The Bankruptcy Reform Act of 1978 and the Farmer: A Survey of Applicable Provisions

by

J.W. Looney

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THE BANKRUPTCY REFORM ACT OF 1978 AND THE FARMER: A SURVEY OF APPLICABLE PROVISIONS

J.W. LOONEY*

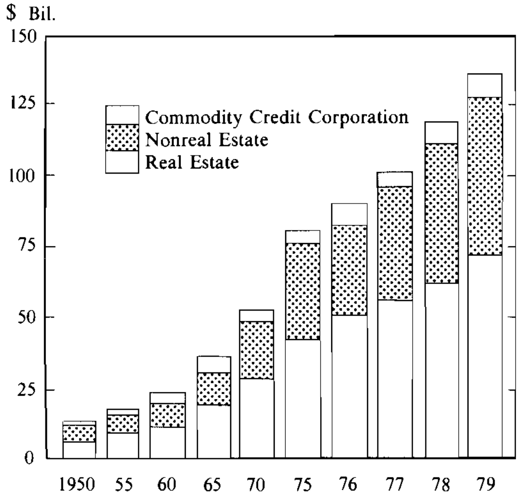
The Bankruptcy Reform Act of 1978 includes several provisions that apply directly to the farmer facing bankruptcy. This article summarizes each of these provisions and analyzes its potential impact.

INTRODUCTION

The Bankruptcy Reform Act of 1978[1] made a number of significant changes in the substantive law of bankruptcy. While these changes generally affect any debtor facing bankruptcy, there are a number of provisions that directly affect the farmer-debtor. Now more than ever, farmers are using a significantly large amount of credit. In view of this trend, the provisions of the new Bankruptcy Act are of increased importance.

According to recent United States Department of Agriculture data, indebtedness per farm has increased from an average of $2,200 in 1950 to $52,100 at the beginning of 1979.[2] Farm debt totaled 137.5 billion dollars in early 1979.[3] The value of farm assets has increased at a rate roughly parallel to the growth in farm debt. The average investment in farmland, machinery, livestock, and other assets was $310,000 in 1979.[4]

Farm Debt[5]



Farm loans outstanding January 1, 1979 preliminary.

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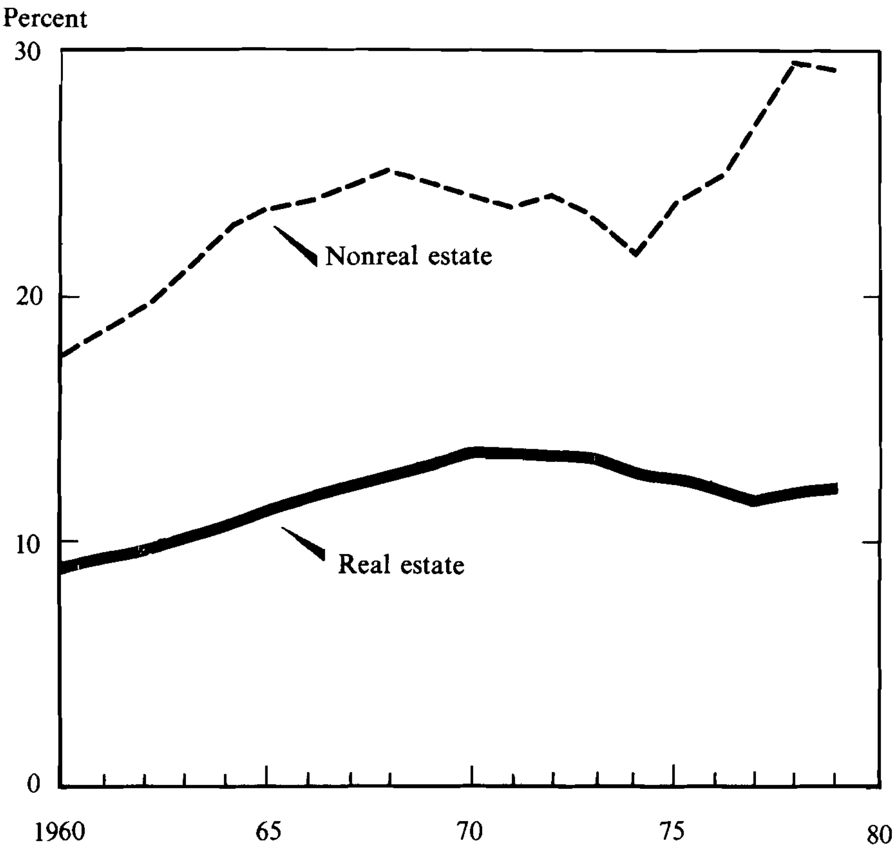
* B.S.A., University of Arkansas, 1966; M.S., University of Missouri, 1968; J.D., University of Missouri-Kansas City, 1971; M.S., University of Missouri, 1976; Associate Professor, Agricultural Law, Kansas State University; Member of Arkansas, Missouri and Virginia Bars.

1. Pub. L. No. 95-593, 92 Stat. 2549 (1978).
2. U.S. DEP'T OF AGRICULTURE NO. 561, 1979 HANDBOOK OF AGRICULTURAL CHARTS (1979).
3. *Id.*
4. *Id.* at 10-11.
5. *Id.*

While both farm debt and the value of farm assets have increased significantly in recent years, the most revealing data is that of the debt-to-asset ratio for non-real estate items. This ratio has moved upward to nearly thirty percent in recent years.[6]

Farm Debts as Percent of Assets[7]



Debt is shown as percent real estate debts to real estate assets and percent nonreal estate debts to nonreal estate assets.
Data as of January 1, 1979

The increasing debt-to-asset ratio reflects the increasing use of credit by farmers for operating expenses and capital expenditures. This increased reliance on borrowing as a source of funds, rather than internal financing, raises the spector of bankruptcy for some farmers, particularly if fluctuating farm product prices result in abnormally low income years. Per capita income for the farm population has generally been below that for non-farmers

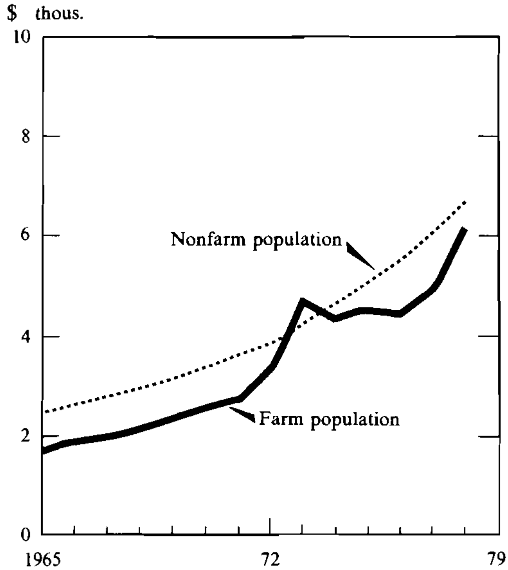
6. *Id.* at 10.
7. *Id.*

and is considerably more variable.[8]

The increasing use of credit by farmers has accompanied the increasing use of consumer credit. The increase in total farm debt to 137.5 billion dollars in 1979 is small in comparison to the 1979 figure for total consumer

8. *Id.* at 9.

Disposable Income per Capita



Disposable personal income represents income from all sources less personal contributions for social insurance and personal tax and nontax payments.

Disposable Income Per Capita

	1975	1976	1977	1978
		Dollars		
Per capita income from all sources:				
Total population	5,088	5,505	6,018	6,673
Farm population	4,520	4,314	4,946	6,069
Nonfarm population	5,113	5,553	6,058	6,696
		Percent		
Farm as percentage of nonfarm	88.4	77.7	81.6	90.6

Data from *Farm Income Statistics*, 1979 (ESCS).

credit outstanding, which reached 288 billion dollars.[9] This is an eighteen percent increase from the previous year and is over $1300 per capita.[10] The tremendous increase in the use of credit for personal, family, and household purposes has been paralleled by a 2000 percent increase in the number of bankruptcies since World War II.[11]

Prior to the Bankruptcy Reform Act of 1978, a number of problems existed in accomodating the "consumer credit society." In 1970, Congress directed attention to these problems by creating the Commission on Bankruptcy Laws of the United States. Following the Commission report in 1973, Congress drafted a series of legislative proposals directed at the inadequacies in the existing law and the inefficiencies in the bankruptcy system itself.[12] These proposals culminated in the Bankruptcy Reform Act of 1978, which was designed to modernize and update existing bankruptcy law.[13] The new Act greatly alters the status and role of bankruptcy courts and includes provisions for presidential appointment, and Senate confirmation,[14] and expanded jurisdiction.[15] The Act also makes a number of significant changes in the substantive law of bankruptcy.[16]

While all of these changes have an impact on any debtor facing bankruptcy, this article will focus on four specific provisions having a direct impact on the farmer-debtor, and one having an indirect impact on some farmers. First, farmers continue to be exempt from involuntary bankruptcy proceedings. Second, a new debtor rehabilitation chapter is applicable to wage earners and individuals with regular income, including farmers. Third, farm products are defined as inventory for purposes of bankruptcy, and new voidable preference provisions can directly affect the secured creditor who holds a perfected security interest in farm products under Article 9 of the Uniform Commercial Code. Fourth, provisions applicable to property held in joint tenancy and tenancy by the entirety affect a majority of

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9. AGRICULTURAL HANDBOOK, *supra* note 2 at 66; for documentation of the increasing reliance on consumer credit *see* COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. DOC. NO. 137, 93rd Cong., 1st Sess. 33-59 (1973) [hereinafter cited as H.R. DOC. NO. 137].

10. *Id.*

11. HOUSE COMMITTEE ON THE JUDICIARY, H.R. REP. NO. 595, 95th Cong., 1st Sess. 116 (1977) [hereinafter cited as H.R. REP. NO. 595].

12. *See* H.R. DOC. NO. 137, *supra* note 9. The later H.R. REP. NO. 595, *supra* note 11, also reemphasized that prior law was directed toward business bankruptcies and that the system itself contributed to the ineffectiveness of the bankruptcy remedy, especially for the consumer debtor.

13. H.R. DOC. NO. 137, *supra* note 9, and the views of the National Bankruptcy Conference and the National Conference of Bankruptcy Judges were influential in the eventual legislative product. *See*, Aaron, *The Bankruptcy Reform Act of 1978: The Full Employment-For-Lawyers Bill Part I: Overview and Legislative History*, 1979 UTAH L. REV. 1; *Part II: Consumer Bankruptcy*, 1979 UTAH L. REV. 175 [hereinafter cited as Aaron, *Part II*]; *Part III: Business Bankruptcy*, 1979 UTAH L. REV. 405 (1979) [hereinafter cited as Aaron, *Part III*].

14. 28 U.S.C. §§ 152-53 (Supp. II 1979).

15. 28 U.S.C. § 1471 (Supp. II 1979).

16. For a general review of the new Act *see* Klein, *The Bankruptcy Reform Act of 1978*, 53 AM. BANKR. L.J. 1 (1979); H. LAVIEN, BANKRUPTCY FORMS (1979). For a thorough analysis *see* Aaron, *supra* note 13; COLLIER ON BANKRUPTCY, (15th Edition 1979).

farmers since a substantial amount of farm property is held in these co-ownership arrangements. Finally, the new Act specifically addresses the rights of customers of bankrupt commodity brokerage firms. Many farmers deal with commodity brokerage firms ("futures commission merchants") in the buying and selling of futures contracts. The Act recognizes the unique problems that may develop upon bankruptcy of these firms. The Act also addresses particular problems that may arise in the handling of assets of a bankrupt customer of futures commission merchants.

EXEMPTION FROM INVOLUNTARY BANKRUPTCY

Involuntary bankruptcy petitions may be filed by creditors under either Chapter 7 (liquidation) or Chapter 11 (reorganization) of the Bankruptcy Act. Under Chapter 7 the petitioning creditor seeks to have the debtor's assets distributed for the benefit of creditors. Under a Chapter 11 involuntary bankruptcy petition the creditors seek to force a reorganization of the business-debtor and set up a specific plan for the payment of debts.

Under section 303 of the Bankruptcy Code the creditors of an insolvent debtor may petition to have the debtor adjudged an involuntary bankrupt if the creditors' claims aggregate at least $5,000 more than the value of any security held by the creditors.[17] At least three creditors must join in the petition if the debtor has twelve or more creditors. Such an involuntary proceeding is available only for Chapter 7 (liquidations) or Chapter 11 (reorganization). It is not available for Chapter 13, debtor rehabilitation plans.

Under the Bankruptcy Reform Act farmers continue to be exempt from involuntary petitions.[18] The retention of this exemption is evidence of congressional recognition of the special nature of the farm business. The policy of excluding farmers from involuntary bankruptcy has been questioned,[19] but the reason for continuing the exemption was clearly stated in the House Report: "One drought year or one year of low prices, as a result of which a farmer is temporarily unable to pay his creditors, should not subject him to involuntary bankruptcy."[20] The exemption is obviously based on the cyclical and unpredictable nature of the farm business.

17. 11 U.S.C. § 303(b) (Supp. II 1979). The number of involuntary petitions has been only a fraction of the total number of bankruptcies. *See* [1978] DIRECTOR OF THE ADMINISTRATIVE OFFICE OF THE UNITED STATES COURTS, ANN. REP. 14. This fact was apparently a major concern and resulted in a revamping of the provisions for involuntary petitions to encourage their use when appropriate. Aaron, *Part II, supra* note 13, at 411-13.

18. 11 U.S.C. § 303(a) (Supp. II 1979). The provision for conversion or dismissal reinforces the section 303(a) exemption for farmers. If a case is commenced under Chapter 11, reorganization, the debtor has remained in possession of the property and continued to operate the business and the debtor requests a conversion to Chapter 7, liquidation, this is normally granted. If the conversion request is by a party in interest other than the debtor, however, the consent of the debtor is required to convert to a liquidation proceeding if the debtor is a farmer. 11 U.S.C. §§ 1307(c)-1307(e) (Supp. II 1979).

19. Aaron, *Part III, supra* note 13, at 409.

20. H.R. REP. NO. 595 at 322.

For purposes of this exemption, a "farmer" is defined as a person who, during the previous taxable year, received more than eighty percent of his gross taxable income from a farming operation which he owned or operated.[21] A "farming operation" includes "farming, tillage of the soil, dairy farming, ranching, production or raising of crops, poultry, or livestock, and production of poultry or livestock products in an unmanufactured state."[22]

Definition of Farmer

The debate relating to the exemption of farmers from involuntary bankruptcy centers around the definition of "farmer" and whether entities other than individuals should be exempt if engaged in a farming operation. The Commission on the Bankruptcy Laws of the United States recommended relief from involuntary petition only for the individual farmer who received at least one-half of his gross income from farming.[23] This proposal limited the exclusion to individual farmers; corporations and partnerships would not have been eligible. Nevertheless, under the House version of H.R. 8200, individuals, partnerships or corporations (but not governmental units) could qualify as farmers and thereby be exempt from involuntary petitions. "Person", as used in the Act, includes partnerships and corporations as well as individuals.[24] The House version contained both an earnings percentage limitation and a dollar limitation. The original House committee version of H.R. 8200 defined "farmers" as those who received more than seventy-five percent of their gross income from a farming operation and whose annual gross income was less than $275,000.[25] The Senate version, S. 2266, omitted the dollar limitation. No dollar limitation appeared in the final version and the gross income percentage limitation was increased to eighty percent.[26]

The definition of "farmer" could conceivably extend the exclusion to a so called "corporate farm" since no limitation on the form of business organization nor dollar income limitations are included in the new definition. It appears that the original intent of Congress was to limit the exclusion to small farmers.[27] The percentage of gross income test eliminates the protection offered by the exclusion to the non-farm business owner who has substantial income from non-farm sources. Nevertheless, the large firm that owns and operates a farm and can meet the percentage income test is exempt from involuntary petitions.[28]

21. 11 U.S.C. § 101(17) (Supp. II 1979).
22. 11 U.S.C. § 101(18) (Supp. II 1979).
23. H.R. Doc. No. 137, *supra* note 9.
24. 11 U.S.C. § 101(30) (Supp. II 1979).
25. H.R. Rep. No. 595, *supra* note 11, at 311.
26. 11 U.S.C. § 101(17) (Supp. II 1979).
27. *Id.* at 311, 322.
28. The 80% limitation could conceivably *exclude* some small operators from the definition of "farmer." Not only does non-farm income of the average farmer exceed income from farm

Bankruptcy law prior to the 1978 Act contained neither an income limitation nor a percentage of gross income requirement. A "farmer" was considered to be one who was chiefly engaged in farming.[29] The court had to determine whether a person was a farmer at the time an "act of bankruptcy" occurred.[30] This determination was factual in nature. Cases on this point focused on determining whether farming was the chief occupation of the debtor and considered such factors as the permanency of the business, the reliance on the business as a means of livelihood, the capital, time and physical effort devoted to the business, the degree of involvement in other businesses, and the relative importance of all of the debtor's activities.[31]

The new definition of "farmer" and "farming operation" in the new Act should alleviate some of the difficulty in determining when the exemption is proper. By adding the phrase "in farming operations owned or operated by such person" to the definition of a farmer, a wide range of persons who could not have qualified as farmers under the old definition should now qualify. The addition of the eighty percent gross taxable income limitation test, which can be easily calculated, should help eliminate definitional problems. This, coupled with resolution of the question of whether partnerships and corporations can be exempt if engaged in farming operations, should eliminate the uncertainty generated by the prior definition.

"Corporate Farming"

The debate relating to the exemption of farm corporations from involuntary bankruptcy reflects Congress' continued concern for the structure of agriculture and the preservation of the family farm. Considerable attention has focused on the corporate farm, with some suggesting that the increasing involvement of corporations in farming is a threat to the traditional family farm.[32] The data, however, does not seem to support allegations that non-farm corporations are gaining control and ownership of farm resources.

While ninety percent of those farms with $2,500 or more in annual sales are individually owned, partnerships account for nine percent, and corpora-

sources, but it is the families with smaller farms that depend most heavily on off-farm sources of income. *See* AGRICULTURAL HANDBOOK *supra* note 2, at 8-9.

29. 11 U.S.C. § 1(17) (1976).

30. For a general discussion of the definitional problem *see* 8 C.J.S., *Bankruptcy* § 95 (1962) and cases cited therein. Note that under the prior law, in order to initiate an involuntary petition the creditors had to allege one of the six acts of bankruptcy. Under 11 U.S.C. § 21(a) (1976) (old law) the acts were: 1) fraudulent transfer or concealment; 2) preferential transfer; 3) failure to remove a lien thirty days from imposition or five days before sale; 4) general assignment for benefit of creditors; 5) appointment of a general receiver; and 6) an admission by the debtor, in writing, of inability to pay debts and a willingness to be adjudicated. The new law eliminated these acts. Instead the new grounds are 1) inability to pay debts as they become due; or 2) appointment of a general custodian over the debtor's property within 120 days preceding the involuntary petition. 11 U.S.C. § 303(h) (Supp. II 1979).

31. *See* cases referred to in *supra* note 30.

32. *See The Family Farm: Hearings on the Family Farm Before the Subcomm. on Family Farms of the House Comm. on Agriculture*, 88th Cong., 1st Sess. (1963).

tions less than two percent.[33] Eighty-seven percent of the corporations engaged in farming derived fifty percent or more of their corporate receipts from farming. In addition, seventy-five percent of the corporations engaged in farming are family-owned. In 1974, publicly-held corporations represented about 0.5 percent of all farms and only about 3.5 percent of total farm product sales.[34]

It appears that the concern for exempting farm corporations from involuntary bankruptcy is misdirected. Based on the latest data, only 162 publicly-held corporations were engaged primarily in farming, that is, had over fifty percent of corporate receipts from farming.[35] Applying the eighty percent gross income test to that figure indicates that the number of farm corporations qualifying for the exemption is probably insignificant. Generally, the involuntary bankruptcy exemption for farmers remains intact under the new Act. Moreover, the new Act clarifies the application of this provision by providing a more realistic and workable definition of who qualifies as a farmer for purposes of this exemption.

DEBTOR REHABILITATION PLANS

Under previous bankruptcy law, Chapter 13 was designed to prevent the wage earner from being forced into a "straight" bankruptcy proceeding, that is, a liquidation of assets to pay debts. The provisions of Chapter 13 provided for debtor rehabilitation by allowing a debtor to submit a plan for paying off debts, in whole or part, over an extended period of time. The debtor did not have to relinquish his or her property but was required to pay off the debt from future earnings. These provisions were available to an individual whose principal source of income was wages, salary, and commissions. The resulting payment plans were frequently referred to as "wage earner plans."[36]

Under previous bankruptcy law no comparable relief was available to the self-employed individual, even if his income was sufficiently regular and at a level providing an adequate source for debt repayment. The farmer, as a self-employed individual, had no alternative but liquidation through a straight bankruptcy proceeding.

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33. Reimund, *Form of Business Organization*, U.S. DEPT. OF AGRICULTURE, AGRICULTURAL ECONOMICS REPORT 438 (1979). Data from 1974 Census of Agriculture survey of farm corporations reported therein.

34. *Id.* at 129. Publicly-held corporations with less than 50% of corporate receipts from farming account for only 3% of the total number engaged in farming. Schertz, *Farming in the United States*, U.S. DEPT. OF AGRICULTURE, AGRICULTURAL ECONOMICS REPORT 438 (1979).

35. *Id.* at 30.

36. For a general discussion of the effectiveness of these plans *see* Boren and Ralston, *Chapter XIII Wage Earner Plans: an Analysis of Their Effectiveness*, 15 AM. BUS. L.J. 293 (1978).

The Farmer's Access to Chapter 13

Under the Bankruptcy Reform Act, the farmer-debtor is now granted access to Chapter 13 and may pursue the alternative of debtor rehabilitation rather than liquidation.[37] The new provisions apply to any individual (but not corporations or partnerships) with regular income, including those engaged in business, self-employed debtors, farmers and entrepreneurs, if the individual falls within a specified debt limit.[38] To qualify, the individual must have less than $100,000 in liquidated, noncontingent, unsecured debts and less than $350,000 in liquidated, non-contingent, secured debts at the time of filing for bankruptcy.[39] Under these provisions, a large number of sole proprietors and self-employed individuals are eligible for debtor rehabilitation who were unable to qualify for such relief under prior law. It is reasonable to anticipate an increase in filings by farmers under these provisions, although the question remains whether the farmer is an individual with "regular income."[40] The courts will undoubtedly be called upon to resolve the possible question of whether a farmer has "regular income" for Chapter 13 purposes.[41]

As one of the requirements for approval of a plan under Chapter 13, the bankruptcy court must determine that the debtor is able to make the payments called for under the plan.[42] The debtor, however, is given exclusive rights to propose a repayment plan.[43] In view of this requirement, it appears that a farmer whose income is sufficiently regular and stable should be able to propose a realistic plan that will satisfy a court's concern as to feasibility. No requirement of weekly or monthly payments is mentioned in the Act and did not appear in either the House Report or the earlier Commission Report.[44] It would seem that many farmers could easily show "regular income," even if the income is derived from annual crops. The more difficult question is whether the income is sufficiently stable to satisfy a court that a repayment schedule can be met. As recognized in the congressional discus-

37. For a discussion of the changes in Chapter 13, *see*, Aaron, *Part II, supra* note 13; Anderson, *Debtor and Creditor Consumers and the Bankruptcy Reform Act*, 2 W. NEW ENG. L. REV. 5 (1979); Biery, *Debt Adjustment Under Chapter 13 of th Bankruptcy Reform Act of 1978*, 11 ST. MARY'S L.J. 473 (1979); Lee, *Chapter 13 nee Chapter XIII*, 53 AM. BANKR. L.J. 303 (1979); Merrick, *Chapter 13 of the Bankruptcy Reform Act of 1978*, 56 DEN. L.J. 585 (1979).

38. 11 U.S.C. § 109(e) (Supp. II 1979). Stockbrokers and commodity brokers are not allowed to file for relief under this section.

39. *Id.*

40. It appears that Congress intended to include small farmers in the category of eligible individuals. The House Report expressed concern that dollar limits on secured debt would "freeze out" many businesses for which Chapter 13 relief is appropriate. A "small farmer" with secured debts of $500,000 was used as an example of such a business. H.R. REP. NO. 595, *supra* note 11, at 119.

41. Lee, *supra* note 37, at 304.

42. 11 U.S.C. § 1325(a)(6) (Supp. II 1979).

43. 11 U.S.C. § 1321 (Supp. II 1979).

44. H.R. DOC. NO. 137 *supra* note 9 at 164 used this phrase: "regular income out of which a predetermined *periodical payment* can be made and applied *regularly* to the reduction of the creditor's debts" (emphasis added).

sion of exemption from involuntary proceedings, the farmer's business is both cyclical and unpredictable.[45] The question may be more easily resolved if the courts take a liberal view in interpreting congressional intent. The House Report used examples of small businessmen and other self-employed individuals—barber, a grocer, worm digger, house painter, and independent carpenter—who are eligible for Chapter 13 relief despite unpredictable income levels.[46] The tenor of the House Report itself indicates an intent to encourage Chapter 13 rehabilitation rather than straight bankruptcy liquidation. Some courts were even willing to broadly construe the concept of a "wage earner" under prior law. Included as "wage earners" were persons whose sole income was from social security benefits,[47] unemployment benefits[48] or from self employment as a carpenter.[49]

Assuming a court concluded that a particular farmer's income was not sufficiently regular or stable to permit approval of a Chapter 13 plan, the farmer-debtor would still be able to obtain relief under Chapter 11, business reorganization.[50] New Chapter 11 is a consolidation of three prior chapters dealing with some aspect of business debts.[51] Voluntary reorganization proceedings are available under new Chapter 11 for businesses including sole proprietorships, partnerships or corporations.[52] Thus, the farmer who voluntarily elects to file under Chapter 11 may be allowed to remain in possession and continue to operate the business.

Although Chapter 11 is available as an option to the farmer, Chapter 13 offers several advantages. Under Chapter 13 the debtor may be able to pay off the debts in a less expensive and less complex manner.[53] Additionally, only the debtor may file a plan under Chapter 13, creditor acceptance of a rehabilitation plan is not required, and Chapter 13 makes no provision for creditors' committees.[54] As one authority notes, "[t]he Chapter 13 debtor can utilize many of the favorable provisions of Chapter 11 while avoiding many of the problems."[55] The obvious advantages of Chapter 13 were detailed in the House Report as follows:

45. *Id.* at 322. While price variation would account for much of the unpredictability of income for producers of most commodities, an obvious exception would be the dairy farmer. Milk prices should be relatively stable due to federal milk marketing orders which establish a system for pricing. For a discussion of milk order regulation *see*, Masson and Eisenstat, *The Pricing Policies and Goals of Federal Milk Order Regulation: Time for Reevaluation*, 23 S.D.L. REV. 662 (1978).

46. H.R. REP. No. 595, *supra* note 11, at 119.

47. *In re* Bradford, 268 F. Supp. 896 (N.D. Ala. 1967).

48. *In re* Wilson, 4 COLLIER BANKR. CAS. 10 (D.P.R. 1975).

49. *In re* Reed, 368 F. Supp. 615 (E.D. Va. 1968).

50. *See* Lee, *supra* note 37, at 304; H.R. REP. No. 595, *supra* note 11, at 119.

51. Under prior law, Chapter X dealt with reorganizations of corporations, Chapter XI with business continuation arrangements, and Chapter XII with arrangements for non-corporate debtors involved in real estate. All three were consolidated into Chapter 11 in the new Act.

52. 11 U.S.C. § 109(b) (Supp. II 1979).

53. Biery, *supra* note 37, at 500; H.R. REP. No. 595, *supra* note 11, at 118.

54. Biery, *supra* note 37 at 501.

55. *Id.* at 500. Lavien, *supra* n.16 at 674-75.

> The purpose of chapter 13 is to enable an individual, under court supervision and protection, to develop and perform under a plan for the repayment of his debts over an extended period. In some cases, the plan will call for full repayment. In others, it may offer creditors a percentage of their claims in full settlement. During the repayment period, creditors may not harrass the debtor or seek to collect their debts. They must receive payments only under the plan. This protection relieves the debtor from indirect and direct pressures from creditors, and enables him to support himself and his dependents while repaying his creditors at the same time.[56]

Secured Creditors and Chapter 13

Under prior bankruptcy law secured creditors had three options when a debtor filed a bankruptcy petition: (1) the creditor could waive the security interest and be treated as an unsecured creditor; (2) the creditor could affirm the security interest and file a claim in bankruptcy for any deficiency; or (3) the creditor could rely on the collateral for repayment.[57]

Under the new law, all creditors, including secured creditors, may file a proof of claim and it is deemed allowed unless a party in interest objects.[58] Under the new Chapter 13 provisions, a secured creditor whose interest is "dealt with" in the proceeding must consent to the debtor's rehabilitation plan.[59] If the secured debtor does not accept the plan, the debtor may (a) allow the secured creditor to retain the lien and distribute to the secured creditor (under the plan) an amount no less than the allowed amount of the claim, or (b) surrender the property to the creditor.[60] The "allowed amount" of the secured claim is the value of the collateral.[61] The remainder of the claim is treated as unsecured. The impact of these provisions is of particular importance in situations where the collateral has little resale value. In such cases, the cost of replacement to the debtor is high and the threat of repossession operates as pressure on the debtor. Most of this pressure is relieved by the option which allows the debtor to have the value of such collateral established and distribution of payments provided for in the plan.[62]

In the farm situation, the non-real estate debts of farmers are frequently covered by a security agreement providing for a security interest not only in collateral such as machinery and equipment, livestock and crops, but also in

56. H.R. REP. No. 595, *supra* note 11, at 118.

57. *See* Zilavy, *Enforcement of Secured Transactions: Self-Help and Civil Actions in Agricultural Transactions* and Martin, *Treatment of Secured Creditors and Collateral Under Present Law and Under the Bankruptcy Reform Act of 1978* in ALI-ABA TAX AND BUSINESS AND PLANNING FOR AGRICULTURE (1979); Hagedorn, *The Survival and Enforcement of the Secured Claim Under the Bankruptcy Reform Act of 1978*, 54 AM. BANKR. L.J. 1 (1980).

58. 11 U.S.C. §§ 501, 502(a) (Supp. II 1979).

59. 11 U.S.C. § 1325(a)(5) (Supp. II 1979). If a secured creditor does not consent, the plan must provide him with a lien securing his claim. 11 U.S.C. 1325(a)(5)(B)(i) (Supp. II 1979).

60. 11 U.S.C. § 1325(a)(5)(B) and (C) (Supp. II 1979).

61. 11 U.S.C. § 1325(a)(5)(B)(ii) (Supp. II 1979).

62. *Id.*

the proceeds from the sale of that collateral. Most security agreements include after-acquired property clauses, which could result in the majority of a farmer's non-real estate assets being covered by the agreement. Thus the secured creditor would either receive the property itself or be paid the value of the property in payments scheduled under the plan. As to any difference in value, the creditor would stand as an unsecured creditor.[63]

The majority of farm debt is secured by real estate.[64] Under prior law, wage earner plans did not cover debts secured by real estate mortgages.[65] The 1978 Act excludes claims secured only by the principal residence of the debtor, but other claims secured by real property can be modified by the plan.[66] Even if the rights of creditors with liens on the residence cannot be modified, it is likely that the creditor can be stayed from foreclosing and that the plan can provide for payment of arrearages.[67] Current payments would be made outside the plan. Thus, the plan can still be useful even if a large portion of farm debt is secured debt, since under the new Act, real property claims can be modified in the plan. The plan could provide for the curing of any default on real estate mortgages and for payments due during the term of the plan.[68]

Discharge

Chapter 13 may be particularly attractive to farmers in light of provisions allowing the debtor to receive discharge after three years, even if the debtor has failed to complete payments. To receive such a discharge, the debtor must show that the failure was "due to circumstances for which the debtor should not justly be held accountable," that modification of the plan is not practicable and that unsecured creditors have received at least as much as they would have in liquidation.[69] For the farmer, these provisions could open the door to discharge. Weather factors and changes in government programs and policies—such as grain embargos—can result in price levels and production levels below normal. As a result, the farmer-debtor could arguably receive discharge for failure to complete payments on the basis of these or similar circumstances, even if a plan has not been completed.

Long-term debt, however, with payments extending beyond the term of

63. *Id.*
64. *See* AGRICULTURAL HANDBOOK, *supra* note 2.
65. *See* §§ 606(1), (4), 646(2) of the old Act were previously codified as 11 U.S.C. §§ 1006(1), (4), 1046(2); also *see* Lavien, *supra* note 16 at 671.
66. 11 U.S.C. § 1322(b)(2) (Supp. II 1979).
67. *See* 11 U.S.C. § 362(e) (Supp. II 1979) regarding the stay. Cases under prior law held that while the plan could not provide for payment of real estate mortgages, the debtor could prevent foreclosure by providing payment of arrearages. Such an action was acceptable because it did not "materially and adversely affecting the rights of the creditors." For a general discussion on this point *see* Biery, *supra* note 37 at 482-83 and cases cited therein at n.66.
68. 11 U.S.C. § 1322(b)(5) (Supp. II 1979).
69. 11 U.S.C. § 1328(b) (Supp. II 1979).

the plan, cannot be discharged under the hardship provisions. In all probability, farm debt will be secured debt with payments scheduled for longer than the usual three to five year terms of the plan.[70] Furthermore, short term debt is often secured debt and, presumably, subject to the lien of the secured creditor. Therefore a hardship discharge may have no effect on a significant portion of the total debt.

Clearly, the broadened provisions of Chapter 13 offer new alternatives for the farmer-debtor. The extent to which farmers will utilize these new options is yet to be determined. But the advantages offered by this chapter make an evaluation of the alternatives essential when confronted with the prospect of bankruptcy.

VOIDABLE PREFERENCES

A transfer of property by the debtor prior to a voluntary bankruptcy petition may be nullified under provisions regulating voidable preferences. Generally, the trustee in bankruptcy has the power to avoid transfer of property of the debtor if five conditions are met. The transfer can be avoided if the transfer was:

(1) to or for the benefit of a creditor;
(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
(3) made while the debtor was insolvent;
(4) made—
 (A) on or within 90 days before the date of the filing of the petition; or
 (B) between 90 days and one year before the filing of the petition, if such creditor, at the time of such transfer—
  (i) was an insider; and
  (ii) had reasonable cause to believe the debtor was insolvent at the time of such transfer; and
(5) that enables such creditor to receive more than such creditor would receive if—
 (A) the case were a case under Chapter 7 of this title;
 (B) the transfer had not been made; and
 (C) such creditor received payment of such debt to the extent provided by the provisions of this title.[71]

This provision protects those creditors who are prejudiced by such transfers and therefore provides for equal treatment of all creditors similarly stated.

The voidable preferences section of new Act made significant changes

70. 11 U.S.C. § 1322(c) (Supp. II 1979). Data compiled for 1978 from the records of 2655 Kansas farm operators revealed that the average short term (current) debt for these farmers was $61,505, intermediate $9,793 and long-term $59,086. The amount of short-term debt exceeded the level of the long term loans only for those operators with annual gross income in excess of $200,000. COOPERATIVE EXTENSION SERVICE DEPT. OF ECONOMICS, KANSAS STATE UNIVERSITY. FARM MANAGEMENT: STATE SUMMARY AND ANALYSIS REPORT (1978).

71. 11 U.S.C. § 547(b) (Supp. II 1979).

that specifically affect the secured interest under Article 9 of the Uniform Commercial Code.[72] These changes include various exceptions to the voiding power of the trustee. The exceptions are detailed in the new Act.[73] One of the exceptions specifically applies to farm products. In bankruptcy, "inventory" is defined to include farm products such as crops or livestock, held for sale or lease.[74] This definition is broader than that of "inventory" as defined in section 9-109(4) of the Uniform Commercial Code. Farm products are separately defined in section 9-109(3) of the Uniform Commercial Code.

Under the voidable preference provisions of the Bankruptcy Act, a transfer to a creditor with a security interest in a floating mass, such as inventory or accounts receivable, is subject to attack by the trustee if the creditor's position is improved during the ninety day period prior to filing of the bankruptcy petition.[75] Improvement of the creditor's position results when the creditor acquires a lien on additional, after-acquired receivables or inventory during this ninety day period, and no new advances are made to match the improved position.

Applying this provision to a typical agricultural financing transaction raises the possibility of preferences occurring in ordinary events such as the harvest of farm products shortly before bankruptcy. Since little value is normally attributed to unharvested crops, a secured lender might show little collateral value on his books until harvest. After harvest the value of the collateral may increase significantly and could arguably be considered as a preferential transfer under section 547(c)(5).[76]

Professor Clark argues that in such situations there is no preference. He contends that even though there is "improvement in position," there is no "transfer" within the meaning of the Act and no prejudice to the estate of the debtor.[77] The increased value of the collateral does not result from an expenditure of the debtor's unencumbered assets, but rather from the natural increase in the value of the collateral. Professor Clark provides further explanation:

> Assuming that the creditor had at all times a perfected security interest in the crops, there is no secret lien. There is no last-minute disposition of property from debtor to preferred creditor. There is no "floating mass" involving the constant replacement of inventory or accounts. There is in fact nothing more than a realization of collateral which was

72. *See* Clark, *Preferences Under the Old and New Bankruptcy Acts*, 12 U.C.C. L.J. 154 (1979); Orr and Klee, *Secured Creditors Under the New Bankruptcy Code*, 11 U.C.C. L.J. 312 (1979).
73. 11 U.S.C. § 547(c) (Supp. II 1979).
74. 11 U.S.C. § 547(a)(1) (Supp. II 1979).
75. 11 U.S.C. § 547(c)(5) (Supp. II 1979).
76. This possibility has been raised by Clark *supra* note 72, at 180 and is also discussed by Mann and Phillips, *Floating Liens as Preferential Transfers Under the Bankruptcy Reform Act*, 85 COMM. L.J. 7 (1980).
77. Clark, *supra* note 72, at 180.

there all the time and which has increased in value relative to the amount of the debt.[78]

Professor Clark's argument that there is no "prejudice" to the estate of the debtor is supported by both the Commission Report and an earlier Report of the Committee on Coordination of the Bankruptcy Act and the Uniform Commercial Code. Both reports indicated that improvement in position by harvesting farm products immediately prior to bankruptcy would not be considered as prejudicial.[79] In addition, Professor Clark's conclusion that such an event is not a "transfer" within the meaning of Section 101(40) of the Bankruptcy Act has further support. The section 101(40) definition of "transfer" requires a "disposing of" or "parting with" the property.[80] While an increase in the market value of the inventory improves the position of the secured creditor, the debtor neither parts with nor disposes of an interest in the property.[81]

The voidable preference section of the Act should not pose any particular problems in the ordinary agricultural transaction. Nevertheless, the inclusion of farm products in the definition of inventory for purposes of voidable preference determination dictates an examination of the potential application of this provision when the farmer-debtor has farm products covered by a perfected security interest.[82]

JOINTLY OWNED PROPERTY

Farm assets are often owned jointly by spouses. In twenty-four states and the District of Columbia such interests are recognized as tenancies by the entirety. The remaining states, except for the community property states, recognize joint tenancies between spouses.[83] Due to the wide variation in state law, the results under prior bankruptcy law were often inconsistent when jointly owned property was involved.[84] To achieve more consistent

78. *Id.*

79. H.R. DOC. No. 137, *supra* note 9, at 206-210; Report of the Committee on Coordination of the Bankruptcy Act and the Uniform Commercial Code (1970) reprinted in U.S. Code Cong. Adm. News (Supp. 11c, 1978) at 392.

80. 11 U.S.C. § 101(40) (Supp. II 1979) defines transfer as "every mode, direct or indirect, absolute or conditioned, voluntary of involuntary, or *disposing of* or *parting with* property or with an interest in property, including retention of title as a security interest." (emphasis added).

81. Professor Clark uses the following illustration. A $50,000 loan is secured by $30,000 in diamond inventory 90 days prior to bankruptcy. At the time of bankruptcy the market value of the diamonds has increased to $40,000. Does the $10,000 change amount to a preference? Professor Clark answers with a "resounding negative." Clark, *supra* note 72, at 179. Contrast this conclusion to that in Mann and Phillips, *supra* note 76, at 15, where the authors reach the opposite conclusion in a similar example. Professor Clark's analysis is the more realistic. Note that in neither case can "prejudice" to the estate be shown. This determination could resolve the entire transfer issue.

82. *See* 4 COLLIER § 547.04 (15th ed. (1979). *See* Grilliot and Yocum, *Tenancy by the Entirety: An Ancient Fiction Frustrates Modern Creditors*, 17 AM. BUS. L.J. 341 (1979).

83. For an analysis of the impact of the new Act on community property *see* Pedlar, *Community Property and the Bankruptcy Reform Act of 1978*, 11 ST. MARY'S L.J. 349 (1979).

84. 2 COLLIER § 363.09 (15th ed. 1979); Aaron, *Part III, supra* note 13, at 424-428.

results, an attempt was made in the new Act to clarify provisions relating to such property.

No particular problems arise under old or new law when a debtor holds an interest in tenancy in common or joint tenancy property, at least in those states where a creditor of one spouse can reach the property. In bankruptcy, the debtor's interest in such property passes to the trustee.[85]

In those states recognizing tenancies by the entirety, the trustee in bankruptcy receives no greater interest than a creditor of the debtor-spouse receives under applicable state law.[86] Thus, under the law in some states, property held in tenancy by the entirety may be retained by the debtor and is not available in bankruptcy.[87]

Under the new Bankruptcy Act, the debtor may continue to exempt tenancy by the entirety or joint tenancy property from bankruptcy proceedings to the extent such property is exempt under applicable nonbankruptcy law, if the debtor chooses state exemptions in lieu of those provided in the Act.[88] The debtor may exempt "any interest in property in which the debtor had, immediately before the commencement of the case, an interest as a tenant by the entirety or joint tenant by the entirety or joint tenant. . . ."[89] This provision essentially follows prior law, except for the requirement that the debtor must select state exemptions to obtain the exemption. The new law differs, however, in the power given the trustee to sell co-owned property under certain circumstances.[90]

The new Act specifically provides for inclusion of all rights in real property as part of the debtor's estate.[91] When co-owned property is included in the estate and does not qualify for exemption, special problems may arise relating to the interest of the co-owner in the property. While due regard must be given to the protection of the co-owner's interest, the trustee is authorized to sell the property even without the consent of the co-owner.[92] The conditions for such sale have been described as follows:

> The trustee is permitted to realize on the value of the property by selling it without the consent of the co-owner. The co-owner, however, has a right of first refusal at the sale of the property. The trustee is required to pay over to the co-owner the value of the co-owner's inter-

85. 11 U.S.C. § 541(a)(1) (Supp. II, 1979).
86. *See* Grilliot and Yocum, *supra* note 83, at 349-353 and cases cited therein.
87. For example, Virginia exempts tenancy by the entirety property. Vasilion v. Vasilion, 192 Va. 735, 66 S.E.2d 599 (1951) and Oliver v. Givens, 204 Va. 123, 129 S.E.2d 661 (1963). For an extreme example of the potential "loophole" *see*, France v. Hart, — Fla. —, 170 So. 2d 52 (D. Fla. 1965).
88. 11 U.S.C. § 522(b) (Supp. II 1979). This new section requires that the debtor file a list of claimed exempt property. The debtor then has the alternative of selecting a federal list of exemptions or the applicable state list, unless the state has precluded the debtor from selecting the federal list.
89. 11 U.S.C. § 522(b)(2)(B) (Supp. II 1979).
90. 11 U.S.C. § 363(h) (Supp. II 1979).
91. 11 U.S.C. § 541(a)(1) (Supp. II 1979).
92. 11 U.S.C. § 363(h) (Supp. II 1979).

> est if the property is sold to someone else. The trustee's right to sell such property exists only if partition is impracticable; the benefit to the estate of a sale of such property free of the interests of co-owners outweighs the detriment, if any, to such co-owners. . . .[93]

The applicability of the section dealing with the sale of such co-owned property is unclear when petitions are filed by or against only one spouse, or where the federal exemption is not elected or is prohibited by state law.[94] In addition, valuation problems may arise when any of the forms of co-owned property are partitioned, since the value of any property partitioned in kind is to be divided "according to the interests of such spouse or co-owners, and of the estate."[95]

This new power of the trustee can have a profound impact on farm assets. Farm assets are often difficult to partition in kind. A sale might be the likely alternative—especially for real estate. A sale could have an adverse impact on the interest of the non-debtor spouse even with the most diligent efforts of the trustee to protect that interest. The overall impact of the changes relating to jointly owned property is less obvious. Certainly, the changes call for more pre-bankruptcy planning in those situations where a non-debtor spouse holds an interest in property as co-tenant and has a spouse who is facing bankruptcy. This may frequently be the case in the farm situation.

Commodity Broker Bankruptcies

A growing number of farmers trade in futures contracts as a means of shifting price risks. Hedging, and to a lesser degree, speculating in the futures market have attracted the interest of producers of a wide range of commodities. While participating in the futures trading, the farmer deals with a commodity brokerage firm, which is called a futures commission merchant (FCM) in bankruptcy law. The new Bankruptcy Act addresses two issues relating to FCM's: (1) the rights of customers in FCM bankruptcies, and (2) the handling of customer's assets by the FCM's upon bankruptcy of the customer.[96]

If a FCM goes into bankruptcy, the customers are afforded priority with regard to funds held by the FCM that belong to the customers.[97] The customers are entitled to a pro rata distribution of "customer property" before any distribution can be made to other creditors. If the "customer property"

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93. Klien, *supra* note 16, at 21. The trustee's right of sale does not apply to jointly-owned property used for the production, transmission or distribution for sale of electric energy or of natural or snythetic gas for heat, light or power. 11 U.S.C. § 363(h)(1)-(4) (Supp. II 1979) lists the requirements that must be met before such property can be sold.

94. *See generally* Aaron, *Part III, supra* note 13, at 424-29.

95. 11 U.S.C. § 363(j) (Supp. II 1979).

96. Both of these issues are treated extensively in White, *Rights of Commodities Futures Customers in Commodity Broker Bankruptcies*, 1 Ag.L.J. 641 (1980).

97. 11 U.S.C. § 766(h) (Supp. II 1979).

held by the FCM is insufficient to pay the customers in full, the customers become general creditors as to the unpaid amounts.[98] In addition, the new Act specifically provides that the trustee must request instructions from the customers regarding the handling of futures contracts being carried by the FCM for the customers, and must comply with the request to the extent practicable.[99]

These provisions, as well as a number of related changes, offer greater protection to the customer of a FCM in the case of a commodity broker bankruptcy. On the other hand, the new Act also addresses two issues relating to customer bankruptcies: (1) May the trustee in bankruptcy recover margin payments[100] made to the FCM prior to bankruptcy? (2) May the FCM liquidate the futures positions of a bankrupt customer?

Under prior law a trustee in bankruptcy probably would have been able to recover from a FCM any commodity margin payments made by the bankrupt within a year prior to bankruptcy, under specified conditions.[101] The new Act limits this authority to those situations where the customer has made payments with "actual intent" to defraud creditors.[102]

The new Act addressed the second issue by prohibiting the FCM from liquidating a customer's position because of the customer's bankruptcy, even if authorized to do so by the FCM-customer agreement.[103] The FCM, however, is still authorized to liquidate futures positions if the customer fails to meet margin deposit requests ("margin calls") unless precluded by court order from doing so.[104]

While neither the provisions relating to FCM bankruptcies nor those relating to the bankruptcy of a FCM customer can assure those involved in futures transactions of complete protection, the provisions do operate to benefit the commodity futures market.

CONCLUSION

The Bankruptcy Reform Act was designed to assist both debtors and creditors in making their way through the maze of a bankruptcy proceeding. It was designed to add flexibility in certain areas and to provide relief to some debtors that was not previously available to them. The Act has accomplished these purposes for the farmer, who apparently stands to benefit from both the new options in the Act and the retention of the traditional exemption from involuntary petitions. At the same time, the changes in the new

98. 11 U.S.C. § 766(j) (Supp. II 1979).
99. 11 U.S.C. § 765 (Supp. II 1979).
100. Margin payments are money deposits made by the customer to the FCM and in turn deposited with the futures exchange to keep a futures trade in force.
101. White, *supra* note 96, at 691.
102. U.S.C. § 764(c) (Supp. II 1979).
103. U.S.C. § 365(e) (Supp. II 1979).
104. White, *supra* note 96, at 654-655.

Act that relate to secured interests in farm products, jointly-owned property and to those who deal with commodity brokers, can have a direct impact on the farmer-debtor and deserve particular attention.