who perceive such stock to be without value[200] would recognize that the cost of surrender is loss of autonomy.[201]

Interestingly, the *Massengill*[202] court does not focus on the economic battle underlying the case. Rather, the court resolves a conflict between two federal laws.[203] Certainly, the court made a normative judgment about which underlying policy was more valuable,[204] but it did so in almost cursory fashion. Most of the opinion was devoted, instead, to an analysis of case authority making similar choices of law.[205] The court's focus on a conflict between two federal laws indicates another tension in judicial decisionmaking that may make economic policymaking difficult for courts. Where substantive policy choices are unclear or difficult, courts may seek more familiar legal ground upon which to base their decision. Fortunately, in the case of the surrender of stock at least, the in-

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199. Interview with A. Thomas Small, Bankruptcy Judge, Eastern District of North Carolina, in Raleigh, N.C. (Feb. 8, 1989).

200. *See, e.g., In re* Arthur, 86 Bankr. at 100, 101, 103.

201. "Farmers are extremely independent . . . . They don't like people . . . looking over their shoulder." Interview with A. Thomas Small, Bankruptcy Judge, Eastern District of North Carolina, in Raleigh, N.C. (Feb. 8, 1989).

202. *Massengill*, 73 Bankr. 1008 (Bankr. E.D.N.C. 1987), *rev'd* No. 87-821-CIV-5, (E.D.N.C. May 23, 1988) (unpublished ORDER by Fox, J.). For a discussion of *Massengill*, see *supra* notes 177-95 and accompanying text.

203. For a discussion of the conflicting statutes, see *supra* notes 187, 188 and 191 and accompanying text.

204. *Massengill*, 73 Bankr. at 1012.

205. *Id.* at 1009-12. The district court opinion also focused primarily on the conflict of laws issue. *Id.*

quiry does not end there. Remaining are issues of valuation[206] and the manner in which the surrendered stock will reduce the debt.[207] Where the equities of its decision in a particular case are somewhat unbalanced, the court has the opportunity to balance them with its resolution of these additional issues.

4. Confirmation and post-confirmation modification

In *In re Bartlett*,[208] the district court reversed the bankruptcy court's confirmation order because plan expenses would exceed debtor income during the first year of the plan. Thus, the plan was not feasible based on the debtors' projected negative cash flow.[209] More significant is the case of *In re Hart*.[210] In *Hart*, the court rejected a creditor's argument that section 1229(c)[211] prohibited post-confirmation modification of a plan if the plan provided for payments over a period longer than three to five years.[212] Acknowledging that section 1229(c), "[s]tanding alone . . . could be read to support [the creditor's] position,"[213] the court reasoned that the section was to be read in connection with the entire legislative scheme.[214] Because Chapter 12 specifically provided for plan payments over a period longer than three or five years and since the confirmed plan in this case had utilized those provisions, there was no reason to prohibit the modification of those long term payments, particularly when the affected creditor was receiving monthly payments.[215]

The decision in *Hart*[216] may explain more about the pitfalls of drafting "hybrid" statutes than about the abilities of bankruptcy courts to oversee economic policy. The provision at issue in the case was "taken verbatim from chapter 13's section 1329(c)."[217] In the context of Chapter 13, the language forbidding post-confirmation modifications that provide for payments beyond the three or five year period makes sense because no plan may provide for payments beyond that time under Chapter 13.[218] In the context of Chapter 12, where certain payments may extend beyond

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206. *See In re* FCX, Inc., 853 F.2d 1149 (4th Cir. 1988), *cert. denied*, 109 S. Ct. 1118 (1989).

207. *See In re* Arthur, 86 Bankr. 98 (Bankr. W.D. Mich. 1988).

208. 92 Bankr. 142 (E.D.N.C. 1988).

209. *Id.* at 144.

210. 90 Bankr. 150 (Bankr. E.D.N.C. 1988).

211. 11 U.S.C. § 1229(c) (Supp. IV 1986) provides:

> A plan modified . . . may not provide for payments over a period that expires after three years after the time that the first payment under the original confirmed plan was due, unless the court, for cause, approves a longer period, but the court may not approve a period that expires after five years after such time.

212. *Hart*, 90 Bankr. at 153.

213. *Id.*

214. *Id. See also* United States Sav. Ass'n of Texas v. Timbers of Inwood Forest Assocs., 484 U.S. 365, _ (1988).

215. *Hart*, 90 Bankr. at 154-55.

216. *Id.* at 150.

217. *Id.* at 153.

218. *Id.*

the three or five year period,[219] the limitation is clearly out of place, particularly where a debtor is seeking to modify a payment already scheduled to be paid over a longer time period. If Congress chooses to re-enact Chapter 12, section 1229(c) should either be removed as superfluous or amended by adding the following language after the last word of the section: *unless an extended payment period would be permissible under sections 1222(b)(5) or (b)(9).*

5. Strict construction: proof of claim and right of set-off

Two cases strictly construed rules requiring the filing of proofs of claims. In *In re King*,[220] the court denied the debtors' motion to file a proof of claim on behalf of an unsecured creditor.[221] The debtor made the motion over a year after the filing of claims was barred.[222] The late filing occurred because, at the time of their January 5, 1987 Chapter 12 petition, the debtors believed that insurance would fully cover Mrs. King's medical bills.[223] The bar date was set for May 28, 1987 and the plan was confirmed on August 3, 1987.[224] After learning that insurance would not cover the medical bills, the debtors filed their motion to file a late proof of claim on April 11, 1988.[225] In overruling the motion, the court strictly construed the applicable bar date, even though the "equities . . . favor[ed] the debtors,"[226] because "the dividend to unsecured creditors with timely filed claims . . . [would] be [adversely] affected . . . unless all claims are paid in full."[227]

In *In re Britton*,[228] the court concluded that the failure of a creditor to timely assert a right of set-off constituted a waiver of the right.[229] Several cases were consolidated for hearing on the set-off issue.[230] In those cases, each family farmer was "indebted to the Farmers Home Administration."[231] Each was participating in the Commodity Credit Corporation's (CCC) price support program through which they became "entitled to certain payments" at the end of the crop season.[232] In each case, the Farmer's Home Administration (FmHA) filed proofs of claims, but failed to assert the right to set-off the payments which the CCC owed to the farmers.[233] Finally, in each case, the FmHA asked the court to lift the

219. 11 U.S.C. §§ 1222(b)(5), (b)(9), (c) (Supp. IV 1986).
220. 90 Bankr. 155 (Bankr. E.D.N.C. 1988).
221. *Id.* at 158.
222. *Id.*
223. *Id.* at 156.
224. *Id.*
225. *Id.*
226. *Id.* at 158.
227. *Id.*
228. 83 Bankr. 914 (Bankr. E.D.N.C. 1988).
229. *Id.* at 921.
230. *Id.* at 916.
231. *Id.*
232. *Id.*
233. *Id.* at 916-17.

automatic stay and attempted to amend their proofs of claims so as to assert the right of set-off.[234]

The court noted that the right of set-off is recognized under the Bankruptcy Code "where it exists in nonbankruptcy law."[235] Then, the court found that such a right would exist in these cases under North Carolina law.[236] However, the creditor's failure to assert this right upon filing its proof of claim *and* its failure to obtain the court's permission to so assert that right through a lift of the automatic stay constituted a waiver of the right.[237] Finally, the court noted the particular importance of timely assertions of rights by creditors in Chapter 12 proceedings because of the rapidity with which plans are filed and confirmed or cases are dismissed.[238] As the court stated, "these provisions [which speed up the bankruptcy process] are designed to benefit the creditors."[239]

While the *King*[240] facts may be somewhat unique, the issue in *Britton*[241] "has been present in many cases in Chapter 12"[242] because of the numerous federal programs under which farmers may become debtors to and creditors of the government.[243] The right of set-off can be devastating to the debtors' reorganization plan.[244] Thus, the government's assertion of the right of set-off is, in one sense, an announcement of contradictory policy objectives: The government favored rehabilitation when it enacted a special bankruptcy chapter for family farmers, but it may prevent rehabilitation in many cases by asserting a right of set-off. Further, the government's near exclusive ability to exercise the right will give it an advantage over other creditors and in negotiations with the debtor.[245]

Litigation over the right of set-off presents an example of an institutional limitation faced by courts when called upon to promote a particular economic policy. Courts are accustomed to identifying rights and remedying their infringement. Where the enforcement of those rights undercuts some other policy, courts may narrow their application or insist on strict adherence to procedure by the party attempting to assert them. They are unlikely, however, to deny the existence of the right itself. Thus, a creditor who promptly asserts a right of set-off may unilaterally reduce the court's ability to promote an economic policy geared toward rehabilitation despite the fact that Congress generally sought to avoid that result

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234. *Id.*

235. *Id.* at 918.

236. *Id.* at 918-19.

237. *Id.* at 919.

238. *Id.* at 920-21.

239. *Id.*

240. *In re* King, 90 Bankr. 155 (Bankr. E.D.N.C. 1988).

241. *In re* Britton, 83 Bankr. 914 (Bankr. E.D.N.C. 1988).

242. Interview with A. Thomas Small, Bankruptcy Judge, Eastern District of North Carolina, in Raleigh, N.C. (Feb. 8, 1989).

243. *Britton*, 83 Bankr. at 921.

244. Interview with A. Thomas Small, Bankruptcy Judge, Eastern District of North Carolina, in Raleigh, N.C. (Feb. 8, 1989).

245. *Id.*

in Chapter 12.[246] If the right of set-off proves to be a problem in the rehabilitation of family farmers, Congress could limit or specify the circumstances under which the government—as debtor and creditor—may assert the right and thereby aid the bankruptcy courts in carrying out the function Chapter 12 creates for them.

B. Some Facts From the Eastern District

The Eastern District of North Carolina is comprised of 44 counties, running from the western boundaries of Granville, Wake, Harnett, Cumberland, and Robeson counties to the coast.[247] The bankruptcy court sits in Raleigh and Wilson. The purpose of this section is to present some factual data from and apparent trends in Chapter 12 litigation in the Eastern District.

The 167 Chapter 12 filings have been fairly widely dispersed throughout the Eastern District, averaging nearly four per county and ranging from a high of 13 to a low of zero.[248] The following chart indicates the total and yearly number of Chapter 12 filings in the Eastern District by county.

CHAPTER 12 FILINGS BY COUNTY[249]

County	1986*	1987	1988**	Total
Beaufort	1	4	0	5
Bertie	0	2	0	2
Bladen	0	2	0	2
Brunswick	0	3	1	4
Camden	0	0	0	0
Carteret	0	1	0	1
Chowan	0	1	1	2
Columbus	0	5	1	6
Craven	1	4	1	6
Cumberland	0	4	1	5
Currituck	0	0	0	0
Dare	0	0	0	0
Duplin	1	7	0	8
Edgecombe	0	3	0	3
Franklin	0	0	0	0
Gates	1	0	0	1
Granville	0	1	0	1
Greene	0	1	0	1

246. Creditors are denied, in particular, adequate protection of lost opportunity costs, the absolute priority rule and the fully secured election. For a discussion of these and other differences between Chapter 12 and other Bankruptcy Code Chapters, see *supra* notes 85-111 and accompanying text.

247. JUDICIAL STAFF DIRECTORY 457 (1988).

248. Case Log for Credit Bureau, 1-11 (Oct. 6, 1988).

249. *Id.*

Halifax	0	2	2	4	
Harnett	2	3	0	5	
Hertford	0	4	0	4	
Hyde	1	8	0	9	
Johnston	5	7	1	13	
Jones	0	1	0	1	
Lenoir	0	2	1	3	
Martin	3	7	1	11	
Nash	1	2	0	3	
New Hanover	0	0	0	0	
Northampton	2	7	0	9	
Onslow	0	1	0	1	
Pamlico	0	2	0	2	
Pasquotank	0	1	0	1	
Pender	0	1	0	1	
Perquimans	0	5	0	5	
Pitt	2	6	0	8	
Robeson	6	6	1	13	
Sampson	5	6	1	12	
Tyrrell	0	0	0	0	
Vance	0	0	0	0	
Wake	0	1	0	1	
Warren	0	1	0	1	
Washington	0	2	0	2	
Wayne	1	4	1	6	
Wilson	1	4	0	5	
East. Dist.	33	121	13	167	Total

* November 26 - December 31
** January 1 - August 31

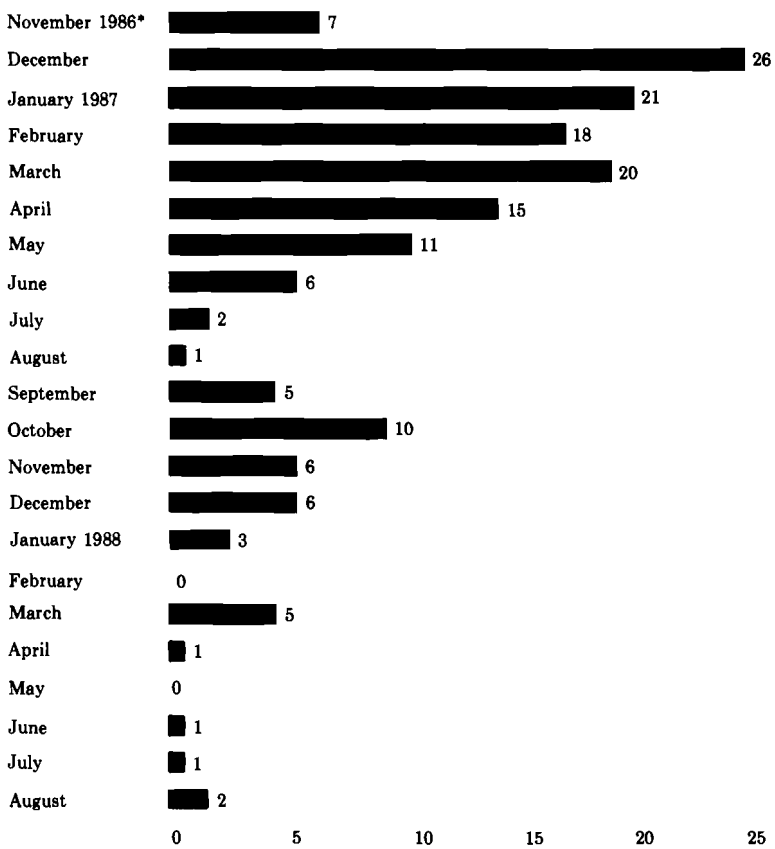
According to Judge Small,[250] almost every Chapter 12 hearing begins with a simple question and answer: "How long have you been farming?" the debtors' attorney asks. The debtor usually answers, "All my life."[251] On the page, that interrogatory is less than revealing. In the courtroom, it indicates a great deal. It indicates the "highly emotional" setting in which Chapter 12 cases occur.[252] It symbolizes the somewhat unexpected fact that older farmers, more than younger ones, are filing petitions and plans and achieving confirmation in Chapter 12.[253] Finally, the debtor's answer may express a faint hope that some details of life will remain secret; and thus, it suggests that a farmer perceives the bankruptcy court as a place where a livelihood can be restored only through a significant intervention

250. Bankruptcy Judge, Eastern District of North Carolina.
251. Interview with A. Thomas Small, Bankruptcy Judge, Eastern District of North Carolina, in Raleigh, N.C. (Feb. 8, 1989).
252. *Id.*
253. *Id.*

in a life.

There is, however, more data than that interrogatory. Four of the 167 filings occurred on the first day Chapter 12 relief became available.[254] The number of filings per month has ranged from a high of 26 to a low of zero.[255] The number of filings between November 1986 and August 1988 averaged nearly eight per month.[256] However, the number of filings was extremely high in 1986 and early 1987. Since then, filings have decreased dramatically because "creditors are giving farmers Chapter 12's" without the debtor first resorting to the courts.[257] The following graph shows the number of Chapter 12 filings by month.

NUMBER OF CHAPTER FILINGS PER MONTH (E.D.N.C.)[258]



* November 26-30.

254. Case Log for Credit Bureau 1 (Oct. 6, 1988).

255. *Id.* at 1-11.

256. *Id.*

257. Interview with A. Thomas Small, Bankruptcy Judge, Eastern District of North Carolina, in Raleigh, N.C. (Feb. 8, 1989).

258. Case Log for Credit Bureau 1-11 (Oct. 6, 1988).

Apparently, this trend toward negotiation between the debtor and creditor extends into the bankruptcy process. Judge Small "has never had to rule on the appropriate interest rate [in Chapter 12 because the parties] always work it out."[259] However, there is "always an objection" to confirmation.[260] In most cases, these objections revolve around the valuation of property and, therefore, the amount of payments under the plan.[261] The most common scenario is a low valuation of retained property by the debtor and consequently low plan payments to a secured creditor.[262] That creditor objects, claiming that the plan does not meet the feasibility requirement.[263] At that point, the parties "will go off to a corner"[264] to negotiate. When they return, the retained property is valued somewhat higher, plan payments are higher and the secured creditor withdraws the feasibility objection—despite the logical inconsistency.[265] Post-confirmation settlements involving extensions also appear to be somewhat routine.[266]

The issue of adequate protection has been noticeably absent from Chapter 12 cases because there is little time for property to deteriorate in value given "the speed" with which the cases move.[267] Thus, the fast pace of Chapter 12 is not only beneficial to creditors, but to debtors since adequate protection was often destructive of reorganization.[268] Apparently, the only disadvantage to the 90-day period between petition and plan is the tremendous strain it places on the clerk's office.[269] That burden has made it virtually impossible to grant extensions without "get[ting] off track."[270] In fact, Judge Small has granted only one extension in Chapter 12, and that was only because the debtor had a heart attack the month the plan was due.[271] Thus, attorneys filing Chapter 12 petitions should expect strict adherence to the deadlines.

Finally, a most significant provision for debtors is their ability to write down the mortgate to the value of the collateral.[272] According to Judge Small, a write-down is "always necessary with respect to the Farmers Home Administration . . . [although] frequently the Land Bank is properly collateralized."[273] The debtor's ability to write down the mort-

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259. Interview with A. Thomas Small, Bankruptcy Judge, Eastern District of North Carolina, in Raleigh, N.C. (Feb. 8, 1989).

260. *Id.*

261. *Id.*

262. *Id.*

263. *Id.*

264. *Id.*

265. *Id.*

266. *Id.*

267. *Id.*

268. Small & Moore, *supra* note 68, at IV-15-IV-16.

269. Interview with A. Thomas Small, Bankruptcy Judge, Eastern District of North Carolina, in Raleigh, N.C. (Feb. 8, 1989).

270. *Id.*

271. *Id.*

272. *Id.*

273. *Id.*

gage has been the subject of significant criticism.[274] From Judge Small's perspective, however, its use has prevented numerous foreclosure sales, thus keeping land off the market and contributing to the stabilization of land values in the Eastern District.[275]

CONCLUSION

This inquiry into Chapter 12 of the Bankruptcy Code began with the assumption that the statute's sunset provision was an invitation to participate in future political battles. That assumption was extended to suggest that those battles would be waged with a variety of conflicting economic data and their lines drawn according to the relative health of the farm economy. After acknowledging various disagreements of both a factual and a normative nature regarding the economic merits of Chapter 12, this comment posed a potentially more fundamental "political" question: Assuming the factual data justifying the enactment of Chapter 12 was accurate and that the policy underlying it was good, or at least expedient, could the courts successfully implement that policy?

While that question was central to this comment, there was an implicit recognition that its answer would be of little import to clients or attorneys facing deadlines. Instead, the legal questions of eligibility, conversion, plan requirements, and relevant judicial decisions and factual data from the Eastern District of North Carolina became the focus. The answers to those quesions, however, revealed several "tensions" in the judicial decision-making process which provide a basis for an affirmative answer to the question of whether courts can successfully effectuate a particular economic policy.

A tension between rule-making and case-by-case reasoning appeared in the context of eligibility. In the context of conversion, a tension existed between assuming the power to act and requiring explicit authority before acting. Where two federal laws conflicted, the court sought to justify its ability to weigh policy through the authority to choose controlling law. The judicial role itself—recognizing rights and providing remedies—and the specific policy goals of Chapter 12—providing effective rehabilitation to family farmers—clashed when the court considered the government's assertion of a right of set-off.

The court's resolution of these tensions suggests a decision-making process that involves numerous levels of conflict. In each case, courts must resolve not only the dispute of the parties before them but numerous subsurface conflicts between competing theories, authority and policy. Likewise, the economy is presumptively competitive on a variety of levels—within and across markets and between contracting parties seeking the better part of a bargain. Thus, both judges and economic actors appreciate the significance of competition to effective decisionmaking; they also recognize that apparent or express goals are often less influen-

274. *Id.*
275. *Id.*

tial than underlying ones. These similarities should enable courts to implement a particular economic policy with success.

The characteristic which distinguishes the two is that legal battles are most often winner-take-all events while economic battles are usually less decisive. Of course, the resolution of the disputes of numerous creditors and a debtor in a single forum, and the likelihood of negotiated settlements there can significantly mitigate a winner-take-all result. However, even where negotiations break down, this distinction between legal and economic battles does not impede a court's ability to effectuate economic policy because, while the particular case may be decisive for one party, the court simultaneously compromises the underlying conflicts presented by the case, thereby retaining the ability to orchestrate a different result in future cases. The distinction becomes significant, when the court is required to resolve an underlying conflict between accomplishing its more general judicial role and effectuating a particular economic policy in order to decide the case before it. In that situation, both the immediate dispute and the underlying conflict have winner-take-all results; the demands of the judicial role are accepted and the particular economic policy is rejected.

Congress accurately assumed that courts could effectuate a policy of family farmer rehabilitation. If it chooses to continue that system by reenacting Chapter 12, two specific amendments—one regarding conversion and the other regarding post-confirmation modification—have been suggested within this comment. On a more general level, however, Congress should consider whether potential conflicts between its overall farm policy and Chapter 12—particularly where the government is both the farmers' debtor and creditor—can be resolved without undercutting the goals of either.

A. Lee Hogewood, III