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An Agricultural Law Research Article

The Interaction of Agricultural Law and Bankruptcy Law: A Survey of Recent Cases

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THE INTERACTION OF AGRICULTURAL LAW AND BANKRUPTCY LAW: A SURVEY OF RECENT CASES

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Financial stress such as that which brings parties to seek relief in bankruptcy invariably produces competition both between the debtor and his or her creditors and between creditors, as each seeks a share of the limited assets that make up the bankruptcy estate. In this context, the bankruptcy courts are asked to determine the rights of the parties, a determination that is likely to require an interpretation of both bankruptcy and nonbankruptcy law. In the cases involving agricultural interests, these determinations may be particularly complex in that the court's ultimate decision may also be influenced by the special rules and exceptions that characterize agricultural law.

This article presents a survey of some of the most significant bankruptcy decisions published in 1991 which affect agriculture and agricultural interests. It focuses primarily on the appellate decisions by the circuit courts, but also provides mention of the most controversial or novel agricultural law issues addressed by the bankruptcy courts. Although most of the cases discussed involve farm bankruptcies, some involve the farmer in the position of creditor rather than debtor. While concerns for space and sanity permit only a discussion of the highlights of the year, an effort has been made to refer, through footnote citation, to as many cases as possible.

The first section of the article addresses issues fundamental to all types of bankruptcy. These issues include the application of the automatic stay and the characterization of property as property of the bankruptcy estate. Both of these issues address the application of a specific provision of the Bankruptcy Code to a case involving agricultural interests.

The second section discusses issues that integrate bankruptcy law and nonbankruptcy issues. In these cases, the bankruptcy courts are asked to interpret state law and/or nonbankruptcy federal law as presented in the bankruptcy forum. Issues addressed include state law issues dealing with the validity and priority of security interests and state law exemption rights. Also addressed

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are two federal statutes, the Agricultural Credit Act of 1987[1] and the Perishable Agricultural Commodities Act.[2]

The third section discusses special issues presented in farm reorganization. Issues addressed include the recent Supreme Court ruling on the combination of Chapter 7 and 13 bankruptcies as well as the requirements for obtaining relief in Chapter 12 bankruptcy.

The final section addresses the issues of dischargeability and dismissal. A number of cases that address fraud and improper activities by debtors are discussed.

I. FUNDAMENTAL BANKRUPTCY ISSUES

This section reviews cases involving issues specific to bankruptcy law as applied in farm bankruptcies. The issues addressed are the automatic stay and the definition of property of the estate. Each is discussed as it relates to agricultural interests in bankruptcy.

A. THE AUTOMATIC STAY

When a bankruptcy case is commenced, section 362 of the Bankruptcy Code[3] provides for the immediate imposition of an automatic stay, designed to give the debtor "a breathing spell from his creditors . . . [to permit] the debtor to attempt a repayment or reorganization plan, or simply to be relieved of the financial pressures that drove him into bankruptcy."[4] With few exceptions, this stay prohibits any entity from taking action against the debtor. The types of prohibited actions are specified in section 362(a) and include the initiation or continuation of any attempt to obtain possession of property, such as proceeding with foreclosure or replevin.[5] Thus, the general rule of section 362 is that all creditors' actions of the kind specified in section 362(a) are stayed.

The impact of this stay is tempered, however, by various creditor safeguards which balance the rights of creditors with those of the debtor. Perhaps the most important such safeguard is the procedure for obtaining relief through the lifting of the stay. Section

1. Pub. L. No. 100-233, 101 Stat. 568 (1988) (codified in scattered sections of 7 & 12 U.S.C.).
2. 7 U.S.C. §§ 499a-499t (1988).
3. 11 U.S.C. § 362 (1988).
4. H.R. REP. NO. 595, 95th Cong., 2d Sess. 340 (1978), *reprinted in* 1978 U.S.C.C.A.N. 6296-97.
5. 11 U.S.C. §§ 362(a)(1),(2),(3),(6) (1988).

362(d) sets forth this procedure.[6] It authorizes the court to grant relief from the stay, on request of a party in interest, in two situations. Relief may be granted under section 362(d)(1) "for cause, including the lack of adequate protection of an interest in property of such party in interest."[7] Alternatively, relief may be granted under section 362(d)(2) if "the debtor does not have an equity in such property," and "such property is not necessary for an effective reorganization."[8]

In addition to the procedural safeguard for obtaining relief from stay, there are also exceptions to the applicability of the stay. These exceptions, set forth in section 362(b), delineate circumstances under which the otherwise prohibited activities will not be stayed.[9] In these instances, procedures against the debtor can proceed without interference from the bankruptcy court.

The applicability of the automatic stay, and the necessary showing for obtaining relief from stay, are important issues in farm bankruptcy as in almost all other bankruptcy cases. While it provides strong protection for farm debtors, as the courts have recently emphasized, under certain circumstances this protection will not be available. As is discussed below, in three cases published this year, the Eighth Circuit addressed the automatic stay issue and ruled in favor of the farmer's creditors.

In *Production Credit Ass'n v. Wieseler (In re Wieseler)*,[10] the court reviewed the bankruptcy court's action in vacating its previous order lifting the automatic stay.[11] The case involved a signed stipulation between the farm debtors and their primary creditor, Production Credit Association (PCA).[12] The stipulation contained a "drop dead" clause whereby upon the debtors default, PCA could petition the court for relief from the automatic stay and obtain immediate possession of the debtors' secured property by taking the deeds held in escrow with the bankruptcy court. Under the facts presented in *Wieseler*, the debtors defaulted, and PCA brought an ex parte motion for relief from stay. The bankruptcy court urged settlement. Although it appears that partial settlement may have been reached and, accordingly, the debtors made partial payment, PCA again petitioned the court ex parte based on

6. 11 U.S.C. § 362(d) (1988).
7. 11 U.S.C. § 362(d)(1) (1988).
8. 11 U.S.C. § 362(d)(2) (1988).
9. 11 U.S.C. § 362(b) (1988).
10. 934 F.2d 965 (8th Cir. 1991).
11. Production Credit Ass'n v. Wieseler (*In re* Wieseler), 934 F.2d 965 (8th Cir. 1991).
12. *Id.* at 966.

the debtors' continued default. The bankruptcy court lifted the stay.[13] The debtors then moved for reconsideration, alleging that PCA had not informed the court of the ongoing settlement activities. The court reconsidered and vacated its order, thus leaving the stay in place.[14] Upon appeal by PCA, the district court affirmed,[15] but the Eighth Circuit court reversed.[16]

In rejecting the bankruptcy court's decision, the Eighth Circuit court found that the stipulation had been breached by the debtor and that this breach was sufficient "cause" to mandate the lifting of the stay. The court noted that if "cause" for purposes of section 362(d)(2) is found, the creditor is not required to prove that the debtor does not have equity in the property.[17] The court rejected the bankruptcy court's reasoning that the original stipulation may have placed too great a burden on the debtors, noting that it was "loathe to interfere" with an agreement voluntarily reached by the parties.[18] On this basis, the court held that as a "matter of justice and equity" the stay should have been lifted.[19]

In *Farm Credit Bank v. Franzen*,[20] another Eighth Circuit ruling on the automatic stay, the court also reversed the bankruptcy court's ruling in favor of the farm debtors. In *Franzen*, the lender had obtained relief from stay, enabling it to proceed with a state law foreclosure action. Through this procedure the lender obtained the decree of foreclosure and received a deed to the property as high bidder at the sale. Nevertheless the debtor refused to relinquish possession, so the lender returned to the bankruptcy court, seeking relief from stay to enable it to use state law remedies to obtain possession.[21] The bankruptcy court refused to lift the stay and instead ordered valuation hearings to determine whether "reasonably equivalent value" had been given for purposes of section 548 of the Bankruptcy Code,[22] or whether "fair consideration" under state law had been given pursuant to sections 544 and 549.[23]

The Eighth Circuit reversed, holding that the bankruptcy

13. *Id.*
14. *Id.* at 966-67.
15. *Id.* at 967 (citing *In re* Wieseler, No. 89-4086, slip op. at 25-26 (D.S.D. Sept. 25, 1989)).
16. *Id.* at 968-69.
17. *Id.* at 968.
18. *Id.* at 967 (citation omitted).
19. *Id.* at 968.
20. 926 F.2d 762 (8th Cir. 1991).
21. Farm Credit Bank of Omaha v. Franzen, 926 F.2d 762, 762 (8th Cir. 1991).
22. *Id.* (referencing 11 U.S.C. § 548 (1988)).
23. *Id.* (referencing 11 U.S.C. §§ 544, 549 (1988)).

court was precluded from reviewing the sale.[24] The court noted that the state courts had already reviewed the foreclosure process and determined that it complied with state law, and as such, the bankruptcy court was without authority to involve further review.[25]

A third appellate decision, the case of *Erickson v. Polk*,[26] also delineated the limits of the protection of the automatic stay in a farm bankruptcy. This case, however, addressed an exception to the stay. In *Erickson*, the Chapter 11 debtors alleged the violation of the automatic stay by a lessor of unimproved farmland.[27] The debtors had leased the property in connection with their farming operation for a term of one year.[28] They filed their petition for relief in bankruptcy during this term.[29] Prior to the expiration of the term, and subsequent to the filing of the bankruptcy petition, the lessor notified the debtor in writing of the expiration date of the lease and, subsequent to the expiration date, posted no trespassing signs on the property.[30] The debtor filed a motion with the bankruptcy court, arguing that the automatic stay had been violated.[31]

The bankruptcy court held that a violation of the automatic stay had not occurred, finding that the lessor's activities were excepted from the application of the stay.[32] On appeal, the district court affirmed, and on further appeal the Eighth Circuit court also affirmed. In support of its decision, the Eighth Circuit discussed section 362(b)(10), which provides a specific lessors' exception to the automatic stay.[33] This exception applies to lessors who take possession of property subject to a nonresidential lease that has terminated according to the stated term of the lease, a situation applicable to the *Erickson* facts. The court also noted that under state law, the lease had been correctly terminated, and there were no grounds for finding a holdover tenancy.[34] On this basis, the court held that no violation of the automatic stay had occurred and

24. *Id.*
25. *Id.*
26. 921 F.2d 200 (8th Cir. 1990).
27. Erickson v. Polk, 921 F.2d 200, 200-01 (8th Cir. 1990).
28. *Id.* at 201.
29. *Id.*
30. *Id.*
31. *Erickson*, 921 F.2d at 200-01.
32. *Id.* at 201 (citing 11 U.S.C. § 362(b)(10) (1988)).
33. *Id.*
34. *Id.* at 201-02 (citing case law interpreting Nebraska state law on holdover tenancies) (citations omitted).

that the lease was terminated.[35]

Other decisions interpreting the automatic stay as applied to farm bankruptcy have held that the automatic stay tolls the statute of limitations for purposes of the enforcement of debt,[36] that the stay is inapplicable to actions commenced by the debtor,[37] and that the stay does apply to prohibit the post- petition election by Commodity Credit Corporation to seize commodities under the loan support program.[38]

B. PROPERTY OF THE BANKRUPTCY ESTATE

Section 541 of the Bankruptcy Code[39] broadly provides for the creation of an estate upon the commencement of a bankruptcy. Commencement is accomplished by the filing of a bankruptcy petition with the bankruptcy court.[40] According to section 541, when the estate is created, with few exceptions, it is comprised of "all legal or equitable interests of the debtor in property as of the commencement of the case."[41] It includes interests "wherever located and by whomever held."[42]

In addition to a general definition of "property of the estate," section 541 also sets forth a listing of specific items that are to be included. Of particular applicability to agricultural bankruptcies is section 541(a)(6)'s inclusion of "[p]roceeds, product, offspring, rents, or profits of or from property of the estate, except such as are earnings from services performed by an individual debtor after the commencement of the case."[43]

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35. *Id.*

36. *See In re* Brichat, 129 B.R. 235, 238 (D. Kan. 1991) (determining that the letters from Farmers Home Administration (FmHA) to the debtor regarding the repayment of an FmHA loan did not constitute an acceleration notice for purposes of the running of the statute of limitations for the enforcement of a debt and holding, in addition, that the automatic stay tolls the running of the statute of limitations for purposes of the enforcement of a debt).

37. *See* Merchants & Farmers Bank v. Hill, 122 B.R. 539, 541 (E.D. Ark. 1990) (holding, in part, that the automatic stay is inapplicable to actions originally commenced by the debtor). *See infra* note 47.

38. *See* Commodity Credit Corp. v. Marlow (*In re* Julien Co.), 117 B.R. 910, 920-23 (Bankr. W.D. Tenn. 1990) (holding that the title to cotton under the loan support program does not pass to Commodity Credit Corporation (CCC) until there has been a default on the loan and CCC has made an election authorized by its regulations; this CCC election is subject to the automatic stay, and CCC cannot make its election post-petition without seeking relief from the stay). *See infra* note 51 and accompanying text.

39. 11 U.S.C. § 541(a) (1988).

40. 11 U.S.C. §§ 301-03 (1988).

41. 11 U.S.C. § 541(a)(1) (1988).

42. 11 U.S.C. § 541(a) (1988).

43. 11 U.S.C. § 541(a)(6) (1988). The specific enumerations of interests within the definition of property of the estate include several other items that transcend the general "commencement of a case" rule. For example, § 541(a)(5) provides that certain properties acquired by "bequest, devise, or inheritance" within 180 days of filing will be included. 11

Although the definition of "property of the estate" is so broad that it is seemingly all-inclusive, the variety of formally and informally held farm assets frequently results in litigation to determine whether the property is, in fact, property of the estate. In most cases, the property is included. For example, in recent decisions, the courts have found herbicides that were returned to the debtor, as agent of the manufacturer, to be property of the debtor's estate.[44] Similarly, cooperative dividends earned pre-petition,[45] elevator maintenance contracts,[46] and causes of action that the debtor accrued prior to the bankruptcy[47] have been found to be property of the estate.

One of the most interesting recent cases on this issue is the case of *Commodity Credit Corp. v. Marlow (In re Julien)*.[48] In this case, the definition of "property of the estate" arose in determining who holds title to the commodities underlying a nonrecourse loan program contract.[49] Under the federal farm program known as the nonrecourse loan program, the program participant receives a payment based on a set loan rate for the particular commodity. Although the participant holds the commodity, it is subject to a security interest in favor of the Commodity Credit Corporation (CCC), and it may be informally referred to as CCC grain. At the end of the loan term, the participant may either sell the commodity and repay the CCC loan with interest or forfeit the crop to the CCC. If the crop is forfeited, no additional payment is required.[50] The issue that affects the property of the estate determination is when title to the commodity vests in the CCC.

U.S.C. § 541(a)(5) (1988). Similarly, § 541(a)(7) calls for the inclusion of "[a]ny interest in property that the estate acquires after the commencement of the case." 11 U.S.C. § 541(a)(7) (1988).

44. *See* CIBA-Geigy Corp. v. Flo-Lizer, Inc. (*In re* Flo- Lizer, Inc.), 946 F.2d 1237 (6th Cir. 1991) (holding that, under Ohio "sale or return law," herbicides shipped to the manufacturer, pre-petition, were property of the estate).

45. *See* Holder v. Bennett (*In re* Bennett), 126 B.R. 869, 873 (Bankr. N.D. Tex. 1991) (holding that post-petition patronage dividends from cotton cooperative based on pre-petition farming activities were property of the Chapter 7 estate).

46. *See* Drewes v. FM Da-Sota Elevator Co. (*In re* Da-sota Elevator Co.), 939 F.2d 654, 655-56 (8th Cir. 1991) (holding that elevator maintenance contracts are not personal service contracts, therefore they are property of the estate and ordinarily must be transferred for reasonably equivalent value).

47. *See* Merchants & Farmers Bank v. Hill, 122 B.R. 539, 542 (E.D. Ark. 1990) (holding in part that "causes of action belonging to the debtor at the commencement of the bankruptcy" become property of the estate). *See supra* note 37.

48. 117 B.R. 910 (Bankr. W.D. Tenn. 1990).

49. Commodity Credit Corp. v. Marlow (*In re* Julien Co.), 117 B.R. 910, 919 (Bankr. W.D. Tenn. 1990).

50. For an explanation of the loan support program, *see* ECONOMIC RESEARCH SERV., U.S. DEP'T OF AGRIC., THE BASIC MECHANISMS OF U.S. FARM POLICY 14 (Misc. Pub. No. 1479, 1990); ECONOMIC RESEARCH SERV., U.S. DEP'T OF AGRIC., THE 1990 FARM ACT AND THE 1990 BUDGET RECONCILIATION ACT 8-13 (Misc. Pub. No. 1489, 1990).

In attempting to sort out the true nature of the loan program and the transfer of title issue, the court in *Julien* thoroughly examined the loan program contract and the applicable ASCS regulations.[51] The court first addressed the issue of whether the program participant receives a true loan or whether there is a purchase of the commodity. As is required under the program, the debtor in *Julien* signed a form note and security agreement that incorporated the ASCS regulations in addition to reciting specific program requirements.[52] Included among the contract's terms was the ambiguous provision that the producer "sells, assigns, and mortgages" the commodities to the CCC.[53] As discussed by the court, other contract provisions repeatedly characterized the transaction in terms appropriate for a loan and security interest, not a sale of the commodities. The court concluded that the cotton was collateral for a loan.[54]

The court next examined the contract and the regulations providing for the commodity's passage of title to the CCC. The contract attachments provided that the "title to the collateral will vest in CCC on the day following the loan maturity date."[55] However, other contract provisions and the regulations provided for participant redemption of the commodity and a specific procedure to be followed if timely redemption is not made.[56] This procedure requires the CCC to make an election to take title to the commodity. After analyzing the election language and the testimony of ASCS personnel, the *Julien* court determined that until the ASCS makes the proper administrative election, title to the commodities under the loan program remains in the producer.[57] If the producer files bankruptcy before the ASCS has made its election, the commodity becomes property of the bankruptcy estate.[58]

In some cases, however, the courts have found that the property in question was not property of the estate. In *Robbins v. Comerica Bank-Detroit (In re Zwagerman)*,[59] the court found that

51. *Julien*, 117 B.R. at 913-19.
52. *Id.* at 913-14.
53. *Id.* at 913.
54. *Id.* at 919.
55. *Id.* at 914 (citing The Commodity Credit Corporation Price Support Note and Security Agreement Terms and Conditions, Form CCC-601, Apr. 27, 1988) (emphasis added).
56. *Julien*, 117 B.R. at 914-15 (citing Form CCC-813 and 7 C.F.R. § 1427.22(a)(1) (1989)).
57. *See id.* at 924-25.
58. *Id.* at 919. *See also* Cook v. United States (*In re* Earl Roggenbuck Farms, Inc.), 51 B.R. 913, 921 (Bankr. E.D. Mich. 1985) (holding that post-petition transfer of corn by the CCC without a court order authorizing the transfer was an avoidable post-petition transfer).
59. 125 B.R. 486 (W.D. Mich. 1991).

cattle held under a custom feeding arrangement were not property of the estate in that they were held pursuant to a bailment relationship and title remained in the bailor.[60] The court determined that section 2-326 of the Uniform Commercial Code, which applies to goods that are held by another for sale, was inapplicable because the cattle were not delivered for sale, but only for custom feeding.[61]

The court in *Farm Credit Bank v. Halverson (In re Solberg)*[62] also addressed the issue of property of the estate, finding an asset that did not fit into this broad category. In this case, the court held that neither the Minnesota state right of first refusal nor the federal right of first refusal that attaches to property foreclosed by a Farm Credit System (FCS) lender was property of the debtor's Chapter 7 bankruptcy estate.[63]

Under the facts of *Solberg*, the debtor's property had been foreclosed prior to the bankruptcy filing, but the state law redemption period expired after the filing. After reviewing the applicable state statutes, the court determined that under Minnesota law, title to the foreclosed property does not vest in the purchaser at the foreclosure sale (here, the foreclosing lender) until the expiration of the redemption period.[64] Thus, as of the commencement of the case, the debtor held title to the foreclosed property.

With regard to the Minnesota state law right of first refusal, the court in *Solberg* found that this law regulates the lender's post-foreclosure sale or lease of the property and essentially provides the debtor an opportunity to match an offer and regain the prop-

60. Robbins v. Comerica Bank-Detroit (*In re* Zwagerman), 125 B.R. 486, 489-90 (W.D. Mich. 1991).

61. *Id.* at 490-92.

62. 125 B.R. 1010 (Bankr. D. Minn. 1991).

63. Farm Credit Bank v. Halverson (*In re* Solberg), 125 B.R. 1010, 1014-15 (Bankr. D. Minn. 1991). The fact that this was a Chapter 7 bankruptcy case is critical to the court's holding. Section 541's definition of property of the estate applies to bankruptcies filed under either Chapter 7 or 11 of the Bankruptcy Code. In these cases, property of the estate is primarily determined as of the filing of the bankruptcy. 11 U.S.C. § 541(a)(1) (1988). Although proceeds and the like may also be included, such property is generally derived from property that is in existence as of the commencement of the case. 11 U.S.C. § 541(a)(6) (1988). In contrast, in bankruptcies filed under either Chapter 12 or 13, the estate consists of all property described in § 541(a) plus like described property that is acquired by the debtor between the commencement of the case and its closure, dismissal, or conversion. *See* 11 U.S.C. § 1207 (1988) (property of the estate for purposes of Chapter 12 cases); 11 U.S.C. § 1306 (1988) (property of the estate for purposes of Chapter 13 cases). Thus, the definition of the types of properties included is the same in Chapters 7, 11, 12, and 13, but the time period for acquisition is extended in Chapter 12 and 13 cases. In *Solberg*, had the issue arisen in a Chapter 12 or 13 bankruptcy, the right presumably would have been property of the estate.

64. *Solberg*, 125 B.R. at 1015 (citations omitted).

erty.[65] Accordingly, the court determined that the debtor's state law right of first refusal attaches at the time that a third-party offer is received by the lender.[66] Under the *Solberg* facts, at the time that the debtor filed the bankruptcy and the Chapter 7 estate was created, the lender did not have title to the property, nor had any third-party bids been received. The court thus found that the right came into existence post-petition and was not part of the bankruptcy estate.[67]

With regard to the federal right of first refusal, mandated by the Agricultural Credit Act of 1987,[68] the court found that the federal right of first refusal under the FCS provisions of this Act arises when FCS lender acquires the property.[69] Again turning to Minnesota state foreclosure law, as FCS would not acquire title until after the expiration of the redemption period, the right of first refusal could not arise until that point in time. Thus, the right arose post-petition and was not part of the Chapter 7 bankruptcy estate.[70]

Thus, while property of the estate is an expansive category that encompasses most property associated with the debtor, certain types of property are excluded. Agriculture presents examples of these potential exclusions.

The categories of the automatic stay and the property of the estate encompass most of the recent cases that address agricultural interests in the context of a specific interpretation of the Bankruptcy Code. These cases are of particular importance in that these two categories present such fundamental aspects of a bankruptcy. Readers are cautioned, however, that additional decisions interpreting specific sections of the Code can also be found.[71]

II. NONBANKRUPTCY ISSUES PRESENTED IN THE BANKRUPTCY FORUM

The cases discussed to this point have addressed fundamental

65. *Id.* at 1019-20.
66. *Id.* at 1020-21.
67. *Id.* at 1021.
68. Pub. L. No. 100-233, 101 Stat. 568 (1988) (codified in scattered sections of 7 & 12 U.S.C.).
69. *Solberg*, 125 B.R. at 1013-16.
70. *Id.*
71. For example, in the case of State Bank v. Bucyrus Grain Co., Inc. (*In re* Bucyrus Grain Co., Inc.), 127 B.R. 45 (D. Kan. 1988), *appeal dismissed*, 905 F.2d 1362 (10th Cir. 1991), the court found a grain elevator to be a "futures commission merchant" despite the fact that it did not receive a commission. The farmers who purchased futures contracts through the elevator were "customers" entitled to special protection under §§ 761 and 766 of the Bankruptcy Code. *Id.* at 50-51.

bankruptcy issues. In addition, however, the bankruptcy courts are frequently asked to rule on issues that are not intrinsically bankruptcy related and that call for nonbankruptcy law interpretations. These interpretations may require the bankruptcy courts to examine the interaction of bankruptcy and nonbankruptcy law, or they may call for a straight interpretation of a nonbankruptcy law issue. In either case, the nonbankruptcy law issue, such as the validity of security interests or the remedies available to sellers under the Perishable Agricultural Commodities Act, may transcend the bankruptcy forum, essentially creating law applicable in other forums.

With regard to an interpretation of state law, two issues have been addressed by numerous bankruptcy courts. These are the issues of the debtor's right to exemptions and the validity of security interests. While the courts have also addressed other issues,[72] these issues have produced the most significant decisions overall.

A. EXEMPTIONS

One area where bankruptcy law and nonbankruptcy state law interact is the area of exemptions. The Bankruptcy Code provides that a debtor may either exempt property from the bankruptcy estate under the applicable state law exemption statutes or, unless state law prohibits, the federal exemption scheme.[73]

Regardless of which is chosen, the debtor will be bound by certain bankruptcy rules, and within the context of these rules, the bankruptcy court will interpret the exemption law chosen.[74]

On this basis, many of the decisions in agricultural bankruptcies involve the bankruptcy court interpreting state exemption statutes as applied in bankruptcy. Among the recent opinions on

72. *See, e.g.*, Heartline Farms, Inc. v. Daly, 934 F.2d 985 (8th Cir. 1991) (holding that under Nebraska law, an installment sale land contract is a security device rather than an executory contract; holding that the installment land contract must be judicially foreclosed and that strict foreclosure will not be permitted).

73. 11 U.S.C. § 522(b) (1988).

74. For an example of a bankruptcy rule affecting both state and federal exemptions, see *In re* Kingsbury, 124 B.R. 146 (Bankr. D. Me. 1991). The court in *Kingsbury* addressed the effect of an untimely objection to a debtor's claimed exemption, an issue that could affect either a state or federally based exemption. The court held that the objection would be considered, but only to determine whether a good faith statutory basis existed for the exemption. As such, the court followed the line of cases that have held that an exemption claim that has no statutory basis can be denied despite an untimely objection. Other courts, however, have held that once the time period for objecting to exemptions has run, the property is deemed exempt. This approach was recently articulated by the Third Circuit in *Taylor v. Feeland & Kronz*, 938 F.2d 420 (3d Cir. 1991), *cert. granted*, 112 S. Ct. 632 (1991). The Supreme Court has accepted certiorari in the *Taylor* case in order to resolve this conflict. *Taylor*, 112 S. Ct. 632 (1991).

this issue are cases interpreting the requirements for claiming a homestead exemption under Texas law,[75] the restrictions on claiming a partnership property exemption under Iowa law,[76] and the definition of the "tools of the trade" exemption under Texas law.[77]

Although some of the cases may have limited utility outside the particular state of applicability, sometimes there are principles that can be transferred to other similar exemption statutes under other settings. For example, the Seventh Circuit case of *In re Szekely*[78] may have widespread applicability. *Szekely* involved a value-based homestead exemption under Illinois law. According to this exemption statute, each person is "entitled to an estate of homestead to the extent in value of $7500."[79] The Szekelys filed for relief under Chapter 7 of the Bankruptcy Code and claimed their full entitlement to this exemption for a total homestead value of $15,000.[80] Their home was worth and eventually was sold for approximately $135,000 and was subject to two mortgages.[81] The Szekelys continued to reside in their home after filing the bankruptcy, but did not make any payments on either of the mortgages.[82] It was not disputed that the value of the homestead, in excess of the amount claimed exempt, was property of the estate.[83]

The trustee alleged that the estate should be entitled to receive rental payments for the fair rental value of the home from the Szekelys. He proposed that these rental payments be deducted from the homestead exemption, diminishing the amount the debtors would realize upon the eventual sale of the property. Both the bankruptcy court and the district court agreed with this

75. *See In re* Mitchell, 132 B.R. 553 (Bankr. W.D. Tex. 1991) (holding that the Texas rural homestead exemption does not require demonstration of economic use of the homestead property; the person claiming exemption must demonstrate a possessory interest in the land, the intent to claim it as a homestead, and use for some purpose as a home; although economic use is one permissible purpose, other possibilities include shelter, protection, comfort, convenience, and enjoyment); *In re* Bohac, 117 B.R. 256 (Bankr. W.D. Tex. 1990) (discussing the abandonment of a prior homestead and the creation of a new homestead under Texas law; debtor was found to not have met the necessary burden of proof in establishing rural homestead).

76. *See In re* Indvik, 118 B.R. 993, 1003-04 (Bankr. N.D. Iowa 1990) (holding, in part, that under Iowa law, an individual cannot claim partnership property as exempt).

77. *See In re* Sugarek, 117 B.R. 271 (Bankr. S.D. Tex. 1990) (finding that a tractor, planter and disk are tools of the trade necessary for the operation of the debtor's farming business and holding that the debtor is allowed to exempt this equipment).

78. 936 F.2d 897 (7th Cir. 1991).

79. *In re* Szekely, 936 F.2d 897, 899 (7th Cir. 1991) (citing ILL. REV. STAT., ch. 110, 12-901, 12-1201).

80. *Id.*

81. *Id.*

82. *Id.*

83. *Id.* at 899-900.

reasoning and set the amount of rent at $600 per month.[84] As the Szekelys resided in the home for eight months prior to its sale, their accumulated rental charges totaled $4800, which reduced their homestead exemption to $10,200.[85]

On appeal, the Seventh Circuit court noted that the issue presented was a "surprisingly fundamental, and difficult question" on which the court was unable to find any authority.[86] The court further noted that the trustee would clearly be authorized to pay the debtors the amount of their claimed exemption ($15,000) and evict them from the house.[87] However, when the court analyzed the "fresh start" that Chapter 7 promises to debtors[88] and the purpose of the homestead exemption,[89] the court found the trustee's rental charge unacceptable. The court found that it had the effect of forcing the debtors to attempt to maintain a lifestyle they could no longer afford.[90] The court analogized the relationship between the bankruptcy estate and the debtors to the relationship between tenants in common, noting that "[n]either tenant can charge the other rent, but either can demand that the property be partitioned between them."[91] On this basis, the court stated that the trustee was entitled to obtain sole rights to the property by paying the debtors the amount of their exemption, but that until he acquired sole rights, he could not interfere with the debtors' possession. The court held that the Illinois homestead exemption "entitles the debtor to remain in his home rent free until he receives the cash value of the exemption."[92]

B. SECURITY INTERESTS AND STATUTORY LIEN RIGHTS

Another area where the bankruptcy courts are frequently asked to interpret state law is with regard to liens and security interests. This interpretation is important in bankruptcy because the rights of the creditors may well be determined by, if not limited to, their status as secured creditors. Frequently the bank-

84. *Id.* at 899.
85. *Id.*
86. *Szekely*, 936 F.2d at 898.
87. *Id.* at 902.
88. *Id.* at 901.
89. *Id.* at 903 (noting that the homestead exemption is "designed to assist the debtor to the extent of the exemption to obtain more modest living quarters.").
90. *Szekely*, 936 F.2d at 903.
91. *Id.* (citations omitted).
92. *Id.* Under the facts of *Szekely*, the homestead was worth more than the encumbrances against it. In a situation where there was insufficient equity to support the exemption, presumably, the estate would abandon its interest and the lender would foreclose, eventually evicting the debtor.

ruptcy decisions involve an interpretation of the Uniform Commercial Code (UCC) as adopted by the state. These decisions generally involve the application of little or no bankruptcy law as such.

For example, in *Citizens National Bank and Trust Co. v. Serelson (In re Burkhart Farm and Livestock)*,[93] the court was called upon to interpret UCC sections 9-203 and 9-110 as adopted in Wyoming to determine the validity of a creditor's security interest.[94] The court held that the security agreement which referred to crops growing "in and around" specific property was vague and did not reasonably identify crops growing on unspecified contiguous sections of property.[95]

Similarly, in *United States v. Georgia Vegetables Co., Inc.*[96] the court was asked to determine whether a creditor's financing statement was sufficient, applying UCC section 9-402 as adopted in Georgia.[97] There, the court found that the listing of the husband, acting as an agent for the wife/owner, as owner of the property on the financing statement was minor error and not seriously misleading.[98]

Other cases involve the validity of a state statutory lien law. These cases may involve a determination as to the validity of the lien, or they may arise in the face of the trustee in bankruptcy's special avoidance power. Section 545 of the Bankruptcy Code allows the trustee to avoid statutory liens to the extent that they would be unenforceable against a bona fide purchaser.[99] Thus, in addition to determining the status of the lienholder, the bankruptcy court is frequently asked to determine whether a creditor's statutory lien will withstand trustee avoidance.

The Eighth Circuit addressed this issue in the recent case of *Drewes v. Carter (In re Woods Farmers Cooperative Elevator Co.)*.[100] This case concerned the North Dakota statute that creates a lien in favor of producers who store grain at a warehouse or grain

93. 938 F.2d 1114 (10th Cir. 1991).

94. Citizens Nat'l Bank and Trust Co. v. Serelson (*In re* Burkhart Farm and Livestock), 938 F.2d 1114, 1115-16 (10th Cir. 1991) (citing WYO. STAT. §§ 34.1-9-203(a)(i), 34.1-9-110 (1991)).

95. *Id.* at 1116.

96. 123 B.R. 456 (Bankr. M.D. Ga. 1990).

97. United States v. Georgia Vegetables Co., Inc., 123 B.R. 456 (Bankr. M.D. Ga. 1990) (citing O.C.G.A. § 11-9-402).

98. *Id.* at 461.

99. 11 U.S.C. § 545(2) (1988).

100. 946 F.2d 1411 (8th Cir. 1991).

elevator.[101] The court held that the trustee was not allowed to avoid the statutory liens held by the farmers in this case, because the North Dakota statute provides that the lien is enforceable against all but buyers in the ordinary course of business.[102] The lien can be enforced against a bona fide purchaser unless he or she meets the "additional buyer in the ordinary course" standard.[103] Therefore, because the section 545 test was not met, the trustee was not allowed to avoid the liens.[104]

Other decisions involving statutory liens have interpreted the producer's lien under California state law,[105] the preparer's lien under Washington state law,[106] and the Indiana agister's lien.[107]

C. THE AGRICULTURAL CREDIT ACT OF 1987

In addition to interpreting state statutes, the bankruptcy court may be called upon to construe a nonbankruptcy federal statute. Among the federal statutes that have been addressed in recent agricultural bankruptcy cases is the Agricultural Credit Act of 1987 (the Act).[108] This statute, passed as a direct result of the economic crisis of the farm economy,[109] creates a variety of rights for farm borrowers with Farmers' Home Administration (FmHA) or FCS lenders.[110] Some of these rights have been interpreted in bankruptcy litigation.[111]

The most significant recent case involving the Act in a bankruptcy context was the Eighth Circuit case of *Lee v. Yeutter*.[112]

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101. Drewes v. Carter (*In re* Woods Farmers Coop. Elevator Co.), 946 F.2d 1411, 1413 (8th Cir. 1991) (citing N.D. CENT. CODE § 60-02-25.1 (1985)).

102. *Id.* at 1414.

103. *Id.*

104. *Id.*

105. *See In re* T.H. Richards Processing Co., 910 F.2d 639 (9th Cir. 1990) (holding that neither an agreement to accept deferred payments for produce nor a demand-payment arrangement acts to automatically release the producer's state law lien under California producer's lien statute; moreover, the transfer of produce to a warehouseman pursuant to a non-negotiable warehouse receipt does not defeat the producer's lien).

106. *See In re* Young, 127 B.R. 456 (Bankr. W.D. Wash. 1991) (holding that a creditor who provided grain to a dairy farmer in chapter 12 bankruptcy was not a "producer" entitled to protection under the Washington statutory "preparer's lien" statute).

107. *See* Stookey Holsteins, Inc. v. Van Voorst (*In re* Stookey Holsteins, Inc.), 117 B.R. 402 (Bankr. N.D. Ind. 1989) (finding that a cattle boarder holds a state law agister's lien on cattle turned over to the Chapter 11 debtor despite the failure of the lienholder to issue a receipt notifying the debtor of its right to sell the cattle to pay charges; interpreting the statute as requiring the issuance of a receipt only to authorize sale and not as a requirement for the creation of the lien rights).

108. Pub. L. No. 100-233, 101 Stat. 568 (1988) (codified in scattered sections of 7 & 12 U.S.C.).

109. Farm Credit Bank v. Halverson (*In re* Solberg), 125 B.R. at 1010, 1013 (Bankr. D. Minn. 1991).

110. *Id.*

111. *Id.*

112. 917 F.2d 1104 (8th Cir. 1990).

This case concerned FmHA borrowers who received a discharge in bankruptcy prior to the Act. At issue was whether these farmers were still "borrowers" for purposes of the Act.[113] If they were "borrowers," they would be eligible for the debt restructuring consideration mandated by the Act.[114] In general terms, the Act directs FmHA to restructure the debt of eligible borrowers, enabling them to keep possession of their farms if they can establish that restructuring will produce as much or more income for FmHA than would foreclosure.[115] The plaintiffs in *Lee* wanted to be considered for this restructuring because despite their discharge in bankruptcy, FmHA still held mortgages on their farms and threatened foreclosure.[116] These farmers remained in possession of their mortgaged property and had requested restructuring consideration from FmHA.[117] The FmHA took the position, however, that these farmers were no longer borrowers and, as such, were ineligible for consideration.[118]

The case arose under the Administrative Procedure Act as a challenge to the FmHA regulations. The Eighth Circuit stated that the appropriate analysis involved a two-part inquiry.[119] The first question is "whether Congress has directly spoken on the [issue]."[120] If not, the court proceeds to the second inquiry, whether the agency's regulation is "based on a permissible construction of the statute."[121]

Applying this analysis to the facts of *Lee*, the court first found that Congress had not demonstrated a clear indication as to whether farmers such as the Lees who had received a discharge in bankruptcy should be considered under the debt restructuring provisions of the Act.[122] On this basis, the court limited itself to a

113. Lee v. Yeutter, 917 F.2d 1104, 1106 (8th Cir. 1990). The court noted that the critical issue under the statutory definition of borrower set forth in 7 U.S.C. § 1991(b)(1) (1988) is the meaning of the term "obligation." The court stated, "This case hinges on the Secretary's interpretation of one of the words Congress used to define a borrower; specifically, the term 'obligation.'" *Id.*

114. *Id.* at 1105-06 (citing 7 U.S.C. §§ 1991(b)(1), 1991(b)(3) (1988)). At issue in *Lee* was the farmers' eligibility for the category of programs termed the primary loan servicing programs. The farmers' eligibility for the secondary loan servicing programs was not at issue. *Id.*

115. *Id.* at 1105 (citing 7 U.S.C. § 2001(a) (1988)).

116. *Id.*

117. *Lee*, 917 F.2d at 1106.

118. *Id.*

119. *Id.*

120. *Id.*

121. *Id.* (quoting Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 843 (1984)).

122. *Lee*, 917 F.2d at 1107.

review of whether the agency's determination was permissible.[123] It held that even though agency's interpretation was not the only one which could be reasonable, the FmHA agency interpretation was permissible.[124]

The court addressed the Act as applied to FCS lenders in *Farm Credit Bank of St. Paul v. Halverson (In re Solberg)*.[125] This decision provided a detailed analysis of the right of first refusal under the Act. The FCS alleged that the Act allowed it to sell property at public auction and avoid at least a portion of the right of first refusal provisions afforded to a former owner.[126] Following *Payne v. Federal Land Bank*,[127] the court rejected the FCS position and held that FCS must make a private right of first refusal offering to the former owner before it could sell the property by public auction.[128]

Although the issue is now far from controversial,[129] in another bankruptcy decision under the Act, the Eighth Circuit court confirmed that there is no private right of action for borrowers to sue FCS lenders under the Act.[130] The United States Supreme Court refused to review this decision.[131]

Another issue arising in bankruptcy is the interaction of the borrower's rights provisions of the Act and the Bankruptcy Code. Although cases such as *Solberg*[132] addressed the rights that the borrower retains after bankruptcy filing, another case held that under a confirmed Chapter 12 plan, the plan terms control and any provisions of the Act are irrelevant.[133]

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123. *Id.*

124. *Id.* at 1108 (citation omitted).

125. 125 B.R. 1010 (Bankr. D. Minn. 1991). *See supra* note 62 and the accompanying text.

126. Farm Credit Bank v. Halverson (*In re* Solberg), 125 B.R. 1010, 1017 (Bankr. D. Minn. 1991).

127. 916 F.2d 179, 181 (4th Cir. 1990).

128. *Solberg*, 125 B.R. at 1017-19.

129. *See, e.g.*, Saltzman v. Farm Credit Servs., 950 F.2d 466 (7th Cir. 1991); Zajac v. Federal Land Bank, 909 F.2d 1181 (8th Cir. 1990) (en banc); Griffin v. Federal Land Bank, 902 F.2d 22 (10th Cir. 1990); Harper v. Federal Land Bank, 878 F.2d 1172 (9th Cir. 1989), *cert. denied*, 493 U.S. 1057 (1990) (each finding no private cause of action for borrowers to sue an FCS lender for violations of the Agricultural Credit Act).

130. Euerle Farms v. Farm Credit Systems, 928 F.2d 274 (8th Cir. 1991), *cert. denied*, 112 S. Ct. 179 (1991).

131. *Euerle Farms*, 112 S. Ct. 179 (1991).

132. 125 B.R. 1010 (Bankr. D. Minn. 1991).

133. Farm Credit Bank v. Coleman (*In re* Coleman), 125 B.R. 621 (Bankr. D. Mont. 1991) (holding that the confirmed Chapter 12 plan that incorporated the right of first refusal under Montana state law was controlling; holding that the parties are bound to the terms of the plan and that additional statutory provisions such as those in the Act are irrelevant).

D. THE PERISHABLE AGRICULTURAL COMMODITIES ACT

Another nonbankruptcy federal law that is frequently interpreted in the context of bankruptcy proceedings is the Perishable Agricultural Commodities Act (PACA).[134] This statute provides various protections for sellers of perishable agricultural commodities. Perhaps the most powerful of these protections is the creation of a nonsegregated statutory trust that automatically arises in favor of sellers of these commodities.[135] The perishable agricultural commodities received by produce dealers, commission merchants, and brokers, together with "all inventories of food or other products derived from perishable agricultural commodities, and any receivables or proceeds from the sale of such commodities or products" are held in trust for the benefit of all unpaid sellers and suppliers until they are fully paid for the commodities sold.[136] To preserve the benefits of the trust, the seller or supplier must give timely notice to the purchaser of the commodities and the Secretary of Agriculture.[137]

The existence and extent of the PACA statutory trust are issues that are likely to arise in bankruptcy cases filed by the purchasers of agricultural commodities. It is now settled law that if the trust exists, it is separate from the bankruptcy and does not become property of the bankruptcy estate.[138] This elevates the unpaid sellers from the lowly status of unsecured creditors to the favored status of pro-rata shareholders in the trust assets. Because this can be such a powerful remedy, it is frequently the subject of litigation.

In recent cases that have dealt with the PACA trust, the issue of what assets are included in this trust has been addressed. As an indication of how broadly the trust may be construed, one court held that the trust included accounts receivable from the debtor's intrastate commodity transactions because they were the type of commodity typically sold in interstate commerce.[139] Similarly, another court recently held that assets purchased by the commod-

134. 7 U.S.C. §§ 499a-499t (1988).
135. 7 U.S.C. § 499e(c)(2) (1988).
136. *Id.*
137. 7 U.S.C. § 499e(c)(3) (1988).
138. *See, e.g.*, C & E Enterprises, Inc. v. Milton Poulos, Inc. (*In re* Poulos), 107 B.R. 715 (Bankr. 9th Cir. 1989).
139. Bank of Los Angeles v. Official PACA Creditors' Comm. (*In re* Southland & Keystone), 132 B.R. 632 (Bankr. 9th Cir. 1991) (holding that the PACA statutory trust included accounts receivable from debtors' intrastate perishable agricultural commodity transactions because the commodities were the type typically sold in interstate commerce; finding therefore that the PACA claimants, as opposed to secured creditor, were entitled to these proceeds).

ity buyer/debtor while the PACA trust fund was in existence were presumed to have been purchased with trust funds.[140] As such, the truck and equipment purchased by debtor after the trust had arisen were held to be part of trust fund assets rather than property of the bankruptcy estate.[141] On a related issue, however, another court held that the trust assets cannot be traced to a third party who had no knowledge of the character of the funds received.[142]

In addition, there are two recent PACA cases of interest that enlarge the significance of the trust in other ways. In the case of *C & E Enterprises, Inc. v. Milton Poulos, Inc. (In re Milton Poulos)*,[143] the Ninth Circuit Court of Appeals reversed the Bankruptcy Appellate Panel and ordered that attorneys fees were to be paid from the trust fund. In the case of *Tom Lange Co., Inc. v. Stout (In re Stout)*,[144] the bankruptcy court held that the PACA trust satisfies the fiduciary capacity requirement of section 523(a)(4) of the Bankruptcy Code. Accordingly, failure to pay for the purchase of produce is a defalcation under section 523(a)(4) and the debt to the seller protected by PACA is nondischargeable.[145]

As is apparent from this wide variety of cases, bankruptcy litigation frequently transcends the traditional notions of bankruptcy law and the application of the Bankruptcy Code. In many bankruptcy cases, the courts are asked to construe and apply nonbankruptcy law, and in so doing, these courts make law that can be, and is, applied in nonbankruptcy forums.[146]

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140. *In re* Atlantic Tropical Market Corp., 118 B.R. 139 (S.D. Fla. 1990).

141. *Id.* at 142.

142. Lyng v. JDC Enterprises, 117 B.R. 268 (S.D. Tex. 1990) (holding that PACA trust assets cannot be recovered from third parties who had no knowledge of the character of the funds received). *See also* Woeiner Produce Co., Inc. v. So Good Potato Chip Co. (*In re* So Good Potato Chip Co.), 124 B.R. 298 (Bankr. E.D. Mo. 1991) (holding that the nine-month statute of limitations for the initiation of administrative proceedings under PACA does not apply to the initiation of judicial proceedings in district court; PACA creates a trust relationship between the seller and buyer of perishable agricultural commodities for payment for the goods sold, but it does not create a trust relationship between the seller and a third party buyer that does not have privity of contract with the seller).

143. 947 F.2d 1351 (9th Cir. 1991) (per curium).

144. 123 B.R. 412, 415 (Bankr. W.D. Okla. 1990).

145. Tom Lange Co., Inc. v. Stout (*In re* Stout), 123 B.R. 412, 415 (Bankr. W.D. Okla. 1990).

146. As an example of another situation in which the bankruptcy court is asked to construe nonbankruptcy law, see Lee v. Bartlett and Co., 121 B.R. 872 (D. Kan. 1990) (holding that a grain storage agreement can be found even in the absence of a warehouse receipt; interpreting the federal law that requires issuance of a warehouse receipt in storage arrangements as not precluding a finding of a storage agreement when a warehouse receipt is not issued; and holding that the custom and practice of the parties can support a finding that storage charges were to be deducted from the sale proceeds for the grain).

III. FARM REORGANIZATION ISSUES

Many cases were decided in the farm reorganization arena during the last year. Some involved reorganizations under Chapter 12 bankruptcy, the Chapter designed specifically for the reorganization of family farms.[147] Others, however, involved farmers attempting to reorganize their operations under Chapters 11 or 13. This section of the article discusses the most notable of these decisions.

A. RESTRUCTURING MORTGAGE DEBT: JOHNSON V. HOME STATE BANK

Perhaps the most significant farm reorganization decision of the year was a Supreme Court decision involving a Chapter 13 bankruptcy. In *Johnson v. Home State Bank*,[148] the Supreme Court resolved a split in the circuits on the issue of the whether a mortgage obligation that survives a Chapter 7 bankruptcy discharge can be reorganized in a subsequent Chapter 13 bankruptcy. Justice Marshall, writing for a unanimous Court, held that under the applicable bankruptcy law, a mortgage obligation was a "claim" and, as such, could be restructured under a Chapter 13 plan, provided that other Chapter 13 requirements are met.[149]

The facts in *Johnson* involved farm property that was mortgaged to the Home State Bank (the Bank).[150] After the mortgagor, Mr. Johnson, defaulted on his promissory notes to the Bank, the bank initiated foreclosure proceedings.[151] While these proceedings were pending, Johnson filed for relief under Chapter 7 of the Bankruptcy Code and eventually received a discharge.[152] Although this discharge relieved Johnson of personal liability on his notes to the Bank, the Bank's in rem right to proceed against the farm pursuant to the mortgage obligation survived.[153] Accordingly, after the automatic stay was lifted, the Bank re-initiated foreclosure proceedings.[154] After state court litigation, the Bank eventually obtained an in rem judgment against the mortgaged property.[155] A foreclosure sale pursuant to the in rem judgment

147. Bankruptcy Judges, United States Trustees and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, tit. II, § 255, 100 Stat., 3105-3113 (1986).
148. 111 S. Ct. 2150 (1991).
149. Johnson v. Home State Bank, 111 S. Ct. 2150, 2156 (1991).
150. *Id.* at 2152.
151. *Id.*
152. *Id.*
153. *See* 11 U.S.C. § 522(c)(2) (1988).
154. *Johnson*, 111 S. Ct. at 2152.
155. *Id.*

was scheduled, but prior to this sale, Johnson filed for relief under Chapter 13 of the Bankruptcy Code.[156] Although Johnson's first reorganization plan was rejected by the bankruptcy court as not feasible, Johnson went on to file an amended plan that treated the mortgage as a claim against the estate and proposed a payment plan equal to the Bank's in rem judgment.[157] The bankruptcy court confirmed this amended plan over the Bank's objection.[158]

The Bank appealed the plan confirmation, presenting alternative arguments. First, it argued that the Bankruptcy Code does not allow a debtor to use Chapter 13 to reorganize a mortgage obligation for which personal liability has been discharged.[159] The Bank reasoned that while Chapter 13 provides for the reorganization of creditors' claims against the debtor, there was no longer any recognized claim because the debtor's personal liability had been discharged.[160] Second, the Bank argued that Johnson's plan had not been filed in good faith and that it was not feasible.[161]

The district court reversed, holding that the Bankruptcy Code did not permit Johnson to reorganize the obligation to the Bank.[162] It found that Chapter 13 authorizes the reorganization of "claims" and then noted that the Code defines a "claim" as a "right to payment."[163] The court reasoned that when a mortgage obligation is discharged, only the lien is retained. There is no longer any right to payment, only a right to the property. Thus, the mortgagee no longer holds a "claim" capable of reorganization and is no longer a creditor of the debtor.[164]

The Tenth Circuit affirmed.[165] This affirmance created a split in the circuits on the issue, with the Eleventh and the Ninth Circuits holding that a mortgage lien that is not supported by personal liability, because a Chapter 7 discharge is still a claim for purposes of Chapter 13 reorganization.[166]

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

156. *Id.*
157. *Id.*
158. *Johnson*, 111 S. Ct. at 2152.
159. *Id.*
160. *Id.*
161. *Id.*
162. *Id.* (citing *In re* Johnson, 96 B.R. 326, 328-30 (Bankr. D. Kan. 1989)).
163. *Johnson*, 96 B.R. at 330 (citing 11 U.S.C. § 101(4)).
164. *Id.*
165. *In re* Johnson, 904 F.2d 563 (10th Cir. 1990).
166. *See* Jim Walter Homes, Inc. v. Saylors (*In re* Saylors), 869 F.2d 1434, 1436 (11th Cir. 1989); Downey Savings and Loan Ass'n v. Metz (*In re* Metz), 820 F.2d 1495, 1498 (9th Cir. 1987) (each permitting the inclusion of a mortgage lien in a Chapter 13 reorganization plan despite the debtor's discharge from personal liability on the mortgage debt).

liability, is a "claim" subject to inclusion in a Chapter 13 reorganization.[167] In reaching its decision, the Court relied primarily on the definition of "claim" found in the Bankruptcy Code. The Court cited its previous ruling on this definition for the proposition that "Congress intended . . . the broadest available definition . . . ."[168] The Court also noted that in *Pennsylvania Department of Public Welfare v. Davenport*, they had concluded that " 'right to payment' [means] nothing more nor less than an enforceable obligation."[169]

Based on this broad definition, the Court concluded that a mortgage holder has a "right to payment" even after the personal liability on the debt has been discharged.[170] This "right to payment" can be found in the mortgage holder's right to the proceeds of the sale of the mortgaged property. Alternatively, because the Code also defines a "claim" as a "right to an equitable remedy for breach of performance if such breach gives rise to a right to payment," the Court noted that the surviving right to foreclose can be considered a "right to an equitable remedy" based on the debtor's default.[171]

On that basis, the Court reversed the judgment of the court of appeals and remanded the case for further proceedings.[172] Because neither the district court nor the court of appeals had addressed the alternative objections of the Bank regarding good faith and feasibility, the Court directed the lower court to consider them on remand.[173]

While the long range impact of *Johnson* is difficult to predict, the filing of a reorganization bankruptcy under either Chapter 12 or 13 may be an option that will now be considered by discharged farmers who wish to reorganize the debt on their mortgaged homestead property. This option may be particularly appealing to FmHA debtors who are ineligible for debt restructuring because of their discharge.[174]

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167. *Johnson*, 111 S. Ct. at 2153.
168. *Id.* at 2154 (citing Pennsylvania Dept. of Public Welfare v. Davenport, 110 S. Ct. 2126 (1990)).
169. *Johnson*, 111 S. Ct. at 2154 (quoting *Davenport*, 110 S. Ct. at 2131).
170. *Id.*
171. *Id.*
172. *Id.* at 2156.
173. *Id.*
174. *See* Lee v. Yeutter, 917 F.2d 1104 (8th Cir. 1990); Drewes v. Carter (*In re* Woods Farmers Coop. Elevator Co.), 946 F.2d 1411 (8th Cir. 1991).

B. ELIGIBILITY FOR CHAPTER 12 REORGANIZATION

Chapter 12 offers significant powers to the debtor—powers that may not be available under other bankruptcy chapters.[175] For this reason, the issue of whether a debtor meets the specific eligibility requirements is frequently litigated.

Only a "family farmer with regular annual income" is eligible for Chapter 12 relief.[176] The term "family farmer" is defined in section 101(17) of the Bankruptcy Code, with specific requirements for individuals[177] and similar, but distinct, requirements for partnerships and corporations.[178] In general terms, section 101 requires that in order to be a "family farmer," the debtor must be engaged in farming, have debts below the maximum amount of total debt, have the requisite percentage of debt stem from the farming operation, have the requisite percentage of income arise from the farming operation and, if a partnership or corporation,

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175. For example, under Chapter 12 there is no "absolute priority rule" as exists under Chapter 11. *See* 11 U.S.C. § 1129(b)(2)(B)(ii) (1988). The "absolute priority rule," which prohibits the retention of any equity interest by the debtor over the interest of objecting creditors, has made Chapter 11 plans for family farm operations extremely difficult to confirm. *See* Norwest Bank v. Ahlers, 485 U.S. 197 (1988) (defining the absolute priority rule as applied to farming operations). Similarly, creditors involved in a Chapter 12 bankruptcy do not have the § 1111(b) election that is available to creditors of Chapter 11 debtors. 11 U.S.C. § 1111(b) (1988).

176. 11 U.S.C. § 109(f) provides: "Only a family farmer with regular annual income may be a debtor under Chapter 12 of this title." 11 U.S.C. § 109(f) (1988).

177. For individuals, § 101(17)(A) provides that a "family farmer" is:

> [an] 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 preceding the taxable year in which the case concerning such individual or such individual and spouse was filed.

11 U.S.C. § 101(17)(A) (1988).

178. For corporations and partnerships, § 101(17)(B) provides that a "family farmer" is:

> [a] 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.

11 U.S.C. § 101(17)(B) (1988).

meet the ownership and organization requirements.[179] The "regular annual income" requirement is defined as annual income that is "sufficiently stable and regular to enable such family farmer to make payments" under a Chapter 12 plan.[180]

The Eighth Circuit addressed the Chapter 12 eligibility issue in the recent case of *State Bank of Towner v. Edwards (In re Edwards)*.[181] One of the issues presented was whether the debtors' role as lessors constituted farming, an issue much debated by the courts.[182] The court's finding on this issue was based on the test adopted by the court in *Otoe County National Bank v. Easton (In re Easton)*.[183] According to this test, the debtor must have had "a significant degree of engagement in, played some significant operational role in, or had an ownership interest in the crop production which took place on the acreage they rented."[184] Applying this test, the court found that the evidence that the debtors "had a significant role in crop production taking place on their rented land" was sufficient to meet the definition of "family farmer" for purposes of Chapter 12 eligibility.[185]

The court in *In re Voelker*[186] summarized an alternative test

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179. 11 U.S.C. § 101(17) (1988).

180. 11 U.S.C. § 101(18) (1988).

181. 924 F.2d 798 (8th Cir. 1991).

182. The issue of whether the leasing of farmland is a farming activity and whether rental payments can be considered as farm income for purposes of Chapter 12 eligibility standards has been addressed by numerous courts. Much of this litigation references the Seventh Circuit decision in the 1987 case of *In re* Armstrong, 812 F.2d 1024 (7th Cir. 1987), *cert. denied*, 484 U.S. 925 (1987). In this case, the majority held that for income to be categorized as farm income, it must meet what has been termed the risk test. Its receipt must be dependent upon the risk that is inherent in traditional farming operations. If it is not, as in the case of cash rent for leased farmland, it is not farm income. *Id.* at 1028. The dissent strongly rejected this mechanical approach and proposed a totality of the circumstances test. *Id.* at 1031. Under the dissent's view, the debtor's overall situation could be examined and an equitable result reached. *Id.* Since *Armstrong*, many lower courts have lined up on one side or the other, with the majority appearing to reject the *Armstrong* risk test. Cases that have followed the majority's approach in *Armstrong* include: *In re* Krueger, 104 B.R. 223 (Bankr. D. Neb. 1988); *In re* Maschhoff, 89 B.R. 768 (Bankr. S.D. Ill. 1988); *In re* Seabloom, 78 B.R. 543 (Bankr. C.D. Ill. 1987); *In re* Haschke, 77 B.R. 223 (Bankr. D. Neb. 1987). Cases that have rejected the *Armstrong* majority include: *In re* Vernon, 101 B.R. 87 (Bankr. E.D. Mo. 1989); *In re* Coulston, 98 B.R. 280 (Bankr. E.D. Mich. 1989); *In re* Hettinger, 95 B.R. 110 (Bankr. E.D. Mo. 1989); *In re* Jessen, 82 B.R. 490 (Bankr. S.D. Iowa 1988); *In re* Burke, 81 B.R. 971 (Bankr. S.D. Iowa 1987); *In re* Rott, 73 B.R. 366 (Bankr. D. N.D. 1987). Note that subsequent to the opinions referenced above, the Eighth Circuit rejected both the majority and the minority *Armstrong* opinions, declaring a new test for the farm income determination. Otoe County Nat'l Bank v. Easton (*In re* Easton), 883 F.2d 630, 636 (8th Cir. 1989).

183. 883 F.2d 630 (8th Cir. 1989). For a discussion of *Easton* and the Eighth Circuit's treatment of Chapter 12 eligibility issues, see P. Maureen Bock-Dill, Note, *Get Down and Dirty: The Eighth Circuit's Admonition to Farmers Seeking the Protection of Chapter 12*, 43 ARK. L. REV. 701 (1990).

184. *Edwards*, 924 F.2d at 799 n.4 (citing *Easton*, 883 F.2d at 636).

185. *Edwards*, 924 F.2d at 799.

186. 123 B.R. 749 (Bankr. E.D. Mich. 1990).

for addressing the "family farmer" definition. The court first discussed the requirement that the debtor own or "operate" a farming operation. On this issue, it defined "operate" as meaning "being actively involved in the day-to-day management" of the business.[187] In turning to the issue of whether rental income is farm income for purposes of Chapter 12 eligibility, the court relied upon an analysis of six factors. These factors were:

1) whether the debtor's operation is a continuing one;
2) whether there is a physical presence of family members on the farm;
3) whether the debtor owns traditional farm assets;
4) whether leasing out land is a form of scaling down the previous farm operations;
5) the form of the lease; and
6) whether the debtor ceased all of its own investment of labor and assets to produce crops or livestock.[188]

Applying these factors to the facts in the *Voelker* case, the court found the rental income to be farm income.[189]

Other cases addressing the definition of farming for purposes of Chapter 12 eligibility have held that a sawmill was not a farming operation,[190] that social security disability payments are included in gross income for applying the farm income percentage test,[191] and that debt forgiveness, although categorized as "income from discharge of indebtedness" for tax purposes, is not included in gross income.[192] In addition, when discussing the eligibility determination, one court has held that when a debtor's eligibility for Chapter 12 bankruptcy relief is challenged, the debtor has the burden of proof to establish that he or she is eligible.[193]

C. CONFIRMATION STANDARDS FOR CHAPTER 12 PLANS

Another Chapter 12 issue that is frequently litigated is whether the plan proposed by the debtor meets the requisite con-

187. *In re* Voelker, 123 B.R. 749, 751 (Bankr. E.D. Mich. 1990) (quoting Exec. Order No. 12138, 44 F.R. 29637 (1979)).

188. *Id.* at 752 (citation omitted).

189. *Id.* at 753.

190. *See In re* Miller, 122 B.R. 360, 365 (Bankr. N.D. Iowa 1990) (applying the definition of "farming operation" set forth by the Eighth Circuit in *Easton*, 883 F.2d at 634, and holding in part, that operating a sawmill is *not* a farming operation). *Contra In re* Sugar Pine Ranch, 100 B.R. 28 (Bankr. D. Or. 1989).

191. *See In re* Koenegstein, 130 B.R. 281, 286 (Bankr. S.D. Ill. 1991).

192. *Id.* at 287 (quoting 26 U.S.C. § 61(a)(12)). This holding is supported in part because the Tax Code allows debt forgiveness income to be used to reduce net operating loss to avoid its characterization as gross income.

193. *See Voelker*, 123 B.R. at 750.

firmation standards. These standards are set forth in section 1225 of the Bankruptcy Code.[194] With regard to secured claim holders, section 1225 provides that absent secured claim holder acceptance,[195] the debtor's plan must either provide that each claim holder retain the lien securing its claim and be paid an amount not less than the amount of the secured claim or that the secured property be surrendered to the claim holder.[196] The amount of the secured claim is generally the value of the secured property.[197] Thus, a plan can be confirmed over the objection of the secured creditor if the plan provides for payment of the value of the collateral as of the effective date of the plan. This obviously gives rise to valuation disputes. Because in most cases the plan will provide for payments to be made over time, however, it also gives rise to disputes concerning the present value of the stream of payments promised in the plan. Central to these disputes is the issue of what interest rate will provide the secured claim holder with the requisite value of his of her claim.[198]

In *USDA v. Fisher (In re Fisher)*,[199] perhaps the most significant recent decision on the issue of Chapter 12 plan confirmation, the Eighth Circuit rejected the confirmation of a Chapter 12 plan on the grounds that it did not satisfy the confirmation requirements with respect to one of the secured claim holders, FmHA. At issue was the interest rate promised under the plan, a rate based on the weighted average of the debtors' original FmHA contract rates of interest.[200] In reaching its decision, the court addressed two important confirmation issues: first, whether the plan can apply the contract rate of interest to a restructured loan when the contract rate is less that the current market rate, and second, whether FmHA low interest loans can be restructured at lower than market interest rates.[201]

In *Fisher*, under the plan proposed by the debtors and accepted by both the bankruptcy court and the district court, the debtors sought to restructure their secured obligation to FmHA using the weighted average of their original contract rates of inter-

194. 11 U.S.C. § 1225 (1988).
195. 11 U.S.C. § 1225(a)(5)(A) (1988).
196. 11 U.S.C. § 1225(a)(5) (1988).
197. 11 U.S.C. § 506 (1988).
198. For an overview of the different approaches used by the courts in determining an acceptable interest rate under 1225(a)(5), see Thomas O. Depperschmidt & Nancy Hisey Kratzke, *The Search for the Proper Interest Rate Under Chapter 12 (Family Farmer Bankruptcy Act)* 67 N.D. L. REV. 455 (1991).
199. 930 F.2d 1361 (8th Cir. 1991).
200. USDA v. Fisher (*In re* Fisher), 930 F.2d 1361, 1362 (8th Cir. 1991).
201. *Id.*

est.[202] The FmHA objected, claiming that the plan failed to satisfy the Chapter 12 confirmation requirements that require that a secured creditor be paid the present value of its secured claim.[203] The FmHA argued that for purposes of this requirement, present value must be based on the market rate of interest, not the lower FmHA loan rate.[204] However, because of the FmHA's unique status as provider of low interest loans to eligible farmers, the contract rates on the Fishers' loans averaged out to be 5.41%, below the "market rate" applicable to other lenders.[205]

In addressing the contract rate/market rate issue, the Eighth Circuit agreed that the debtors' plan did not meet the confirmation standards required by section 1225(a)(5)(B).[206] It held that the requirement that secured creditors receive the value of their secured claim did not allow for the unequal treatment of creditors.[207] The court interpreted section 1225(a)(5)(B) as requiring a present value determination based on the current market rate, not the contract rate originally agreed upon by the parties.[208] Despite the special purpose underlying FmHA financing, the court reasoned that "[h]aving filed for bankruptcy under Chapter 12, we hold that FmHA enters the bankruptcy proceedings the same as any other creditors and is thus entitled to have its claim valued using a discount rate based not on the contract rate of interest but on the 'market rate' of interest."[209]

In reaching this decision, the court adopted the reasoning of the Sixth Circuit in *United States v. Arnold*.[210] Although not discussed by the court, there are also contrary decisions on this issue holding that the market rate standard is to be applied only in cases where the contract rate is a higher rate, indicating that if the contract rate is lower, this lower rate would be acceptable.[211]

The court explicitly rejected the debtors' reliance on an ear-

202. *Id.* at 1361-62.
203. *Id.* at 1361 (referencing 11 U.S.C. § 1225(a)(5)(B) (West 1986)).
204. *Id.*
205. *Fisher*, 930 F.2d at 1362.
206. *Id.* at 1363.
207. *Id.*
208. *Id.*
209. *Id.*
210. *Id.* (citing 878 F.2d 925 (6th Cir. 1989)).
211. *See, e.g., In re* Turner, 87 B.R. 514, 517-18 (Bankr. S.D. Ohio 1988); Federal Land Bank v. Bartlesmeyer (*In re* Bartlesmeyer), 78 B.R. 975, 977 (Bankr. W.D. Mo. 1987). *See also* Hardzog v. Federal Land Bank (*In re* Hardzog), 901 F.2d 858, 860 (10th Cir. 1990) ("[I]n the absence of special circumstances, such as the market rate being higher than the contract rate, Bankruptcy Courts should use the current market rate of interest used for similar loans in the region.").

lier Eighth Circuit decision, *United States v. Doud*.[212] It stated that *Doud* only addressed the issue of the method used to compute market rate, not the contract rate issue.[213] The *Doud* decision, however, has been interpreted as allowing the use of the lower contract rate.[214] This apparent misinterpretation stems from the fact that although the appellate *Doud* decision only discussed the market rate computation applicable to one of the debtors' loans, it affirmed without discussion the lower court's holding that three of the other loans must be left at the low interest FmHA contract rate.[215]

On the second issue, the applicable market rate to be used for FmHA loans, the court took a step back from the equal treatment of creditors position. The court stated that the special status of the FmHA may be relevant in determining what the applicable "market rate" may be.[216] The FmHA argued that the rate should be based on the same method used by the court for other creditors. This method considers the value of the debtors' property and the amount that the FmHA could collect if this value were deposited in treasury notes. It then adds a risk factor percentage that reflects the risk of default by the debtors.[217] The court was not inclined to accept FmHA's reasoning on this issue, noting that the FmHA was required to sell its inventory land to local farmers.[218] Thus, the court indicated that the proper "market rate" should be defined by the rate that the FmHA could expect to receive if it sold the debtors' property to local farmers. Because evidence on this point had not been presented, the court remanded the case for a determination of the appropriate market rate of interest.[219] In other decisions addressing the interest rate component of confirmation standards for Chapter 12 plans, the courts have rejected five percent and seven percent rates.[220] Nevertheless, courts have approved a twelve percent rate[221] and approved a rate set accord-

212. 869 F.2d 1144 (8th Cir. 1989).
213. *Fisher*, 930 F.2d at 1363.
214. *Bartlesmeyer*, 78 B.R. at 977.
215. For a discussion of the lower court's analysis on this issue, see *Matter of* Doud, 74 B.R. 865, 870 (Bankr. S.D. Iowa 1987).
216. *Fisher*, 930 F.2d at 1364.
217. *Id.*
218. *Id.*
219. *Id.*
220. *See, e.g.*, *In re* Mason, 129 B.R. 990, 991-92 (Bankr. W.D.N.Y. 1991) (rejecting the "cramdown interest rates" of 7% and 5% as not providing the secured creditors the present value of their claims for purposes of Chapter 12 confirmation).
221. *See In re* Foos, 121 B.R. 778, 781 (Bankr. S.D. Ohio 1990) (finding that a fixed rate of 12% per annum, the applicable rate for a similar loan made today, is the appropriate rate for a Chapter 12 plan of reorganization).

ing to the interest rate currently paid on Treasury Bonds, plus a two percent risk factor.[222]

Section 1225 also contains specific confirmation standards that apply to the debtor's unsecured claims. The plan must provide that the value of assets to be distributed under the plan to each unsecured claim holder is not less than the amount that would be paid on such claim if the estate were liquidated under a Chapter 7 bankruptcy.[223] In other words, this requirement, termed either the "best interest of creditors" test or the "liquidation" test,[224] requires that unsecured creditors receive at least as much under the plan as they would receive under a liquidation.[225] The courts are thus required to determine what assets should be included in this hypothetical liquidation and when the valuation of the included assets should occur.[226] These issues have also produced much litigation.

In addressing these issues, some courts have held that the appropriate valuation date should be the effective date of the plan and that all assets in existence at that time would be valued.[227] The recent case of *In re Foos*[228] rejected this in so far as it called for the inclusion of post-petition assets. The *Foos* court agreed that the best interests test requires a valuation of assets as of the effective date of the plan, presumably the date of confirmation, but it held that only assets that were property of the estate as of the

222. *See In re* Koch, 131 B.R. 128, 133-34 (Bankr. N.D. Iowa 1991) (holding that an interest rate determined by the treasury bond rate with a two percent risk factor increase is permissible; also holding that the duration of repayment terms on a restructured loan must adhere to the customary lending practices in order to meet Chapter 12 confirmation standards and accepting the "creative approach" of an extended amortization period with an intermediate balloon payment requirement).

223. 11 U.S.C. § 1225(a)(4) (1988).

224. Under Chapter 12, the requirement is set forth at 11 U.S.C. § 1225(a)(4) (1988). The same requirement exists under Chapters 11 and 13 at 11 U.S.C. §§ 1129(a)(7) and 1325(a)(4) (1988), respectively.

225. *Id.*

226. Most of the recently reported decisions interpreting this requirement have been Chapter 12 cases and have focused on the timing of liquidation analysis, with the majority choosing the date of confirmation. *See, e.g.* First Nat'l Bank v. Hopwood (*In re* Hopwood), 124 B.R. 82, 83 (E.D. Mo. 1991) (holding that the appropriate time for evaluating the best interests test is the date of plan confirmation); Gribbons v. Federal Land Bank, 106 B.R. 113, 115 (W.D. Ky. 1989) (same); *In re* Lupfer Bros., 120 B.R. 1002, 1004 (Bankr. W.D. Mo. 1990) (same); *In re* Musil, 99 B.R. 448, 450 (Bankr. D. Kan. 1988) (same); *In re* Bluridg Farms, Inc., 93 B.R. 648, 656 (Bankr. S.D. Iowa 1988) (same); *In re* Perdue, 95 B.R. 475, 477 (Bankr. W.D. Ky. 1988) (same). *But see In re* Neilsen, 86 B.R. 177, 179 (Bankr. E.D. Mo. 1988) (holding that the test is to be applied as of the filing date); *In re* Foos, 121 B.R. 778, 783 (Bankr. S.D. Ohio 1990) (holding that the correct date for valuation is the effective date of the plan, but that the only assets that are to be considered are those in existence as of filing).

227. *In re* Bremer, 104 B.R. 999, 1002-07 (Bankr. W.D. Mo. 1989).

228. 121 B.R. 778 (S.D. Ohio 1990).

bankruptcy filing were to be valued.[229] The court based its holding on the fact that a true Chapter 7 liquidation would only encompass assets belonging to the estate as of filing under section 541.[230] Thus, the court observed that unharvested crops could be excluded from the best interests analysis. With regard to a farm program contract that was also at issue, the court noted that evidence had not been presented at the confirmation hearing on whether the debtor's right to receive future payments was part of the section 541 estate.[231] If this right was property of the estate, the value of the payments, as of the effective date of the plan, would have to be included in the liquidation analysis.[232]

Other decisions on this issue include *In re Braxton*[233] and *First National Bank v. Hopwood (In re Hopwood).*[234] In *Braxton*, the debtor's plan was not confirmed because the court found insufficient evidence to establish that the debtor met the liquidation test.[235] In *Hopwood*, the court confirmed that the correct date for comparing the liquidation value of the property and the amount to be distributed under the Chapter 12 plan to unsecured creditors is the effective date of the plan.[236]

In addition to the liquidation test, unsecured creditors may also be entitled to receive payments from all projected disposable income over the life of the plan.[237] As such, courts have been called upon to interpret both this requirement and the meaning of the term "disposable income."

In *In re Wood*,[238] the court held that Chapter 12 debtors have an affirmative duty to make all payments required under the plan, including payments made under the plan provision that requires payment of disposable income to unsecured creditors.[239] The court further held that the trustee need not seek modification of the plan in order to compel this payment of disposable income.[240]

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229. *In re* Foos, 121 B.R. 778, 781-84 (S.D. Ohio 1990).
230. *Id.* at 782-83.
231. *Id.* at 784.
232. *Id.*
233. 124 B.R. 870, 874 (Bankr. N.D. Fla. 1991) (refusing to confirm a Chapter 12 plan in part because the farmers failed to present sufficient evidence that the proposed plan would offer unsecured creditors as much as they would receive on liquidation or that the plan was feasible).
234. 124 B.R. 82, 85 (E.D. Mo. 1991).
235. *In re* Braxton, 124 B.R. 870, 874 (Bankr. N.D. Fla. 1991).
236. First Nat'l Bank v. Hopwood (*In re* Hopwood), 124 B.R. 82, 85 (E.D. Mo. 1991). *But see In re* Nielsen, 86 B.R. 177, 178 (E.D. Mo. 1988).
237. 11 U.S.C. § 1225(b) (1988).
238. 122 B.R. 107 (Bankr. D. Idaho 1990).
239. *In re* Wood, 122 B.R. 107, 111 (Bankr. D. Idaho 1990).
240. *Id.* at 112.

While the trustee may have the burden of going forward with evidence as to the existence of disposable income, the debtor has the ultimate burden of persuasion.[241] As to the definition of disposable income, the court noted that when determining reasonable expenses, both those amounts already expended and those necessary for future operations must be considered, that capital expenditures are not unreasonable expenses as a matter of law, and whether it is reasonable to require the debtor to seek operating credit as opposed to using cash for operating expenses will depend on the facts of the case.[242] The court held that an analysis of disposable income depends on actual expenses and income figures, not budget projections.[243] Applying this standard, the court found that on the facts of the case, the debtors had no disposable income for distribution.[244]

Another issue that has generated litigation concerning plan confirmation is the compensation afforded to the bankruptcy trustee.[245] Chapter 12 is set up to fund the trustee's compensation through the plan payments. The trustee is to collect a percentage fee from payments made by the debtor under the plan.[246] The issue that has been raised is whether this percentage must be assessed against all payments made by the debtor. Several recent cases have addressed this issue.

One recent court noted that there is a presumption in the Code favoring trustee administration of all plan payments.[247] That court held, however, that a one time cash collateral payment could be paid directly to the impaired creditor and that this direct payment would avoid the trustee's fee.[248] The factors the court considered included the extent of other payments, the impact on the total amount of trustees compensation, the ease of verification of

241. *Id.*
242. *Id.* at 115-16.
243. *Id.* at 117.
244. *Id.* at 118-19. *See also In re* Fleshman, 123 B.R. 842, 846-47 (Bankr. W.D. Mo. 1990) (holding that a Chapter 12 plan, confirmed over the objection of unsecured creditors, must be construed to require payment of all disposable income to unsecured creditors; calculation of disposable income involves a subjective analysis of what expenses are reasonably necessary; and debtors' motion to pay disposable income to secured creditors is denied); *In re* Martin, 130 B.R. 951, 964-66 (Bankr. N.D. Iowa 1991) (finding that life insurance proceeds became income for purposes of "disposable income" analysis).
245. For an excellent article explaining Chapter 12 trustee compensation, see Janet Flaccus, *Bankruptcy Trustee's Compensation: An Issue of Court Control*, November 1991 (available from Professor Flaccus, University of Arkansas School of Law, Fayetteville, AR 72701).
246. In most districts, 28 U.S.C. § 586(e) (1988) governs. In districts in which the U.S. Trustee system is not in effect, 11 U.S.C. § 1202(a) (1988) controls.
247. *In re* Seamons, 131 B.R. 459, 462 (Bankr. D. Idaho 1991).
248. *Id.*

whether the payment has been made, the sophistication of lender, the lender's consent to the direct payment, and debtors' diligence, cooperation and good faith.[249]

The court in *In re Golden*[250] held that the debtor could make direct payments to creditors who are legally sophisticated and who have consented to the plan.[251] Whether payments are made through the trustee or paid directly to the creditor, however, the court held that the trustee is entitled to a commission on all claims modified by the Chapter 12 plan.[252]

In contrast, the court in *Fulkrod v. Barmettler (In re Fulkrod)*[253] took a more liberal approach. The court held that while the statutory trustee's fee must be assessed against all payments made by the trustee, and the trustee should generally disburse all payments on impaired claims, a contrary plan provision providing for the payment of an impaired claim directly by the debtor may be permissible.[254] The court stated that whether such a plan provision is appropriate is dependent upon the sound discretion of the court.[255]

D. OTHER ISSUES IN CHAPTER 12 BANKRUPTCY

In addition to the critical issues of eligibility for relief under Chapter 12 and confirmation of a Chapter 12 plan, the courts have addressed a variety of other issues in Chapter 12 bankruptcies. For example, the Eighth Circuit addressed the issue of whether a debtor can be ordered to make preconfirmation payments to a creditor.[256] The court held that although these payments were not specifically authorized by the Code, the bankruptcy court has the discretion to make such an order.[257]

Several courts addressed the issue of modification of a Chapter 12 plan. For example, the Second Circuit held that the modification of a confirmed Chapter 12 plan to allow for the sale of a negative easement restricting the use of the land to agricultural use was permissible.[258] The court based its decision on the bankruptcy

249. *Id.*
250. 131 B.R. 201 (Bankr. N.D. Fla. 1991).
251. *In re* Golden, 131 B.R. 201, 204 (Bankr. N.D. Fla. 1991).
252. *Id.* at 203-04.
253. 126 B.R. 584 (Bankr. 9th Cir. 1991).
254. Fulkrod v. Barmettler (*In re* Fulkrod), 126 B.R. 584, 588 (Bankr. 9th Cir. 1991). *Accord* Overholt v. Farm Credit Servs. (*In re* Overholt), 125 B.R. 202, 211-12 (S.D. Ohio 1990).
255. *Id.*
256. Stahn v. Haeckel, 920 F.2d 555, 557 (8th Cir. 1990).
257. *Id.*
258. Abele v. Webb (*In re* Webb), 932 F.2d 155, 158 (2d Cir. 1991).

court's finding that the sale increased the feasibility of the plan and was in fact in the best interest of the creditors.[259]

The court in *In re Larson*,[260] held that the allowance of a Chapter 12 plan modification does not require proof of a change in circumstance as a basis for the proposed modification. However, the modified plan must meet the same confirmation standards as the original plan.[261] On the facts of the *Larson* case, the debtors' motion for plan modification was denied for failure to show feasibility and failure to provide secured creditors with the present value of their secured claims.[262]

One final Chapter 12 issue addressed by several courts is the issue of successive bankruptcy filings. The courts appear to agree that there is no per se rule against such filing, but they direct their analysis to whether the filing meets the good faith standard.[263] In addition, some courts have found that a change in circumstances must be shown to justify the most recent filing.[264]

IV. DISCHARGEABILITY, DISMISSAL, SANCTIONS AND FRAUD

As is the case with non-farm debtors, farmers who file for relief in bankruptcy and abuse the system by acting in bad faith or committing fraud are frequently scorned by the bankruptcy courts. Although the agricultural connection in many of the decisions on these issues is irrelevant, several agricultural cases can be highlighted to emphasize the seriousness of this abuse of process.

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259. *Id.* at 157.

260. 122 B.R. 417 (Bankr. D. Idaho 1991).

261. *In re* Larson, 122 B.R. 417, 420 (Bankr. D. Idaho 1991).

262. *Id.* at 420-21.

263. *See, e.g.*, Schuldies v. United States (*In re* Schuldies), 122 B.R. 100 (D. S.D. 1990) (holding that the bankruptcy court must examine the totality of the circumstances surrounding the successive filing of bankruptcy proceedings to determine whether the debtor has acted in good faith for purposes of eligibility for relief; there is no per se rule against successive filings; bad faith warranting dismissal of the bankruptcy can be found either in the filing of the bankruptcy or the proposal of the plan).

264. *See In re* Henke, 127 B.R. 255 (Bankr. D. Mont. 1991) (holding that the filing of successive bankruptcies is not per se bad faith, but the court must examine the filings together to determine whether the statutory requirements, including good faith requirements are met; also holding that a substantial or unexpected change in circumstances must be shown to justify filing of Chapter 12 during performance under confirmed chapter 11 plan); *In re* Miller, 122 B.R. 360 (Bankr. N.D. Iowa 1990) (holding that while there is not a per se rule against successive bankruptcy filings, successive filing may not meet the good faith test if debtors cannot show a "genuine need" for new bankruptcy relief; successive filing may not meet the good faith test if sole purpose for refiling is to renegotiate previously agreed upon plan); *In re* Fuhrman, 118 B.R. 72 (Bankr. E.D. Mich. 1990) (holding that the refiling of a Chapter 12 petition shortly after a prior dismissal places a burden on the debtors to establish that their situation has changed; also holding that prior findings are presumed to be correct and cannot be relitigated).

In cases where fraud is found, the court will deny the debtor discharge, either of the relevant debt[265] or of all debts.[266] For example, in *Frieouf v. United States (In re Frieouf)*,[267] the Tenth Circuit found that the evidence established that the Chapter 11 farm debtor acted in bad faith and in a manner that was prejudicial to his creditors. As such, the court held that the bankruptcy court was justified in denying the debtor a discharge of the debts otherwise dischargeable in his case for a period of three years.[268] The court found, however, that the bankruptcy court was not authorized to deny the debtor access to bankruptcy for longer than the 180-day period specified in section 349(a) of the Bankruptcy Code.[269] Although the access to bankruptcy issue has not been addressed in other recent agricultural bankruptcy cases, several cases have denied or revoked the discharge of debt because of a finding of fraud.[270]

Chapter 12 contains a provision specifically authorizing the court, on request of a party in interest, to convert a pending Chapter 12 case to a Chapter 7 liquidation upon a finding of fraud.[271] This powerful provision has been used in several cases to convert a case, despite the debtor's motion to dismiss the case.[272] Section 1208(b) gives the debtor this right to dismiss the Chapter 12 bank-

265. 11 U.S.C. § 523(a)(2) (1988).
266. 11 U.S.C. § 727(a) (1988).
267. 938 F.2d 1099 (10th Cir. 1991).
268. Frieouf v. United States (*In re* Frieouf), 938 F.2d 1099, 1105 (10th Cir. 1991).
269. *Id.* at 1104 (citing 11 U.S.C. § 349(a) (1988)).
270. Other recent cases on the denial of discharge in agricultural bankruptcies include: Abbott Bank-Hemingford v. Armstrong (*In re* Armstrong), 931 F.2d 1233 (8th Cir. 1991) (holding that the issue of fraud in the conversion of nonexempt assets to exempt assets is a question of fact for the bankruptcy court and that it will not be overturned unless clearly erroneous; in order to find fraudulent use of an exemption, indicia of fraud must be found; factors indicating that fraud may exist include conduct designed to mislead or deceive creditor, use of credit to purchase exemption, conversion of a substantial amount of property combined with fraudulent intent, the existence of conveyances for less than adequate consideration; issue of intent to defraud for purposes of denying discharge is also question of fact that will not be overturned unless clearly erroneous; fraudulent intent is presumed in cases in which the debtor gratuitously conveys valuable property; in this case, the bankruptcy court holding that the exemptions were allowed, but that discharge was denied was affirmed); Holder v. Bennett (*In re* Bennett), 126 B.R. 869 (Bankr. N.D. Tex. 1991) (revoking discharge in a Chapter 7 bankruptcy where the debtors received post-petition patronage dividends from a cotton cooperative based on pre-petition farming activities and refused to turn the same over to the trustee as property of the estate); John Deere Co. v. Myers (*In re* Myers), 124 B.R. 735 (Bankr. S.D. Ohio 1991) (denying the discharge of debt under § 523(a) where the debtor submitted a financial statement nine days before filing bankruptcy showing a net worth of $2.4 million more that the bankruptcy schedules revealed). *But see In re* French, 127 B.R. 434 (Bankr. D. Minn. 1991) (debtor may not be denied discharge in bankruptcy for valid assertion of Fifth Amendment right against self-incrimination at First Meeting of Creditors).
271. 11 U.S.C. § 1208(d) (1988).
272. Graven v. Fink (*In re* Graven), 936 F.2d 378 (8th Cir. 1991); Foster v. North Texas Production Credit Ass'n (*In re* Foster), 121 B.R. 961 (Bankr. N.D. Tex. 1990) *affirmed by*, 945 F.2d 400 (5th Cir. 1991) (Table No. 91-1039).

ruptcy "at any time."[273] However, when confronted with these seemingly conflicting provisions, two circuit courts have affirmed decisions that held that the right of the bankruptcy court to convert the case prevails over the debtor's right to dismiss.[274] These courts have held that when the facts show that the debtors have abused the legal and the bankruptcy process through fraud, the bankruptcy court has the authority to convert a Chapter 12 bankruptcy to a Chapter 7 bankruptcy proceeding, even though the debtor has moved to dismiss the Chapter 12 case. The courts have found that section 1208(b) does not provide the debtor with an absolute and immediate right to dismiss the case. When fraud is shown the court can delay action on this motion while considering other motions, such as one to convert the case because of fraud.[275]

V. CONCLUSION

The competition for scarce assets that is apparent in bankruptcy produces complex litigation of bankruptcy and nonbankruptcy law issues. This is particularly apparent in bankruptcy cases that affect agricultural interests, as these cases must construe not only bankruptcy law, but interpret specific aspects of agricultural law. This article attempted to highlight some of the most significant cases in this area. It is hoped that it will be helpful to those confronting these issues in future cases.

273. 11 U.S.C. § 1208(b) (1988).
274. *Id.*
275. *Id.*