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An Agricultural Law Research Article

Chapter 12 in the Courts

by

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Originally published in SOUTH DAKOTA LAW REVIEW
38 S. D. L. REV. 52 (1993)

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CHAPTER 12 IN THE COURTS

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I. INTRODUCTION

Reacting to pressure from those who argued that the Bankruptcy Code was not well-suited for farm reorganizations and spurred on by deteriorating conditions in the agricultural sector of the economy, Congress enacted Chapter 12 as part of the Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986.[1] The relative stability in the agricultural sector today makes the rhetoric accompanying passage of the bill appear to be hyperbole. For example, Senator Charles Grassley, the chief sponsor in the Senate, stated:

> I am sure I need not remind the Members of this Chambers of the plight of our Nation's farmers. The numbers of farms in financial trouble or on the brink of foreclosure is well known. But the measure of the crisis in agriculture isn't measured by cold numbers of a page. Instead, I measure it in terms of the human tragedy, the disruption of lives, and the despair of being a middle-aged farmer suddenly told to find another livelihood to support a family.
>
> I hear it and I see it when I go back home every weekend. I know

* Professor of Law, University of South Dakota School of Law. The author wishes to thank Lois Lofgren, USD School of Law—Class of 1994, for her very helpful research assistance and for enduring the often vague requests for authority. By way of fair disclosure, the author served as counsel for the debtor in *In re* Erickson Partnership, 856 F.2d 1068 (8th Cir. 1988) and *In re* Erickson Partnership, 83 B.R. 725 (D. S.D. 1988), two of the more significant decisions discussed herein.

1. Pub. L. No. 99-554, 100 Stat. 3105 (1986).

my colleagues have seen it too. We must stop the displacement. We must stop the bleeding on the farm.

[I] harbor no illusions about the ability of the Federal Bankruptcy Code to redress farmers' grievances. I know as well as anyone that the economic cause of the crisis in agriculture lie well beyond the realm of bankruptcy.

But the hearings in the House and Senate led to the unmistakable conclusion that the Bankruptcy Code doesn't work for farmers.[2]

Over in the House, Representative Mike Synar spoke of the need to provide immediate relief for family farmers:

I doubt there will be anything that we do that will have such an immediate impact in the grassroots of our country with respect to the situation that exists in most of the heartland, and that is in the agricultural sector. . . .

[T]hose family farmers who are facing that brink of disaster where they would have to be thrown off their farms can now look to this Congress and to this Government for new hope. That new hope is that we are going to give them the same standard that a small businessman or an individual has at this present time, which is the ability to reorganize.

. . . .

So this legislation is significant. It is important, because I think it is sending a message that we here in the U.S. Congress, we in this Government are sensitive to the family farmers who are facing this very terrible plight at this time.

You know, William Jennings Bryan in his famous speech, the Cross of Gold, almost 60 years ago, stated these words: "Destroy our cities and they will spring up again as if by magic; but destroy our farms, and the grass will grow in every city in our country." This legislation will hopefully stem the tide that we have seen so recently in the massive bankruptcies in the family farm area.[3]

The rhetoric from the critics' perspective was, in some cases, equally strong. Professor James J. White wrote:

In passing Chapter 12 of the Bankruptcy Reform Act, Congress has effectively invalidated certain important provisions of existing farm mortgages. Equally significant, Congress has disabled farmers from granting binding mortgages on the full value of their property. Although no court is likely to find the Chapter to violate the fifth amendment, the Chapter constitutes a substantial and retroactive alteration of the rights of existing mortgagees and a restriction on the powers of prospective mortgagors to grant valid mortgages.

[C]ongress was both wrong and shortsighted in its enactment of Chapter 12. Congress was wrong to enact a law that redistributes wealth from existing mortgagees to existing mortgagors. Congress was shortsighted to enact a law that will have the long-run consequence of diminishing the farm debtor's power to mortgage his land and, thus, his

2. 132 CONG. REC. 28593 (1986) (emphasis added).
3. *Id.* at 28147.

capacity to buy credit.[4]

With the advantage of some hindsight,[5] *it is fair to say that the experience with Chapter 12 offers something in support of both viewpoints.* The General Accounting Office (GAO) in 1989 reported to Congress that Chapter 12 had kept several thousands of farmers in business, but at the price of higher interest rates for all farmers.[6] The initial reaction of some farm lenders to withdraw from the agricultural sector altogether was revised later when it became apparent that their fears had not fully materialized.[7] The evidence does suggest that Congress achieved its primary purpose in enacting Chapter 12, which was "to give family farmers facing bankruptcy a fighting chance to reorganize their debts and keep their land."[8]

In the summer of 1992, the House Judiciary Committee received testimony regarding the extension of Chapter 12, presently due for repeal in October of 1993.[9] One of the principal drafters of Chapter 12, Bankruptcy Judge A. Thomas Small, testified that the creditors' reservations and fears about the law had not been borne out.[10] He stated that Chapter 12 had saved thousands of family farms and had stabilized farm values. In his experience, there was little evidence of abuse by farmers seeking to take advantage of the "cramdown" provision to reduce the mortgage obligation on the basis of a temporary decline in land value. He also noted that Chapter 12 filings had declined as the farm economy had improved and that its presence had encouraged more out-of-court negotiations and settlements between lenders and farmers.[11] Chief Bankruptcy Judge Richard L. Bohanon testified that approximately 60 percent of the Chapter 12 cases filed had been confirmed and that of those confirmed almost 90 percent had been completed successfully.[12] Chapter 12 was also beneficial in giving the financially distressed farmer "something when he comes to the negotiating table with the banker. Without that," Judge Bohanon concluded, "he's virtually helpless. He would only be

4. James J. White, *Taking From Farm Lenders and Farm Debtors: Chapter 12 of the Bankruptcy Code*, 13 J. CORP. L. 1 (1987). *Cf.* Patrick B. Bauer, *Where You Stand Depends on Where You Sit: A Response to Professor White's Sortie Against Chapter 12*, 13 J. CORP. L. 33 (1987).

5. Hindsight, by the way, is not always "20-20." If it were, there would not be such fundamental political differences in questions as, for example, whether the Reagan presidency was good for the country. Likewise, views on Chapter 12 as boon or bust are inevitably shaped by one's overall perspective. *See, e.g.*, U.S. GENERAL ACCOUNTING OFFICE, FARM FINANCE: PARTICIPANT'S VIEWS ON ISSUES SURROUNDING CHAPTER 12 BANKRUPTCY (May 1989) [hereinafter GAO STUDY]. For the record, I am as avid a supporter of Chapter 12 as Professor White is a critic.

6. GAO STUDY, *supra* note 5, at 18-19.

7. Andrea Bennett, *Chapter 12 Changes Ways Lenders Serve Farmers*, AM. BANKER, Feb. 16, 1988, at 26, available in Westlaw, ABF database.

8. H.R. CONF. REP. NO. 958, 99th Cong., 2d Sess. 48 (1986), *reprinted in* 1986 U.S.C.C.A.N. 5227, 5249.

9. Pub. L. 99-554, § 302(f), 100 Stat. 3124.

10. *To Extend the Period During Which Chapter 12 of Title 11 of the United States Code Remains in Effect: Hearing on H.R. 5322 Before the Subcommittee on Economic and Commercial Law of the House Committee on the Judiciary*, 102d Cong., 2d Sess. 21 (1992) [hereinafter *Hearing on Extension of Chapter 12*].

11. *Id.*

12. *Id.* at 6.

liquidated."[13] South Dakota attorney and bankruptcy trustee Rick A. Yarnall testified that there was a high degree of success to Chapter 12 reorganizations.[14] He emphasized the need for Chapter 12 because of the difficulties of reorganizing under Chapter 11 in light of the absolute priority rule.[15] Even the banking representative at the hearing had to admit under questioning by Congressman Mike Synar that the percentage of money loaned by his bank to agriculture had grown since 1986.[16]

In a related development, the movement toward the enactment of a small business reorganization chapter during the summer of 1992 reinforced the argument that Chapter 11 is not the best vehicle for all types of reorganizations, no matter what size. The proposed Chapter 10 (along with an extension of Chapter 12 for two more years) passed the Senate by a vote of ninety-seven to zero.[17] The bill did not pass the House, but further action on both small business and family farm reorganizations is expected in the next Congress. The problem with Chapter 11 may not be in its structure, but possibly in the attitude of creditors operating under the Chapter 11 rules. Consider the following two situations. Debtor A is a small business that owes $50 thousand to the Bank of America. Debtor B is major airline company and has an outstanding debt of $50 million with the same bank. If Debtor A defaults, that is A's problem; if Debtor B defaults, then it is the bank's problem. Chapter 11 is a reasonably good forum for workout of financial problems when the players have to take into account the interests of others; it is less useful when some players may exercise veto power with impunity. In any event, it appears that Congress will continue to work on the problem of small business and family farm reorganizations.

As Congress considers whether to continue Chapter 12, it is appropriate to consider the experience of the federal courts, most notably the bankruptcy courts, with the interpretation and implementation of Chapter 12. If Congress decides to extend the law, it may wish to consider certain amendments in light of this experience in order to better carry out its intention that the Bankruptcy Code provides a realistic remedy for the family farmer to work through times of financial distress. This article will survey those Chapter 12 issues which have been most intensely litigated and will make recommendations regarding the adjustments, if any, which should be made by Congress. In addition, the article will comment on how the federal courts have fared in their interpretation of these issues.

II. CONVERSION OF PENDING CASES

The first and probably most hotly contested issue was whether Chapter 12 was available to family farmers who had filed bankruptcy prior to the effec-

13. *Id.*
14. *Id.* at 32.
15. *Id.* at 31, 35.
16. *Id.* at 47-48.
17. 138 CONG. REC. S8359 (daily ed. June 17, 1992).

tive date of the Act. The passage of time has effectively mooted this issue, but the legal resolution in the courts is instructive nonetheless. The Act had amended sections 1112(d) and 1307(d) of the Bankruptcy Code to allow conversion from Chapter 11 or Chapter 13, respectively, to Chapter 12. It was contended, however, that these amendments did not apply to cases filed prior to November 26, 1986, the effective date of Chapter 12, because a transition provision provided: "The amendments made by subtitle B of title 11 shall not apply with respect to cases commenced under title 11 of the United States Code before the effective date of this Act."[18] Included among the amendments made by subtitle B were the amendments of Chapters 11 and 13, providing for conversion to Chapter 12.

Ordinarily, this would have precluded any possible argument that Chapter 12 could apply to pending cases. But the Joint Explanatory Statement of the House/Senate Committee of Conference indicated just such a result. The language regarding conversion stated:

> *Applicability of Chapter 12 to Pending Chapter 11 and 13 Cases*
>
> It is not intended that there be routine conversion of Chapter 11 and 13 cases, pending at the time of the enactment, to Chapter 12. Instead, it is expected that courts will exercise their sound discretion in each case, in allowing conversions only where it is equitable to do so.
>
> Chief among the factors the court should consider is whether there is a substantial likelihood of successful reorganization under Chapter 12.
>
> Courts should also carefully scrutinize the actions already taken in pending cases in deciding whether, in their equitable discretion, to allow conversion. For example, the court may consider whether the petition was recently filed in another chapter with no further action taken. Such a case may warrant conversion to the new chapter. On the other hand, there may be cases where a reorganization plan has already been filed or confirmed. In cases were the parties have substantially relied on current law, availability to convert to new chapter should be limited.[19]

What then did Congress intend regarding conversion of pending cases? The transition provision forbids it; the Conference Report clearly contemplates it. Was the transition provision the result of an inadvertent mistake which frustrated one of the immediate purposes of Chapter 12, or was it the result of a later compromise that was not reflected in the Conference statement?

According to the principal players, it was the former, not the latter. Senator Grassley, one of the chief sponsors of the Act and a member of the Conference Committee, later addressed the apparent contradiction between the transition provision and the Conference Committee Statement. He cited the applicable language of the Statement contemplating conversion of pending cases to Chapter 12 and then stated:

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18. Section 302(c)(1) of the Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986; Pub. L. 99-554, 100 Stat. 3105.

19. 1986 U.S.C.C.A.N. at 5249-50.

> I want to underscore that *this language was carefully worked out among the conferees and their staffs. It was one of the critical components of the conference agreement on the chapter 12 law.*
>
> Unfortunately, when the bill made it to the floor of both Chambers in the hectic last days of the 99th Congress, *Members did not notice that a statutory provision—found in the transitional title of the bill—contradicted this intent.*[20]

Senator Grassley then criticized those bankruptcy courts which had denied motions to convert pending cases to Chapter 12. These courts "have disregarded the clear congressional intent found in the joint explanatory statement." The courts had followed the letter of the law and thereby frustrated the clear congressional purpose: "This result is plainly at variance with the policy of [c]hapter 12 as a whole—to correct problems farmers have with the bankruptcy code."[21] As a solution to the problem, Senator Grassley introduced an amendment that would have repealed the transition provision that was "inconsistent with the clear congressional intent."[22]

On the very same day it was introduced in the Senate, Representatives Coehlo and Synar introduced the same amendment in the House. Representative Synar was the chief sponsor of Chapter 12 in the House and a member of the Conference Committee. Representative Coehlo stated:

> Now is the time for Congress to correct its own mistakes. The legislation which I have introduced amends the enactment date of the original legislation to allow conversions from chapter 11 to chapter 12. . . .
>
> It is clear that Congress must now act to ensure that the farmers across this country are provided with the relief they need. Chapter 12 is a productive and fair alternative to foreclosure. Please join me in correcting a grave inequity and following through on the true intentions of Congress.[23]

The amendment passed the Senate on July 24, 1987.[24] However, the counterpart in the House apparently died in committee. This outcome is probably best explained in light of the passage of time which made the issue essentially moot in most jurisdictions. That is, either a particular district allowed conversions, and the reorganization proceeded under Chapter 12, or the district did not allow conversions and debtors either reorganized under existing chapters or were dismissed. The pressure to pass the curative legislation understandably waned when debtors in the jurisdictions denying conversion resolved their reorganization situation, one way or the other. In any event, the outcome of the amendment in the 100th Congress cannot be regarded as conclusive on the intentions of the 99th Congress on the conversion issue.

How was the issue resolved in the courts? The majority of courts denied

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20. 133 CONG. REC. 3769 (1987) (emphasis added).

21. *Id.* Senator Grassley inserted Judge Peder Ecker's decision in *In re* Erickson Partnership, 68 B.R. 819 (Bankr. D. S.D. 1987), in the Congressional Record, citing it as a decision which followed Congress' intent. *Id.*

22. 133 CONG. REC. 3771 (1987).

23. *Id.* at 3888.

24. *See In re* Clarke, 78 B.R. 1008, 1010 (Bankr. 9th Cir. 1987).

conversion on the basis of the language of the statute, which was said to be unambiguous.[25] The courts were said to be unable to depart from the "plain meaning" of the statute. The response of the Eighth Circuit in *In re Erickson Partnership* was typical: " 'Legislative history can be a legitimate guide to a statutory purpose obscured by ambiguity, but "[i]n the absence of a 'clearly expressed legislative intention to the contrary,' the language of the statute itself 'must ordinarily be regarded as conclusive.'" ' "[26] For some of these courts, however, there was some discomfort expressed with this result. Bankruptcy Judge Frank Koger, for example, stated:

> Every aspect of this new legislation cries out that conversion was intended, except for the words it was couched in .... The function of the judiciary is to apply the law — not make it or enforce it. As long as the words are clear and subject to unambiguous interpretation, the Court reluctantly finds itself unable to rule in any other fashion.[27]

Other courts held that a literal application of the transition provision would frustrate the expressed intent of Congress to provide a workable reorganization alternative for the financially distressed family farmer.[28] That is, the court may go beyond the literal language of the statute if reliance on that language would defeat the plain purpose of the statute.[29] Bankruptcy Judge Peder Ecker, for example, stated:

> To follow the interpretation urged by the objecting parties would produce a result which is unreasonable in light of the stated purpose of Congress to provide a substantially more feasible method of reorganiza-

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25. *See, e.g.*, Matter of Sinclair, 870 F.2d 1340, 1341 (7th Cir. 1989); *Erickson Partnership*, 856 F.2d at 1070; *In re* Jones, 115 B.R. 351, 353 (Bankr. N.D. Fla. 1990); *In re* Kershaw, 81 B.R. 897, 903 (M.D. Tenn. 1988); *Clarke*, 78 B.R. at 1010; *In re* Willis, 78 B.R. 379, 381 (Bankr. M.D. Ga. 1987); Matter of Carnahan, 77 B.R. 207, 210 (Bankr. N.D. Ind. 1987); *In re* Ryder, 75 B.R. 890, 891 (Bankr. W.D. La. 1987); *In re* Litteral, 74 B.R. 14, 16 (Bankr. W.D. La. 1987); *In re* Solomon, 72 B.R. 506, 507 (Bankr. E.D. Ark. 1987); *In re* McDonald, 72 B.R. 227, 228 (Bankr. D. S.C. 1987); *In re* Evans, 72 B.R. 21, 25 (Bankr. D. Ore. 1987); *In re* Keinath Bros. Dairy Farm, 71 B.R. 993, 1005 (Bankr. E.D. Mich. 1987); *In re* Rossman, 70 B.R. 985, 994 (Bankr. W.D. Mich. 1987); *In re* Ray, 70 B.R. 431, 432 (Bankr. E.D. Mo. 1987); *In re* Hughes, 70 B.R. 66, 68 (Bankr. W.D. Va. 1987); *In re* Council, 70 B.R. 20, 22 (Bankr. W.D. Tenn. 1987); *In re* Glazier, 69 B.R. 666, 669 (Bankr. W.D. Okla. 1987); *In re* Barclay, 69 B.R. 552, 554 (Bankr. C.D. Ill. 1987); *In re* Spears, 69 B.R. 511, 515 (Bankr. S.D. Iowa 1987); *In re* Petty, 69 B.R. 412, 413 (Bankr. N.D. Ala. 1987); *In re* Groth, 69 B.R. 90, 92 (Bankr. D. Minn. 1987); *In re* Albertson, 68 B.R. 1017, 1021 (Bankr. W.D. Mo. 1987); *In re* B.A.V., Inc., 68 B.R. 411, 413 (Bankr. D. Colo. 1986); *In re* Tomlin Farms, Inc., 68 B.R. 41, 43 (Bankr. D. N.D. 1986). A corollary holding was that the debtor in a pending case could not dismiss the case and refile a new case under Chapter 12. *See, e.g.*, *In re* Sadler, 935 F.2d 918, 921 (7th Cir. 1991); *In re* Howe, 913 F.2d 1138, 1148 (5th Cir. 1990); *Sinclair*, 870 F.2d at 1345; *In re* Olson, 102 B.R. 147, 149 (Bankr. C.D. Ill. 1989). *But see In re* Ryder, 75 B.R. 890, 893 (Bankr. W.D. La. 1987); *In re* Gamble, 72 B.R. 75, 77 (Bankr. D. Idaho 1987); *In re* Glazier, 69 B.R. 666, 669 (Bankr. W.D. Okla. 1987) (refiling in Chapter 12 permitted if case was involuntarily dismissed).

26. 856 F.2d at 1070 (quoting Burlington N. R.R. Co. v. Okla. Tax Comm'n, 481 U.S. 454, 461 (1987)).

27. *Albertson*, 68 B.R. at 1021.

28. *See e.g.*, *In re* Cobb, 76 B.R. 557, 559 (Bky. N.D. Miss. 1987); *In re* Nelson, 73 B.R. 363, 364 (Bky. D. Kan. 1987); *In re* Fischer, 72 B.R. 634, 636 (Bankr. D. Kan. 1987); *In re* Anderson, 70 B.R. 883, 885 (Bankr. D. Utah 1987); *In re* Mason, 70 B.R. 753, 756 (Bankr. W.D. N.Y. 1987); *In re* Henderson, 69 B.R. 982, 987 (Bankr. N.D. Ala. 1987); *In re* Big Dry Angus Ranch, Inc., 69 B.R. 695, 700 (Bankr. D. Mont. 1987); *Erickson Partnership*, 68 B.R. at 826, *aff'd* 74 B.R. 670, 673 (D. S.D. 1987), *rev'd* 856 F.2d 1068 (8th Cir. 1988).

29. *See, e.g.*, Bob Jones Univ. v. United States, 461 U.S. 574, 586 (1983); Watt v. Alaska, 451 U.S. 259, 265-66 (1981).

> tion for family farmers. . . . Congress recognized that the provisions of the existing Bankruptcy Code were not working well, if at all, for the farmers who are attempting to reorganize. It clearly violates the purpose of Congress to provide relief to family farmers by dividing them into two groups, thereby creating a double standard for reorganization purposes.[30]

The critics of the double standard argument responded that different treatment is inevitable whenever a new statute is adopted and given effect only prospectively. The chief cited case in support of this position was *Central Trust Co. v. Official Creditors' Committee*.[31] In *Central Trust Co.*, the debtor moved to dismiss its Chapter XI petition (filed under the 1898 Bankruptcy Act) in order to refile under Chapter 11 of the Bankruptcy Reform Act of 1978. The Supreme Court denied the motion, relying upon the unequivocal language of the statute and the accompanying legislative history.[32] Congress' reluctance to apply the new Bankruptcy Code to existing cases was understandable in light of the potential widespread impact of a revision of the *entire* Code on *all* pending cases. Congress also clearly expressed its intention in both the transitional and the supporting legislative history.

By contrast, Chapter 12 was intended to create a special reorganization procedure for a discrete group of debtors. The remarks of the sponsors of Chapter 12 gave no indication of any intent to deny the benefits of Chapter 12 to family farmers already forced to file for reorganization due to economic exigencies. The Joint Explanatory Statement expressly contemplates conver-

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30. *Erickson Partnership*, 68 B.R. at 826. *See* United States v. Am. Trucking Ass'n, 310 U.S. 534, 543 (1940) ("[E]ven when the plain meaning did not produce absurd results but merely an unreasonable one 'plainly at variance with the policy of the legislation as a whole' this Court has followed that purpose, rather than the literal words."); Mangels v. United States, 828 F.2d 1324, 1329 (8th Cir. 1987) ("The plain meaning rule is inapplicable, however, when it yields absurd consequences and there is an alternative interpretation that reasonably effects the statute's purpose."); Pressley v. Capital Credit & Collection Serv., Inc., 760 F.2d 922, 924 (9th Cir. 1985); Hodgson v. Bd. of County Comm'rs, County of Hennepin, 614 F.2d 601, 612 (8th Cir. 1980); Church of Scientology v. United States Dept. of Justice, 612 F.2d 417, 422 (9th Cir. 1979).

31. 454 U.S. 354 (1982).

32. Section 403(a), a transitional rule for the 1978 Bankruptcy Reform Act, provided:

> A case commenced under the Bankruptcy Act, and all matters or proceedings in or relating to any such case, shall be conducted and determined under such Act as if [the new Code] had not been enacted, and the substantive rights of parties in connection with any such bankruptcy case, matter, or proceeding shall continue to be governed by the law applicable to such case, matter or proceedings as if the [new Code] had not been enacted.

92 Stat. 2683. The legislative history also supported an unequivocal reading of § 403. The House Report stated:

> The first phase of transition begins on October 1, [1979,] the primary effective date of the bill. On that date, the new substantive law of bankruptcy as proposed by the bill will be put into effect. It will apply to all cases commenced on or after October 1[, 1979]. The application of the new law will only be to new cases, however. Cases commenced before October 1, [1979,] will continue to be governed by the Bankruptcy Act, as in effect September 30, [1979,] and by all other applicable laws in effect on that date. Those cases will proceed as though this bill had been enacted . . . .
>
> [Section 403(a)] continues cases pending as of the effective date of the bill without change. The new law will not affect cases commenced under the old law. Those cases will proceed as though this Act did not take effect. The section applies to substantive as well as procedural matters.

H.R. REP. NO. 95-595, 95th Cong., 1st Sess. 278-88, 459 (1977) (cited in *Central Trust Co.*, 454 U.S. at 357-58 n.1 (1982)).

sion of pending cases to Chapter 12 on an equitable basis. The Statement recognizes that when a plan of reorganization has been filed or confirmed, there may be reliance by the creditors upon current law.[33]

The case which served to support the argument in favor of conversion was *In re Adamo*.[34] One of the unintended consequences of the enactment of the Bankruptcy Reform Act of 1978 concerned the dischargeability of student loans because of a mistake in the transition provisions. Under the prior law, student loans were nondischargeable. This law was repealed on November 6, 1978, by one of the transition provisions of the 1978 Act and was to be replaced by 11 U.S.C. § 523(a)(8). The effective date of the new provision, however, was not until October 1, 1979. As a result, there was an eleven month "gap" in the law where there was no prohibition of the discharge of student loans. In the wake of many student bankruptcy filings, several bankruptcy courts applied the law literally and ordered a discharge of student loans.[35] Other bankruptcy courts looked to the clear congressional intent and denied discharge even though there was no statutory authority for the result at that time.[36] Thus, the split in the lower courts was on the very same basis as occurred later with respect to the Chapter 12 conversion issue.

The matter was finally resolved in *Adamo*. After describing the problem, the Second Circuit concluded:

> [T]he hiatus between the repeal of section 1087-3 of Title 20 and the effective date of its successor provision, 11 U.S.C. § 523(a)(8), was purely a manifestation of congressional inadvertence and that *to follow blindly the plain meaning of the statute without regard to the obvious intention of Congress would create an absurd result in accord with neither established principles of statutory construction nor common sense*. . . .
>
> Analysis of the legislative history of the [Bankruptcy Reform Act of 1978] supports appellant's contention that the failure of the effective dates of the repeal and replacement statutes to coincide resulted from a mistake of Congress.[37]

When it was realized that a mistake had been made, Congress did not cure the problem with legislation (given the relative shortness of the "gap"

33. *But see Ray*, 70 B.R. at 433 (concluding that conversion to Chapter 12 would deprive creditors of property without due process). Under the reasoning of the *Ray* court, however, a debtor could never convert a case to Chapter 12. It is questionable whether conversion in and of itself diminishes the pre-existing rights of creditors. The creditors' rights do not vest prior to confirmation of a plan of reorganization. Conversion between the various chapters is a well-established right provided to both debtors and creditors. *See* 11 U.S.C. §§ 706, 1112, 1208, 1307.

34. 619 F.2d 216 (2d Cir. 1980), *cert. denied sub. nom.* Williams v. New York State Higher Educ. Serv. Corp., 449 U.S. 843 (1980).

35. See the cases cited in *Adamo*, 619 F.2d at 219.

36. *Id.*

37. *Id.* at 219. *Accord*, Matter of Hogan, 707 F.2d 209 (5th Cir. 1983); Matter of Williamson, 665 F.2d 683 (5th Cir. 1982). *See also In re* Shannon, 670 F.2d 904, 906 (10th Cir. 1982) (following the legislative intent regarding the time for filing notice of appeal rather than give effect to another inadvertent mistake in the transition provisions for the Bankruptcy Reform Act of 1978); *In re* Daily Corp. 72 B.R. 489 (Bankr. E.D. Pa. 1987) (holding that placement of an amendment to 11 U.S.C. § 105(a) within subtitle A of Title II of the 1986 Act was an inadvertent error and concluding that the intention of Congress was to make the amendment effective within 30 days after passage by Congress, even though the transition provision clearly stated otherwise).

period), but instead a Senate Committee issued a legislative report which attempted to clarify the intentions of Congress regarding nondischargeability of student loans. The *Adamo* court gave the report due deference, stating: "Although such an interpretation by a subsequent Congress is not necessarily controlling, it may be useful in determining the intention of an earlier Congress."[38] Although Senator Grassley's and Representative Coehlo's statements regarding the "mistake" are likewise not controlling, they provided further evidence of the intentions of Congress with respect to the conversion issue. Senator Grassley went so far as to insert the text of the bankruptcy court's decision in *Erickson Partnership*[39] into the Congressional Record, stating that it was the first published decision that implemented the "clear congressional intent."[40] The Eighth Circuit was not impressed with this nor the *Adamo* argument and denied conversion.[41]

The weight of the cases eventually was on the side of denying conversion.[42] It is fair to say on this issue that the "plain meaning" of the statute prevailed over the legislative history or the underlying policy of Chapter 12. This issue in any event has become moot with the passage of time. Its chief legacy will be to remind us of how insistent the courts were on following the plain meaning of the statute, even when the purpose and legislative history of Chapter 12 suggested a contrary result. This episode will be particularly instructive if we observe the courts in other Chapter 12 cases departing from the plain meaning of the statute to reach a result more in accord with the court's own notion of sound policy. If those courts who were "compelled" to apply the plain meaning on the conversion issue use policy on other issues when the plain meaning favors the debtor, what could account for such inconsistency? Bias against Chapter 12 debtors, perhaps?

III. ELIGIBILITY FOR CHAPTER 12

There are several conditions which a debtor must meet in order to be eligible for Chapter 12 relief. The general eligibility section, section 109, states that "[o]nly a family farmer with regular annual income may be a debtor under chapter 12 . . . ."[43] The definition of "family farmer" essentially re-

38. *Adamo*, 619 F.2d at 221.

39. *Erickson Partnership*, 68 B.R. at 826.

40. 133 CONG. REC. 3771 (1987) (remarks of Senator Charles Grassley).

41. 856 F.2d at 1070-71. The fact that Congress had not passed the corrections bill suggested to the court that a majority of the Congress did not favor the proposed correction. *Id.* at 1071. *Adamo* was distinguished on the ground that Congress in that instance had clearly made a mistake. *Id.* at 1070.

42. For a list of cases denying conversion on the basis of the language of the statute, see *supra* note 25.

43. The definition of "family farmer with regular annual income" requires that the family farmer must have annual income which "sufficiently stable and regular to enable such family to make payments under a plan . . . ." 11 U.S.C. § 101(19) (1979 & Supp. 1992) [Unless otherwise noted, reference to 11 U.S.C. will automatically refer to the above listed dates]. Although this would appear to be adequately covered by the confirmation requirement of feasibility (§ 1225(a)(6)), this requirement does give a creditor the opening to challenge feasibility at the outset of the case instead of waiting until the time of confirmation or instead of filing a § 362(d) motion for relief from stay.

quires the debtor to be an individual (or, in certain cases, closely-held family partnerships or corporations) engaged in farming, whose debt does not exceed $1.5 million, eighty percent of which must be related to the farming operation, and whose income from farming constituted more than fifty percent of the debtor's gross income in the prior taxable year. These conditions fall into five categories, described more fully as follows.

A. *The Identity of the Debtor*

The debtor may be an individual or an individual and a spouse. Unlike Chapter 13, the debtor may also be a partnership or a corporation, if certain additional conditions are met. More than fifty percent of the outstanding stock or equity must be held by one family or one family and the relatives of the members of such family. The family or relatives must conduct the farming operation. In addition, more than eighty percent of the value of the partnership's or corporation's assets must be related to the farming operation.[44] Thus, there are both ownership and operation requirements.

One of the questions that arises here is who is included in the family? In *In re Cloverleaf Farmer's Co-op*,[45] the debtor was a cooperative organization that was incorporated and was owned by seven families in a Hutterite colony. Section 101(45) defines "relative" to mean an "individual related by affinity or consanguinity within the third degree as determined by the common law . . . ." The bankruptcy court held that there were nine individuals within the third level of affinity or consanguinity who held sixty-four percent of the equity ownership of the debtor.[46]

Another question concerns the use of corporate shareholders of the debtor corporation. In *Matter of Tobin Ranch*,[47] the debtor was a corporation whose stock was owned fifty percent by Paul and Carol Tobin and fifty percent by Leo Tobin Farms, Inc. Leo Tobin Farms, Inc. was owned by Paul Tobin and his three sisters. The bankruptcy court held that the debtor did not qualify for Chapter 12 because Paul and Carol Tobin owned only fifty percent of the debtor's stock and Leo Tobin Farms, Inc. was not a "relative" of any member of the Tobin family so as to count toward the *more* than fifty percent requirement.[48] The court admitted that the result seemed "harsh." This suggests that additional work on the corporate and partnership definition is needed to bring the results more in line with the basic intention to assist the family farmer.

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44. 11 U.S.C. § 101(18)(B).

45. 114 B.R. 1010 (Bankr. D. S.D. 1990).

46. *Id.* at 1015. *See* Matter of LLL Farms, 111 B.R. 1016 (Bankr. M.D. Ga. 1990) (debtor partnership owned by three sisters who did not farm, but operation was conducted by a son of one of the sisters qualified the debtor for Chapter 12 relief); *In re* Schaurer Agric. Enters., 82 B.R. 911 (Bankr. S.D. Ohio 1988) (partnership debtor which was owned by two brothers and operated by one of the brothers qualified for Chapter 12; partnership was not required to meet the fifty percent income test).

47. 80 B.R. 166 (Bankr. D. Neb. 1987).

48. *Id.* at 167.

The operational requirement means something more than part-time participation in the farming operation. In *In re Garako Farms, Inc.*,[49] more than fifty percent of the debtor's stock was owned by an individual who was engaged primarily in the practice of dentistry. This individual did not live on the property and employed a full-time foreman, whom he instructed. The individual periodically walked the property, drove a tractor, irrigated at times, oversaw the payment of expenses, and conducted other farming business in his own name. The original purpose of the corporation was to develop a pension and profit-sharing plan for the employees of the individual. The court held that this was not the type of entity that Congress intended to assist with Chapter 12.[50]

B. *Engaged in a Farming Operation*

The debtor must be engaged in a "farming operation" and the percentage of debt and income tests, described below, are tied to the "farming operation."[51] The Code's definition of "farming operation" has a great deal of circularity to it.[52] This has forced the courts to articulate principles for determining when one is engaged in farming, a task more difficult than it might initially seem. There are two issues here. The first is whether the operation is of the type that constitutes a "farming operation." The second is whether the debtor is still "engaged" in the farming operation.

With respect to defining what constitutes a "farming operation", the bankruptcy court in *In re Maike*,[53] considered whether a game farm and kennel constituted a farming operation. The debtors owned over 360 acres of land in rural Kansas. Part of the operation was devoted to the breeding and raising of pheasants. The crop ground was used to produce feed for the pheasants. Some of the pasture land was leased on a cash rent basis to a neighbor. The debtors also owned approximately 1,000 dogs either for breeding or for sale to pet stores or the public. The debtors sold approximately 7,000 dogs and puppies in an average year. The court declined to stretch the meaning of "livestock" to include dogs, for that arguably would bring zoos and amusement parks within the definition. It also declined to utilize a consumption test because that would eliminate the raising of horses, milo and cotton. Nor could "traditional" farming activities serve as a guide.[54] The court borrowed a gen-

49. 98 B.R. 506 (Bankr. E.D. Cal. 1988).

50. *Id.* at 509. *See In re* Ralph Faber Trust, 113 B.R. 599 (Bankr. D. N.D. 1990) (testamentary trust was not eligible for Chapter 12; trust did not actively farm the property but rented to trust beneficiaries and others).

51. 11 U.S.C. § 101(18)(A).

52. 11 U.S.C. § 101(21) states: " '[F]arming operation' includes farming, tillage of the soil, dairy farming, ranching, production or raising of crops, poultry, or livestock, and production of poultry or livestock products in an unmanufactured state." *Id.*

53. 77 B.R. 832 (Bankr. D. Kan. 1987).

54. *Id.*

> For example, in the early years of the settlement of Kansas, corn was the most common crop; the wheat for which Kansas is famous was not extensively planted until hard red winter wheat was introduced from Russia in the 1880's. Soybeans were not introduced into this part of the country until the 1920's and did not become a major cash crop until approxi-

eral "totality of circumstances" test from an earlier UCC perfection of farm products case:

> [T]he definitions and the commentary . . . stress the notion of *raising* crops or livestock as the essence of farming. *It is this involvement in the process of growing or developing crops and livestock that defines farming.* In the case of crops, farming contemplates the cultivation, caring for and harvesting of the crops. In the case of livestock, farming similarly contemplates the breeding, maintaining, and bringing to maturity of the animals and the subsequent marketing of the animals or their raw products.[55]

It added the following factors: location, the nature of the enterprise (service oriented activities versus raising crops or livestock), the type of product, and the debtor's role in the process. After considering all of the factors, the court concluded that the case was analogous to a cattle feedlot, which is considered to be a farming operation, and held the debtors to be eligible for Chapter 12 relief.[56]

Other operations that have been held eligible for Chapter 12 relief are harvesting of marketable timber on a sustained yield basis,[57] hauling of cattle for third parties,[58] hay cutting and custom combining.[59] Operations that have not been included within the scope of Chapter 12 "farming operations" are horse breeding,[60] a chicken coop cleaning service,[61] sale of manure,[62] agricultural spraying,[63] custom farming,[64] and the harvesting of stone crabs.[65]

With respect to the issue of whether the debtor is presently "engaged" in a farming operation, there must be some active involvement of the debtor in the operation.[66] Generally, the bankruptcy court will look at the totality of

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> mately ten years ago. New hybrid varieties make old crops viable where they were never before considered. Many of the farmers experiencing financial difficulties now are in trouble now because of their inability to adjust to changing conditions and methods. Farmers continually try new crops and enterprises in pursuit of profitability. Christmas trees, catfish and even wine grapes are now raised on "farms" in Kansas.

Id. at 835.

55. *Id.* at 839 (quoting *In re* Butcher, 43 B.R. 513, 519 (Bankr. E.D. Tenn. 1984) (emphasis in original)).

56. *Id.*

57. *In re* Sugar Pine Ranch, 100 B.R. 28 (Bankr. D. Ore. 1989). *But see In re* Miller, 122 B.R. 360 (Bankr. N.D. Iowa 1990) (debtor's sawmill which processed logs harvested from the debtor's land was not part of a "farming operation").

58. *In re* Guinnane, 73 B.R. 129 (Bankr. D. Mont. 1987).

59. *In re* Martin, 78 B.R. 593 (Bankr. D. Mont. 1987).

60. *See, e.g., In re* Cluck, 101 B.R. 691 (Bankr. E.D. Okla. 1989); *In re* McKillips, 72 B.R. 565 (Bankr. N.D. Ill. 1987). *But see In re* Wolline, 74 B.R. 208 (Bankr. E.D. Wis. 1987) (dairy farm operated in connection with the maintaining of horses for riding and leasing was a "farming operation").

61. *In re* McNeal, 848 F.2d 170 (11th Cir. 1988).

62. *Id.*

63. *In re* Richardson, 113 B.R. 28 (Bankr. D. Colo. 1990).

64. *In re* Blackwelder Harvesting Co., 106 B.R. 301 (Bankr. M.D. Fla. 1989); *In re* Hampton, 100 B.R. 535 (Bankr. D. Ore. 1987).

65. *In re* Watford, 898 F.2d 1525 (11th Cir. 1990) (the court remanded the case for a determination of whether the debtors had abandoned all farming operations or whether they were planning to continue farming operations in the form of commercial fish ponds and soybean storage).

66. *In re* Tim Wargo & Sons, Inc., 869 F.2d 1128 (8th Cir. 1989); *In re* Burke, 81 B.R. 971, 976 (Bankr. S.D. Iowa 1987) (corporate debtor which leased farmland under crop share arrangement

the circumstances.[67] Ironically, the scaling down of the farm operation in order to deal with financial distress may cause the debtor to lose eligibility. Intention to continue the farm operation is important if the farm equipment and machinery has been sold.[68] Even if the debtor meets the present tense requirement of being "engaged in a farming operation" at the time of the filing, the income test must be met as well.

C. *Maximum Level of Debt*

The aggregate amount of debt owed by the debtor must not exceed $1.5 million.[69] When joint and several obligations total more than $1.5 million, debtors (who as husband and wife could ordinarily file separate petitions) may not do so to circumvent the limitation.[70] The debt on the debtor's principal residence is excluded for purposes of the eighty percent debt from farming requirement, but is included in the $1.5 million debt ceiling.[71] Attorney's fees and costs incurred by the creditor, but not yet billed to the debtor, are not included in the debt computation.[72] Unlike Chapter 13, disputed debts are included in determining whether the debtor is under the maximum debt ceiling.[73]

This requirement is relatively straight-forward. The only question is whether the $1.5 million ceiling is set at the right level. There is some indication from the GAO study that the limit is too low and thereby eliminates from Chapter 12 relief farming operations which appear very much to be "family" farming operations.[74] Although $1.5 million in debt is indeed a large amount of debt, the nature of cattle ranching today requires both large parcels of land and substantial herds in order to maintain a viable family business. The acquisition of these assets may require substantial financing. Congress should therefore give careful consideration to whether the debt ceiling is too low and unfairly excludes operations that would otherwise fit within the concept of the family farmer.

D. *Percentage of Debt Arising from a Farming Operation*

In addition to setting a maximum amount of debt, the Bankruptcy Code requires that at least eighty percent of the debt arise out of the farming opera-

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would be considered engaged in farming only if family members of the debtor "take an active role in the operation").

67. *In re* French, 139 B.R. 476 (Bankr. D. S.D. 1992) (debtor who had been engaged in farming for approximately 40 years was eligible for Chapter 12 relief notwithstanding fact that at the time of filing his spouse had been awarded temporary possession of the farm property in a divorce proceeding); *In re* Paul, 83 B.R. 709 (Bankr. D. N.D. 1988) (debtors who proposed to enroll a portion of farmland in the conservation reserve program were "engaged in farming").

68. *See In re* Fogle, 87 B.R. 493, 495 (Bankr. N.D. Ohio 1988).

69. 11 U.S.C. § 101(18)(A).

70. *In re* Johnson, 73 B.R. 107, 108-09 (Bankr. S.D. Ohio 1987).

71. *In re* Henderson Ranches, 75 B.R. 225, 226 (Bankr. D. Idaho 1987).

72. *In re* Stedman, 72 B.R. 49, 51 (Bankr. D. N.D. 1987).

73. *In re* Vaughan, 100 B.R. 423, 424-25 (Bankr. S.D. Ill. 1989). *But see In re* Lands, 85 B.R. 83 (Bankr. E.D. Ark. 1988); *In re* Carpenter, 79 B.R. 316 (Bankr. S.D. Ohio 1987).

74. GAO STUDY, *supra* note 5, at 31.

tion. In figuring this percentage, the debt relating to the debtor's principal residence is not counted unless this debt arises out of a farming operation. In other words, the debt on the principal residence will not count against the debtor, unless it relates to the farming operation, in which case it will help the debtor.[75]

The eighty percent requirement is straight-forward. What little litigation that has arisen has concerned whether the debt arose from a farming operation. In *In re Douglass*,[76] a portion of the debt was secured by deeds of trust on the debtors' gas station. The debtors argued that it arose out of a farming operation because the service station had been inherited free and clear of debt and that it was subsequently used as security to acquire funds for farming. Thus, it should be the reason for the debt, not the nature of the collateral that is determinative. The bankruptcy court agreed with this reasoning.[77] In an example of the same principle applied to achieve the opposite result, the bankruptcy court in *In re Kan Corp.*[78] found that farm land encumbered for the purpose of financing the purchase of a beer distributorship did not involve debt arising out of a farming operation.

In *Matter of Rinker*,[79] the debtor had been involved in family litigation which had culminated in a settlement whereby the debtor had agreed to buy-out the interest of his three sisters in land which he had farmed since 1957. The land was the major asset of his parent's estate. The settlement ended years of litigation and was intended by the debtor to preserve his farming operation. The bankruptcy court held that the debts incurred in connection with the purchase of the land arose out of the farming operation.[80]

E. *Percentage of Income Arising from a Farming Operation*

The final requirement is that the debtor's income from the farming operation must exceed fifty percent of the debtor's gross income for the taxable year preceding the year of filing.[81] This requirement has produced some harsh results.

The most common question is whether the income a farmer receives from the cash rent of farm land is income from a farming operation. The majority of cases say no. This result is based on the notion that those who rent out farmland no longer have any connection with the production of crops or live-

75. 11 U.S.C. § 101(18)(A).
76. 77 B.R. 714 (Bankr. W.D. Mo. 1987).
77. *Id.* at 715.
78. 101 B.R. 726 (Bankr. W.D. Okla. 1988).
79. 75 B.R. 65 (Bankr. S.D. Iowa 1987).
80. *Id.* at 68. *Compare with In re* Van Fossan, 82 B.R. 77 (Bankr. W.D. Ark. 1987). The debtor owed $295,000 to his former spouse as a result of a property settlement agreement. *Id.* at 78. The evidence did not indicate whether the monetary award to the former spouse represented her share of the farming operation. If so, the debt would have been like the purchase of land in the *Rinker* settlement. The court in *Van Fossan* held that the debt did not arise out of the farming operation and therefore failed to meet the 80% farming debt requirement. *Id.* at 80.
81. 11 U.S.C. § 101(18)(A).

stock,[82] nor do they face the same risks that confront one who is actively engaged in a farming operation.[83] The minority of cases have preferred to make this determination on a case-by-case basis. For example, the bankruptcy court in *In re Mikkelsen Farms, Inc.*[84] stated:

> Keeping in mind the value judgments made by Congress which lie behind the passage of Chapter 12, I believe the approach a bankruptcy court must take in determining . . . whether an entity is conducting a farming operation at the time the bankruptcy petition is filed must include a review of all the facts and circumstances about that entity and its operations as of the date of filing. I believe I must consider, at a minimum, whether there is a physical presence of family members on the farm, whether the debtor owns traditional "farm assets," whether leasing land is a form of scaling down of previous farm operations, what the form of any lease arrangement is and whether the debtor entity had, as of the date of filing, permanently ceased all of its own investment of assets and labor to produce crops or livestock. I have kept in mind that the leasing of farm land, for either cash or a crop share, has been an integral part of many family farm operations throughout this country for years.[85]

The case-by-case approach does not make a blanket assumption about cash rent. Although cash rent may place the debtor in different financial situation than the farmer who produces crops or livestock, the total circumstances may well indicate that the leasing of farm land is part of the debtor's ongoing farming operation. The debtor may have exercised prudence and scaled down the size of the operation or may have been unable to put in a crop because of a lack of financing. As stated by the bankruptcy court in *In re Rott*:[86]

> After extensive deliberation, this court is unable to formulate a mechanical test for parties to use in determining gross farm income, for purposes of determining eligibility for Chapter 12. The court does not believe that farmers forced to partially liquidate assets or temporarily rent out machinery or farmland, in an effort to salvage their farm operation, should be foreclosed from seeking relief under Chapter 12, if such actions cause the [50 %] farm income test not to be met. Clearly, Congress did not intend that farmers who make sound business decisions pre-bankruptcy in an effort to remedy their financial woes should be excluded from Chapter 12 relief when their immediate intention is to reorganize by actually farming. While an empirical formula for determining Chapter 12 eligibility would be convenient and desirable, this court's beliefs are in line with the dissenting opinion in the Seventh Circuit *Armstrong* case, that "it is appropriate for courts to try to draw realistic

82. *In re* Easton, 883 F.2d 630, 634 (8th Cir. 1989); Matter of Morgan Strawberry Farm, 98 B.R. 584 (Bankr. M.D. Fla. 1989); *In re* Tart, 73 B.R. 78 (Bankr. E.D. N.C. 1987). *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).

83. Matter of Haschke, 77 B.R. 223, 225 (Bankr. D. Neb. 1987); *In re* Mary Freese Farms, Inc., 73 B.R. 508, 510 (Bankr. N.D. Iowa 1987).

84. 74 B.R. 280 (Bankr. D. Ore. 1987).

85. *Id.* at 285.

86. 73 B.R. 366 (Bankr. D. N.D. 1987).

> distinctions . . . on a case-by-case basis, focusing on whether the income in question is essentially derived from a farming operation that is owned or operated by the recipient of the income and that reflects the traditional farming risks of cyclical and unpredictable income."[87]

The court recognizes that the fifty percent income from farming requirement can lead to absurd results if applied mechanically. This does not mean that the court will ignore the fifty percent income requirement established by Congress. What the court is suggesting is that the definition of a farming operation will have to take into account all the circumstances rather than drawing generalizations from the particular form of the income.

The case-by-case approach attempts to differentiate the long-time family farmer who has leased farmland, possibly to forestall bankruptcy, from the non-resident landlord who has no intention to actually "engage" in farming.[88] This minority approach therefore is more faithful to the accepted principle that the definition of a farming operation "is to be construed liberally in order to further Congress' purpose of helping family farmers to continue farming."[89]

The pre-bankruptcy sale of assets should also receive careful consideration of the circumstances. Some cases involve debtors who have completely left the business of farming;[90] other cases involve farmers who have attempted to scale down the size of the operation.[91] Once qualified under Chapter 12, the debtor may propose to scale down the operation and derive income from nonfarm sources without forfeiting continued eligibility for Chapter 12 relief.[92]

The remaining problem concerns the requirement that the percentage of gross income from farming be determined from the last complete tax year prior to the date of filing. When the family farmer is strapped financially, it is common to seek nonfarm income, such as a job in town as a teacher or secretary. The fifty percent requirement undoubtedly contemplated this possibility, but there is reason to believe that the requirement is too high for the severely stressed family farm.[93] Again, the irony is that the family farmer who may need Chapter 12 the most may be ineligible under the present formula. The easiest way to ameliorate this problem is to use an average from a greater number of years. The formula should allow the bankruptcy court to differen-

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87. *Id.* at 373.

88. *See, e.g.*, *In re* Voelker, 123 B.R. 749, 752 (Bankr. E.D. Mich. 1990); *In re* Vernon, 101 B.R. 87, 91 (Bankr. E.D. Mo. 1989); *In re* Coulston, 98 B.R. 280, 282-83 (Bankr. E.D. Mich. 1989); Matter of Burke, 81 B.R. 971, 976 (Bankr. S.D. Iowa 1987); *In re* Welch, 74 B.R. 401, 405 (Bankr. S.D. Ohio 1987); *In re* Mikkelsen Farms, Inc., 74 B.R. 280, 285 (Bankr. D. Ore. 1987); *In re* Rott, 73 B.R. 366, 373 (Bankr. D. N.D. 1987); *Tart*, 73 B.R. at 82.

89. *Watford*, 898 F.2d at 1527. *See Sugar Pine Ranch*, 100 B.R. at 31; *Maike*, 77 B.R. at 835; *Wolline*, 74 B.R. at 209-10; *Tart*, 73 B.R. at 81 (Bankr. E.D. N.C. 1987).

90. *See, e.g.*, *In re* Sohrakoff, 85 B.R. 848, 849 (Bankr. E.D. Cal. 1988) (proceeds from sale of land were not income from a farming operation); *Van Fossan*, 82 B.R. at 81 (proceeds from sale of land were not income from a farming operation).

91. *See, e.g.*, *In re* Shepherd, 75 B.R. 501, 505 (Bankr. N.D. Ohio 1987) (sale of all farm machinery treated as farm income).

92. *In re* Indreland, 77 B.R. 268 (Bankr. D. Mont. 1987).

93. *See* GAO STUDY, *supra* note 5, at 39.

tiate the hobby farmer, a retired farmer, or the investor who has farm income from the long-time farmer who intends to continue in the business of farming.

IV. Cash Collateral and Adequate Protection

Under section 363, the debtor-in-possession is entitled to use, sell, or lease property of the estate during the course of the reorganization. If the use, sale, or lease is within the ordinary course of business of the debtor, then court approval is not ordinarily required.[94] Proposed use, sale, or lease not in the ordinary course of business can be accomplished with court approval, after notice and hearing.[95] The chief exception to the ordinary course of business rule concerns the use of cash collateral, i.e., proceeds from the sale of collateral in which a creditor has a perfected security interest.[96]

The use of cash collateral is vital to farm reorganizations because most Chapter 12 debtors are unable to obtain significant outside financing.[97] The operation must therefore become "self-financed" through the "re-cycling" of the assets on hand. Pursuant to either the approval of the bankruptcy court or the consent of the creditor to the use of cash collateral, grain or livestock is sold and the proceeds re-invested in the farming operation. The condition for obtaining approval from the bankruptcy court is that the debtor must provide the creditor with adequate protection.[98]

Adequate protection is also a key concept in litigating motions for relief from the automatic stay. One of the grounds for lifting the stay is a lack of adequate protection.[99] Congress believed one of the reasons that Chapter 11 was not working for the family farmer was that some courts required the debtor to pay "lost opportunity costs" as adequate protection to the undersecured creditor.[100] Financially distressed farmers did not have available funds to make such payments at the outset of a bankruptcy reorganization and the consequence was loss of assets vital to the reorganization.

Chapter 12 has a special provision which defines "adequate protection" for purposes of the chapter. Section 1205 provides that adequate protection may be accomplished by: (1) cash payments to the extent of a decrease in the value of the collateral; (2) additional or replacement liens to the extent of a decrease in the value of the collateral; (3) in the case of use of farmland, payment of "reasonable rent customary in the community where the property is located"; or (4) such other relief as will adequately protect the value of the

94. 11 U.S.C. § 363(c)(1).

95. 11 U.S.C. § 363(b)(1).

96. 11 U.S.C. §§ 363(a), (c)(2).

97. Crop inputs may be financed by the debtor through outside sources, but that usually will not be sufficient to cover the other expenses of the farming operation as well as living expenses. The major source of internal-financing will be crops and livestock on hand. *See generally* Janet A. Flaccus & Bruce L. Dixon, *The New Bankruptcy Chapter 12: A Computer Analysis of If and When a Farmer Can Successfully Reorganize*, 41 Ark. L. Rev. 263, 318-19 (1989).

98. 11 U.S.C. § 363(e).

99. 11 U.S.C. § 362(d)(1).

100. H.R. Rep. No. 99-764, 99th Cong., 2d Sess. (1986), reprinted in 1986 U.S.C.C.A.N. 5227.

collateral. What is not required is the payment of "lost opportunity costs."[101]

There are relatively few reported cases on the use of cash collateral in Chapter 12. Given that virtually every Chapter 12 case will require use of cash collateral to finance the reorganization, this is a sign that the matter is being worked out through the agreement of debtors and creditors. The cases show the provision of adequate protection through cash payments to cover anticipated decline in value,[102] granting of a replacement lien,[103] and obtaining adequate insurance on the collateral.[104]

The new aspect of adequate protection in section 1205 is the payment of reasonable rent for the use of farmland. This relates to motions for relief from the automatic stay, not cash collateral. It is important to understand the interaction between section 362(d)(1) and section 1205. Section 362(d)(1) allows the creditor to obtain relief from the stay if there is a lack of adequate protection of the creditor's interest in the property. With declining farmland values, this ordinarily would mean that the debtor would have to compensate the creditor for the anticipated decline in value during the reorganization period. However, section 1205(b)(3) makes reasonable rental payments the equivalent of adequate protection. Only when the value of the land is declining is there even a need to consider adequate protection and, in such event, it will be met by the payment of reasonable rent.

This analysis is confirmed by *In re Turner*[105] and *In re Kocher.*[106] In *Turner*, the creditor requested cash payments for the fair rental value of the farmland. The court, sua sponte, noted that there was no showing of any anticipated decline in the value of the land. It noted that the creditor was not simply entitled to payment for use, because that would be the equivalent of lost opportunity costs.[107] The request was denied, subject to a later showing

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101. *Id.* at 5250-51. The Report states:

> [S]ection 1205 of the conference report provides a separate test for adequate protection in Chapter 12 cases. It eliminates the need of the family farmer to pay lost opportunity costs, and adds another means for providing adequate protection for farmland—paying reasonable market rent. Section 1205 eliminates the "indubitable equivalent" language of 11 U.S.C. § 361(3) and makes it clear that what needs to be protected is the value of property, not the value of the creditor's "interest" in property.

Id. Congress' concern with "lost opportunity costs" was effectively mooted by a decision of the United States Supreme Court holding that undersecured creditors are not entitled to receive payments for the value of the use of collateral which the automatic stay prevented the creditor from possessing. United Savings Ass'n of Texas v. Timbers of Inwood Forest Assocs., Ltd., 484 U.S. 365 (1988). *See In re* Turner, 82 B.R. 465 (Bankr. W.D. Tenn. 1988); *In re* Rennich, 70 B.R. 69 (Bankr. D. S.D. 1987).

102. *In re* Anderson, 137 B.R. 819 (Bankr. D. Colo. 1992) (creditor's interest in crops was protecting by paying the fair market value of the crops as the crops were consumed in the debtors' feedlot operation).

103. *In re* Westcamp, 78 B.R. 834 (Bankr. S.D. Ohio 1987) (replacement lien for yet-to-be-grown crops, together with assignment of federal crop insurance and ASCS deficiency payments constituted adequate protection); *In re* Hansen, 77 B.R. 722 (Bankr. D. N.D. 1987) (replacement lien in hogs acquired with cash collateral).

104. *In re* Pretzer, 91 B.R. 428 (Bankr. N.D. Ohio 1988) (insurance coverage on crops required). *See In re* Stacy Farms, 78 B.R. 494 (Bankr. S.D. Ohio 1987) (debtor's offer of adequate protection was too speculative to be sufficient and request for use of cash collateral was denied).

105. 82 B.R. 465 (Bankr. W.D. Tenn. 1988).

106. 78 B.R. 844 (Bankr. S.D. Ohio 1987).

107. *Turner*, 82 B.R. at 468-69.

of a diminution in value prior to confirmation.[108] In *Kocher*, the diminution in land value was conceded. The creditor argued that the customary rent would not be sufficient to offset this diminution. The bankruptcy court held that, under section 1205, reasonable rent for the land was adequate protection per se.[109] Again, the relatively few cases on this question would indicate that the provision is working as Congress intended.[110]

V. VALUATION

Valuation is a key element in the Chapter 12 plan. This is a consequence of the differing treatment between secured claims and unsecured claims. Under section 1225(a)(5), the debtor is required to pay the amount of the allowed secured claim, together with a market rate of interest if payment occurs over time. The holders of unsecured claims are entitled to receive at least as much as they would receive in a liquidation under Chapter 7 and, in most cases, the debtor's projected net disposal income.[111] The liquidation amount is usually zero or something close to it.[112] Given the difficulties of demonstrating the feasibility of repayment of the secured claims alone,[113] it is not unusual to see plans with little or no projected disposable income. Thus, the bifurcation of an undersecured claim into a secured portion and an unsecured portion will greatly affect the amount that will have to be repaid. The absence of voting and the section 1111(b) election in Chapter 12 means that the "cramdown" or modification of the secured creditor's claim will be heavily dependent upon the outcome of the section 506(a) valuation.

Relatively few of the valuation hearings wind up with reported decisions. One reason is that the valuations are intensely factual and thus often of little

108. *Id.* at 469. *See Anderson*, 137 B.R. at 823 (rental payment for use of farm residence not required in the absence of a showing that the value of the lien was declining).

109. *Kocher*, 78 B.R. at 850. The court quoted Senator Grassley's explanation of this point:

> Allowing the farm-debtor to provide adequate protection by paying rent recognizes the economic realities of foreclosure. During a time of depressed farm values, the lender will usually be the high bidder at a foreclosure sale. If the lender cannot resell the property, it typically will rent the property at the market rate. If the debtor pays market rent while he reorganizes, the lender will be getting only what it would realistically get as a result of a foreclosure. Paying a reasonable rent as a method of protecting secured creditors was permitted during the Depression by the second Frazier-Lemke Act, which survived constitutional challenge in the Supreme Court.

Id. (quoting 132 CONG. REC. S3529 (daily ed. March 26, 1986)).

110. *See generally* Nancy Kratzke & Thomas Depperschmidt, *"Reasonable Rent" and Opportunity Cost in the Family Farmer Bankruptcy Act*, 39 DRAKE L. REV. 863 (1989-90); Diana Ryan, *The Changing Standards of Adequate Protection in Farm Bankruptcy Reorganizations*, 37 DRAKE L. REV. 323 (1987-88).

111. 11 U.S.C. §§ 1225(a)(4), (b).

112. *See* J. David Aiken, *Chapter 12 Family Farmer Bankruptcy*, 66 NEB. L. REV. 632 (1987): "Most insolvent farmers will be required to pay unsecured claim holders little, if anything, in Chapter 12 . . . ." *Id.* at 672.

> If the Chapter 12 debtor is insolvent, has no unencumbered nonexempt property, and has no equity in encumbered property, the liquidated value of unsecured claims will be zero. Many, if not most, Chapter 12 plans will be "zero plans" in that unsecured claims will have no liquidation value and the plan will propose no payment to unsecured claim holders.

Id. at 692.

113. For discussion of feasibility, see *infra* notes 236-68 and accompanying text.

precedential value.[114] There is a series of cases from the District of Montana which is helpful in providing some guidance on the elusive question of value in the agricultural context.[115] The bankruptcy courts hear expert testimony utilizing various methods of valuation, including the market data or comparable sales approach, the income approach, and the cost or replacement approach.[116] Valuation is usually determined as of the date of the valuation hearing,[117] although if the issue is valuation of what the unsecured creditors would receive in a hypothetical Chapter 7 liquidation, then the relevant date is the "effective date of the plan."[118]

The principal legal issue concerns the proposed use standard. Section 506(a) states that the value "shall be determined in light of . . . the proposed disposition or use of such property. . . ."[119] The courts have not literally followed this standard in that the debtor's proposed use is not immune from review by the court. The debtor may not artificially drive down the valuation by proposing an unreasonable use. In *Speck v. U.S. through Farmers Home Administration*,[120] the debtor had farmed certain acreage for the previous five years as cropground. However, the debtor proposed to use the acreage as pastureland and submitted an appraisal based on such proposed use. The bankruptcy court, however, accepted the FmHA's appraisal based on its more profitable use as cropground. The bankruptcy court's determination was affirmed on appeal:

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114. In addition, the clearly erroneous standard makes a valuation determination by the bankruptcy court very difficult to overturn on appeal. *See, e.g., In re* Hopwood, 124 B.R. 82, 84-85 (E.D. Mo. 1991).

115. *See, e.g., In re* Cool, 81 B.R. 614 (Bankr. D. Mont. 1987); *In re* Foster, 79 B.R. 906 (Bankr. D. Mont. 1987); *In re* Dunning, 77 B.R. 789 (Bankr. D. Mont. 1987); *In re* Robinson Ranch, Inc., 75 B.R. 606 (Bankr. D. Mont. 1987); *In re* Janssen Charolais Ranch, Inc., 73 B.R. 125 (Bankr. D. Mont. 1987).

116. *See, e.g., In re* Penz, 102 B.R. 826 (Bankr. E.D. Okla. 1989) (consideration of comparable sales); *In re* Anderson, 88 B.R. 877 (Bankr. N.D. Ind. 1988) (consideration of comparable sale and income approaches); *Cool*, 81 B.R. 614 (consideration of comparable sales and income approaches); *Foster*, 79 B.R. 906 (consideration of comparable sales); *In re* Snider Farms, Inc., 79 B.R. 801 (Bankr. N.D. Ind. 1987) (consideration of income and comparable sales approaches); *In re* Beyer, 72 B.R. 525 (Bankr. D. Colo. 1987) (consideration of comparable sales and income approaches; criticism of sole reliance on income approach). *See also* Chaim J. Fortgang and Thomas Moers Mayer, *Valuation in Bankruptcy*, 32 UCLA L. REV. 1061 (1985); James F. Queenan, Jr., *Standards for Valuation of Security Interests in Chapter 11*, 92 COM. L.J. 18 (1987); Kaaran E. Thomas, *Valuation of Assets in Bankruptcy Proceedings: Emerging Issues*, 51 MONT. L. REV. 126 (1990).

117. *Anderson*, 88 B.R. at 884-85.

118. *Hopwood*, 124 B.R. at 85; *In re* Bremer, 104 B.R. 999 (Bankr. W.D. Mo. 1989) (future CRP payment and crops in existence but not harvested as of the date of confirmation should have been included in the valuation for purposes of the best interest of creditors test); *In re* Musil, 99 B.R. 448 (Bankr. D. Kan. 1988) (crops in ground on date of filing of bankruptcy petition and harvested by date of confirmation must be valued as of the confirmation date); Matter of Bluridg Farms, Inc., 93 B.R. 648 (Bankr. S.D. Iowa 1988) (substantial unencumbered postpetition income must be reflected in liquidation analysis); 5 COLLIER ON BANKRUPTCY ¶ 1225.02, at 1225-9 (Lawrence P. King ed., 15th ed. 1990) [hereinafter COLLIER ON BANKRUPTCY].

119. Note that the proposed use standard eliminates the argument that the costs of sale or expenses of foreclosure should be deducted from the market value of the property. Because the proposed use contemplates continued use and possession by the debtor, no such costs or expenses would be incurred, even though they would be if the secured creditor was required to repossess or foreclose. *See In re* Felten, 95 B.R. 629 (Bankr. N.D. Iowa 1988); *In re* Bellman Farms, Inc., 86 B.R. 1016, 1022 (Bankr. S.D. 1988).

120. 104 B.R. 1021 (D. S.D. 1989).

> While the use proposed by the debtor should be considered in determining the value of collateral, the bankruptcy judge should not have his hands tied. . . . [T]he bankruptcy court's valuation will be upheld provided the ultimate valuation is based on a use, i.e., cropland in this instance, that is not wholly inconsistent with the use for which the property is designed or intended. . . . The bankruptcy court should also consider the use made by the debtors at the time the creditor loaned them money and acquired a security interest in their property. These considerations are commensurate with the policies behind the bankruptcy legislation: [n]either debtors nor creditors can use the 506(a) valuation hearing as a sword against the other.[121]

Although not a literal interpretation of the statute, this reading makes good sense. Particularly apt is the observation that the use of the property at the time of the decision to lend and encumber the property as security is at least as important as the debtor's proposed use under the plan. As long as the debtor's proposed use is reasonable, the valuation in Chapter 12 will not consider other higher and better uses.[122]

Note, however, that the proposed use standard is not the ultimate standard in Chapter 11 valuations. There, the "highest and best use" standard is supported by the operation of the confirmation standards, not section 506(a). Under the highest and best use standard, the debtor's proposed use is irrelevant. The reason that Chapter 11 valuations are not required to follow the section 506(a) proposed use standard is that the confirmation test for all claims, including secured claims, requires that the creditor will receive property under the plan of a value at least as great as would be received in a Chapter 7 liquidation.[123] In a Chapter 7 liquidation, the buyers at the trustee's liquidation sale would not be bound by the debtor's past use or proposed use, but presumably will put the property to its highest and best use.[124]

There is nothing in the Chapter 12 cases to date that would indicate the need for amendment in this area by Congress. Because the valuation determinations are virtually appeal-proof, bankruptcy judges must, of course, continue to make these determinations fairly, based on the evidence in the record. Congress cannot legislate good judgment. It is hoped that the judicial appointment process achieves this goal.

VI. Determination of the Appropriate Rate

Holders of allowed secured claims are entitled to receive "the value, as of the effective date of the plan" of the amount of their respective secured claims

121. *Id.* at 1023 (citing 3 COLLIER ON BANKRUPTCY ¶ 506.04[2] (Lawrence P. King ed., 15th ed. 1979)).

122. *See Snider Farms*, 79 B.R. at 817; *Foster*, 79 B.R. at 908. One caveat, however, should be noted. If the secured creditors are oversecured and the property is not claimed as exempt, then valuation for purposes of the liquidation analysis should use the "highest and best use" standard for valuation. *See* 11 U.S.C. § 1225(a)(4).

123. 11 U.S.C. § 1129(a)(7)(A)(ii).

124. *See In re* Ehrich, 109 B.R. 390 (Bankr. D. S.D. 1989).

as determined under section 506(a).[125] This means that unless the secured claim is paid in full at the effective date of the plan, the plan must provide for the payment of interest on the claim as well.[126] Payment over time without interest is not equivalent to payment right now.[127] The problem for the courts is to determine the appropriate rate of interest to accompany payment of the secured claim.[128]

There is general agreement that the rate of interest shall be a market rate, not the rate specified in the contract between the parties[129] or the rate set by statute.[130] This can cut both ways, even when there has been a general drop in the market rate. In some cases, the market rate will be below the contract rate.[131] In other cases, often involving special government loans, the market rate will be above the contract rate.[132] Although there is agreement that the market rate is to prevail, there is significant disagreement concerning how the

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125. 11 U.S.C. § 1225(a)(5)(B)(ii). It should be noted that this requirement does not apply if the holder of an allowed secured claim "accepts" the plan (§ 1225(a)(5)(B)(i)) or if the debtor surrenders the property securing the claim to such holder (§ 1225(a)(5)(C)). If the debtor fails to propose an interest rate that will give the secured creditor the present value of its secured claim, the court will not confirm the plan. *See, e.g.*, *In re* Mason, 129 B.R. 990 (Bankr. W.D. N.Y. 1991) (debtor's proposed interest rates of 7% and 5% were insufficient); *In re* Wright, 103 B.R. 905 (Bankr. M.D. Tenn. 1989) (debtor failed to prove that either original 10% or proposed 11.4% would give the creditor the present value of its secured claim); *In re* Neff, 89 B.R. 672 (Bankr. S.D. Ohio 1988) (court denied confirmation because it could not determine whether 10.3% interest was the market rate for the region); *In re* Snider Farms, Inc., 83 B.R. 977 (Bankr. N.D. Ind. 1988) (proposed rate of 8.98% was lower than return investor could currently receive on risk-free U.S. bond of like maturity and therefore confirmation was denied); *In re* Rott, 73 B.R. 366 (Bankr. D. N.D. 1987) (proposed rate of 1.5% to 3% above the inflation rate, a rate less than the prime rate and 50% less the creditor currently provided to its best customers, did not provide creditor with present value).

126. When the debtor's plan proposes to pay a secured claim in deferred cash installments, the court must find that the present value of the proposed payments is not less than the allowed amount of the secured claim. In order to make this finding, it will be necessary for the court to apply a discount factor to the proposed stream of payments to determine the present value of those payments. This is typically accomplished by ascribing an interest rate to the allowed amount of the claim and by requiring payment of the amount of the claim along with interest at the specified rate.

COLLIER ON BANKRUPTCY, *supra* note 118, ¶ 1225.03[4](c), at 1225-21.

127. *Id.* ¶ 1129.03[4](f)(i), at 1129-82.

128. There is a potential for interest on the unsecured claims, but this is applicable only if the amount proposed to be paid to the unsecureds is at or near the amount that would be paid in a liquidation under Chapter 7. *See* 11 U.S.C. § 1225(a)(4).

129. *See, e.g.*, *In re* Fisher, 930 F.2d 1361 (8th Cir. 1991); *In re* Hardzog, 901 F.2d 858 (10th Cir. 1990); United States v. Arnold, 878 F.2d 925 (6th Cir. 1989).

130. *See, e.g.*, United States v. Neal Pharmacal Co., 789 F.2d 1283 (8th Cir. 1986) (a Chapter 11 case, holding that the prevailing market rate was required, not the statutory interest rate on delinquent tax claims); Matter of Bantam, 120 B.R. 530 (Bankr. D. Neb. 1990) (county not entitled to receive statutory rate of 14% on delinquent taxes); *In re* Case, 115 B.R. 666 (Bankr. 9th Cir. 1990) (debtor's proposed rate of 6.25%, based on statute, was not the market rate to which the FmHA was entitled).

131. *See, e.g.*, *Hardzog*, 901 F.2d 858 (court rejected Federal Land Bank's argument that contract rate of interest should be followed); *In re* Cansler, 99 B.R. 758 (W.D. Ky. 1989) (court applied formula to find market rate, rejected Federal Land Bank's argument that contract rate should be used).

132. *See, e.g.*, *Fisher*, 930 F.2d 1361 (debtors had three special rate notes with FmHA that had a weighted average of 5.41%; the court held that the interest rate should be based on a market rate formula); *Arnold*, 878 F.2d 925 (debtor had two special rate notes with the FmHA, one at 1% interest and the other at 5% interest; the court held that FmHA was entitled to receive its current market rate on the modified claim).

market rate is to be determined.[133] The three most common methods are the formula approach, the prevailing lending rate in the region, and the current rate charged by the creditor involved.

Under the formula approach, the court finds a risk-free base rate, such as the prime rate or the rate on treasury obligations, and then adds a risk factor based on the risk of default and the nature of the security.[134] One reason an abstract formula is preferred is because there is no identifiable market for loans to debtors in bankruptcy.[135] The base rate is also readily ascertainable through use of daily market quotations and thus is easier than taking extensive testimony on regional conditions, or the individual lender's cost of funds, operating expenses, and normal profit.[136]

The risk of default factor has proven to be a matter of some disagreement among the courts. It has been argued to be somewhat reduced with confirmed Chapter 12 plans:

> Since a trustee oversees the affairs of the debtor, administrative and collection costs are lower. Furthermore, the confirmation of a Chapter 12 plan implies that the debtors have convinced the bankruptcy judge that the plan is feasible. The fact that the plan overcame such a hurdle heightens the probability of repayment.[137]

Some courts, however, have noted the heightened risk associated with the nature of the agricultural economy:

> Those risks include the basic unpredictable nature of the agricultural economy itself which cause farmers, creditors and judges to rely upon assumptions concerning prices and yields, the value of the dollar, the weather, foreign production, interest rates and government policies, any or all of which may change to the benefit or the detriment of the debtor's Chapter 12 plan.[138]

As a consequence, the applications under this formula have resulted in a range of approved market interest rates.[139]

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133. For a discussion of this problem, see Frank Carbiener, *Present Value in Bankruptcy: The Search for an Appropriate Cramdown Discount Rate*, 32 S.D. L. REV. 42 (1987).

134. *See In re* Fowler, 903 F.2d 694, 697 (9th Cir. 1990).

135. *See Cansler*, 99 B.R. at 762; *In re* Paddock, 81 B.R. 51, 54 (Bankr. D. Mont. 1987).

136. *See Hardzog*, 901 F.2d at 860; *Cansler*, 99 B.R. at 762.

137. *In re* Shannon, 100 B.R. 913, 939 (S.D. Ohio 1989).

138. Matter of Wichmann, 77 B.R. 718, 721 (Bankr. D. Neb. 1987). *See Fowler*, 903 F.2d at 697; United States v. Doud, 869 F.2d 1144, 1145 (8th Cir. 1989); *In re* Patterson, 86 B.R. 226, 228 (Bankr. 9th Cir. 1988) (one of the few cases to authorize a variable interest rate, the court did so because of the volatility of the agricultural economy).

139. *See, e.g.*, *Doud*, 869 F.2d at 1146 (8th Circuit affirmed bankruptcy court's finding of discount rate on FmHA commercial loan to be the yield on a treasury bond plus a 2% risk factor); Matter of Rose, 135 B.R. 603, 607 (Bankr. N.D. Ind. 1991) (court required "an interest rate equal to the prime rate for a similar loan plus an additional 3% for the added risk in the transaction"); Matter of LLL Farms, 111 B.R. 1016, 1022 (Bankr. M.D. Ga. 1990) (court set interest rate at 10.2%, consisting of the current yield on a 15-year treasury bond plus an additional 2% for risk); *Cansler*, 99 B.R. at 761 (district court affirmed bankruptcy court determination of interest rate at prime rate plus a risk factor of two to three points, depending upon the size of the loan); Matter of Underwood, 87 B.R. 594, 601 (Bankr. D. Neb. 1988) (court set interest rate at the applicable treasury bill rate plus 2% for the portion of the loan secured by equipment and real estate, and the applicable treasury bill rate plus an additional 4 1/2% for the portion of the loan secured by cattle); *In re* Bar L O Farms, West, 87 B.R. 125, 127 (Bankr. D. Idaho 1988) (court set interest rate at 10% plus an additional risk factor of 1%);

Other courts have rejected the abstract formula approach, believing that the prevailing regional rate best achieves the statutory standard of present value.[140] The asserted problem of proof is downplayed on the ground that the current interest rate for similar loans in the region is relatively easy to determine on the basis of evidence submitted by the respective parties.[141] In addition, modification of the secured claims under Chapter 12 is properly viewed as a "new loan" and thus the current rate for similar loans is said to be the fairest method for both parties.[142] The interest rates arrived at under this approach tend to be a little higher on average than those arrived at through the formula method.[143]

A few courts use the current rate which the particular creditor offers to other customers. Again based on the "new loan" concept, this method looks to the creditor's cost of obtaining funds, plus additional amounts for loan expense, risk, and profit. In effect, the individual creditor establishes the "market" rate.[144] The criticism of this approach is that it does not arrive at a market rate; it allows the particular characteristics of the creditor to set the rate, even though the creditor "may have rates which are higher than the average rate because of unusually large loans in default, [or] bad management de-

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Patterson, 86 B.R. at 228 (variable interest rate set at the prime rate plus a 4% risk factor, to be adjusted quarterly because the loan was long-term and the agricultural economy was viewed as volatile); *In re* Caudill, 82 B.R. 969, 980-81 (Bankr. S.D. Ind. 1988) (court set interest rate at the published yield for the applicable term of the Treasury Bond plus a risk factor of three points); *Cool*, 81 B.R. at 621 (court set interest rate at "prime plus 1 1/4%, or 10%, to be paid over 20 years); *Paddock*, 81 B.R. at 54 (court set interest rate at prime plus 1 1/2%, or 10 1/4%); *In re* Bergbower, 81 B.R. 15, 16 (Bankr. S.D. Ill. 1987) (court set interest rate at the applicable treasury bond rate plus a 2% risk factor); *Wichmann*, 77 B.R. at 721 (court set interest rate at the applicable treasury bond rate plus a 2% risk factor).

140. *See, e.g.*, *Arnold*, 878 F.2d at 929. The Collier's Treatise prefers this method. COLLIER ON BANKRUPTCY, *supra* note 118, ¶ 1225.03[4](c) at 1225-22. *See also In re* Neff, 89 B.R. 672, 679 (Bankr. S.D. Ohio 1988), which states:

> The problem with [the formula] approach is that it does not permit sufficient latitude for consideration of unusual factual circumstances present in particular cases and is not specific for a particular market segment. Further, because the added component initially must be determined by the Court, adoption of this procedure requires the judiciary to ascribe rate increments for future risks to debtors and collateral and to forecast other events with a precision which this Court doubts its ability to accurately assess. Expressed in another fashion, for this Court the element of subjectivity in the second step of [the formula] approach is unacceptably high.

Id.

141. *See, e.g.*, *Hardzog*, 901 F.2d at 860.

142. *See Arnold*, 878 F.2d at 929; *Hardzog*, 901 F.2d at 860.

143. *See, e.g.*, *In re* Richardson, 113 B.R. 28, 30 (Bankr. D. Colo. 1990) (13.5%); *In re* Miller, 106 B.R. 136 (Bankr. N.D. Ohio 1989) (12.75%); *In re* Batchelor, 97 B.R. 993, 996 (Bankr. E.D. Ark. 1988) (12.5%); *In re* Neff, 96 B.R. 800, 804 (Bankr. S.D. Ohio 1989) (11.18%); *In re* Rott, 94 B.R. 163, 169 (Bankr. D. N.D. 1988) (11.75%); *In re* Townsend, 90 B.R. 498, 500 (Bankr. M.D. Fla. 1988) (13%); *In re* Kloberdanz, 83 B.R. 767, 772 (Bankr. D. Colo. 1988) (11.5%); *In re* Claeys, 81 B.R. 985, 994 (Bankr. D. N.D. 1987) (12%); *In re* Robinson Ranch, Inc., 75 B.R. 606, 610 (Bankr. D. Mont. 1987) (9%); *In re* Edwardson, 74 B.R. 831, 836 (Bankr. D. N.D. 1987) (12%).

144. *See Fisher*, 930 F.2d at 1364. The court stated:

> [I]t could be plausibly argued that because FmHA must sell its land to local farmers, the "market rate" should be defined as the rate FmHA could realistically expect to receive if it sold the property to local farmers. This approach would preclude courts from requiring the debtors to pay more for the property than another buyer.

Id. See also In re Schaal, 93 B.R. 644, 647 (Bankr. W.D. Ark. 1988); *In re* O'Farrell, 74 B.R. 421 (Bankr. N.D. Fla. 1987); *In re* Citrowske, 72 B.R. 613, 617 (Bankr. D. Minn. 1987).

cisions not characteristic of the market segment generally."[145]

Notwithstanding the range of interest rates arrived at through the different methods, there is no compelling need for Congress to clarify the meaning of "present value" by setting a uniform standard. A uniform standard has the potential of imposing a rate on certain Chapter 12 debtors and lenders that does not exist for other similarly situated debtors and creditors in the region. Despite the variations, it appears that the bankruptcy courts are doing a reasonably good job of determining the issue on the basis of the evidence in the record.

VII. TRUSTEE'S FEES

The Chapter 12 trustee is entitled to a commission, not to exceed ten percent, on the payments received by the trustee. The statutory authority for the trustee's commission provides, in pertinent part: "[The Chapter 12 trustee] shall collect such percentage fee from all payments received by such individual under plans in the cases under chapter 12 . . . ."[146] The language "received by such individual" was added by Congress in connection with the enactment of Chapter 12. Prior to this amendment, the standing trustee in a Chapter 13 case was entitled to a fee "from all payments under plans."[147] Thus, the question arose as to whether the debtor could make direct payments to creditors and limit the Chapter 12 trustee's compensation to a percentage of the payments received by the trustee.

This issue, while not ignored in Chapter 13, became more hotly contested in Chapter 12 because of the impact of the commission on the larger debt service. The impact, in some cases, could effect feasibility because the addition of a ten percent commission on top of a payment of principal and interest on a secured claim could push the effective "interest rate" (i.e., disbursements other than amounts credited to principal) up to or over twenty percent. The imposition of the ten percent fee on all payments by the debtor could also adversely affect the holders of unsecured claims because the trustee's fee effectively reduces the amount of a disposable income available for the unsecureds.

The leading case on this question is *In re Erickson Partnership*.[148] In *Erickson Partnership*, the district court held that the debtor could make direct payments to creditors on account of secured claims and that such payments were not subject to the trustee's ten percent commission.[149] The court relied primarily on the statutory provisions regarding payments. Section 1225(a)(5)

145. *Neff*, 89 B.R. at 677. *See Caudill*, 82 B.R. at 979.

146. 28 U.S.C. § 586(e)(2) (1991). *See generally* Janet A. Flaccus, *Bankruptcy Trustee's Compensation: An Issue of Court Control*, 9 BANKR. DEV. J. 39 (1992).

147. *See* Pub. L. 95-598, Title II, § 224(a), 92 Stat. 2549, 266-64 (1978). *See also Erickson Partnership*, 77 B.R. at 751 n.15 (quoting Memorandum of Thomas J. Stanton, Director and Counsel, Executive Office for United States Trustees, on the amendment of 28 U.S.C. § 586(e)(2): "This rather crucial section was changed . . . . The added language clearly precludes the standing trustee from receiving the statutory percentage fee on payments not actually received by the standing trustee.").

148. 83 B.R. 725, 727-28 (D. S.D. 1988). As a matter of fair disclosure regarding the author's biases on this issue, the author served as the debtor's counsel in this case.

149. *Erickson Partnership*, 83 B.R. at 729.

expressly recognizes the ability of the debtor to make direct payments to holders of secured claims. The "property to be distributed by the trustee *or the debtor* under the plan" shall not be less than the present value of the allowed secured claim.[150] Could the language "or the debtor" be read as sanctioning direct payments only when the creditor's claim is not modified? This reading would not account for the fact that the section in question is the "cram down" test for payment of secured claims. This section is utilized to determine whether the modification of secured claims meets the minimum standards for confirmation.[151] Section 1225(a)(5)(B)(ii) permits direct payments by the debtor to secured creditors whose claims have been modified pursuant to section 506(a) as long as the present value of each distribution is not less than the allowed secured claim. It should be noted that there is no similar provision for direct payments by the debtor on the unsecured claims.[152]

In Chapter 12, only the debtor may file a plan.[153] Subject to the limitations set forth in sections 1222 and 1225, the debtor has the discretion to draft the plan in a manner so as to effectuate a successful reorganization. Section 1226(c) provides: "Except as otherwise provided in the plan or in the order confirming the plan, the trustee shall make payments to creditors under the plan."[154] This clearly contemplates that the plan may provide "otherwise" for payments to creditors. The only other place to find a restriction, if any, on the debtor's ability to make direct payments would be section 1222. Under section 1222, the debtor may classify claims, modify the rights of creditors (including secured creditors), cure defaults, and make various provisions for payments to creditors. There is no restriction, however, on the debtor's ability to make direct payments. In fact, section 1222(a)(1) carefully preserves the debtor's control over the money to be used for direct payments: "*The plan shall—(1) provide for the submission of all or such portion* of future earnings or other future income of the debtor to the supervision and control of the trustee *as is necessary for the execution of the plan.*"[155]

The provisions of Chapter 12 affirm, at each turn, the ability of the debtor to make direct payments to holders of secured claims and to thereby avoid the payment of a trustee's commission. Section 1225(a)(5) expressly recognizes that debtors may distribute property to the holders of secured claims. Section 1226(c) allows the debtor to provide in the plan for payments other than payments to the trustee. Section 1222(a)(1) does not require the debtor to submit

150. 11 U.S.C. § 1225(a)(5)(B)(ii) (emphasis added). By contrast, § 1325(a)(5)(B)(ii) does not have the language "or the debtor."

151. *See* COLLIER ON BANKRUPTCY, *supra* note 118, ¶ 1225.03[a] at 1225-16-17. The section which most closely fits the treatment of unmodified secured claims is § 1225(a)(5)(A).

152. *See* 11 U.S.C. § 1225(a)(4). *See also Erickson Partnership*, 83 B.R. at 727-28 (holding that Chapter 12 debtors may not make direct payments on unsecured claims).

153. 11 U.S.C. § 1221.

154. Section 1226(b)(2) provides: "Before or at the time of each payment to creditors under the plan, there shall be paid . . . the percentage fee fixed for such standing trustee under section 1202(e) of this title." 11 U.S.C. § 1226(b)(2). The reference to § 1202(e) is erroneous because this section does not exist. The reference should be treated as a reference to 28 U.S.C. § 586(e) which provides for a commission on all payments "received" by the standing trustee.

155. *Erickson Partnership*, 83 B.R. at 727 (emphasis added).

all earnings or income to the trustee, but only so much as is necessary for the execution of the plan. Finally, 28 U.S.C. § 586(e)(2) expressly ties the compensation of Chapter 12 trustees to payments received by the trustee, not to all payments made under the plan, as is the case with Chapter 13. It is fair to say therefore that the case for direct payments by the debtor to avoid the payment of the full commission rests on solid statutory grounds. The majority of courts that have considered this question have, more or less, followed the foregoing analysis.[156]

Not all courts, however, have accepted this conclusion. Several of the early cases on the trustee's compensation issue arose in non-pilot districts where the new amendment fixing the ten percent fee had not yet become effective.[157] In *In re Mikkelsen Farms, Inc.*,[158] the bankruptcy court limited the trustee's fee to a "reasonable value" for services in connection with a transfer of property. In *In re Hagensick*,[159] the bankruptcy court set the fee of the Chapter 12 trustee at five percent. In *In re Meyer*,[160] the bankruptcy court stated that the compensation of the trustee was subject to review in each case. In these districts, during the "phase-in" period, the bankruptcy judge had the power to set the percentage fee.[161] The cases from the "phase-in" districts naturally did not discuss the impact of the amendment of 28 U.S.C. § 586(e)(2) because these districts were not covered by the amendment at the

156. *See In re* Teigen, 142 B.R. 397 (Bankr. D. Mont. 1992); *In re* Beard, 134 B.R. 239 (Bankr. S.D. Ohio 1991); *In re* Overholt, 125 B.R. 202 (S.D. Ohio 1990); *In re* Cannon, 93 B.R. 746 (Bankr. N.D. Fla. 1988); Matter of Pianowski, 92 B.R. 225 (Bankr. W.D. Mich. 1988); *In re* Crum, 85 B.R. 878 (Bankr. N.D. Fla. 1988); *In re* Land, 82 B.R. 572 (Bankr. D. Colo. 1988), *aff'd* 96 B.R. 310 (D. Colo. 1988). Some of the later decisions use the factors articulated in *Pianowski*, in considering whether to permit direct payments in a particular case:

1. The past history of the debtor;
2. the business acumen of the debtor;
3. the debtor's post-filing compliance with statutory and court-imposed duties;
4. the good faith of the debtor;
5. the ability of the debtor to achieve meaningful reorganization absent direct payments;
6. the plan treatment of each creditor to which a direct payment is proposed to be made;
7. the consent, or lack thereof, by the affected creditor to the proposed plan treatment;
8. the legal sophistication, incentive and ability of the affected creditor to monitor compliance;
9. the ability of the trustee and the court to monitor future direct payments;
10. the potential burden on the Chapter 12 trustee;
11. the possible effect upon the trustee's salary or funding of the U.S. Trustee system;
12. the potential for abuse of the bankruptcy system;
13. the existence of other unique or special circumstances.

Pianowski, 92 B.R. at 233-34 (footnotes omitted). Other cases admit the possibility of direct payments without incurring a commission but are willing to do so on a more limited basis. *See, e.g.*, *In re* Seamons, 131 B.R. 459 (Bankr. D. Idaho 1991); *In re* Golden, 131 B.R. 201 (Bankr. N.D. Fla. 1991); *In re* Heller, 105 B.R. 434 (Bankr. N.D. Ill. 1989); *In re* Martens, 98 B.R. 530 (Bankr. D. Colo. 1989); *In re* Kline, 94 B.R. 557 (Bankr. N.D. Ind. 1988).

157. Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986. Pub. L. 99-554, § 302(d)(1) & (2), 100 Stat. 3088 (1986).

158. 74 B.R. 280 (Bankr. D. Ore. 1987).

159. 73 B.R. 710 (Bankr. N.D. Iowa 1987).

160. 73 B.R. 457 (Bankr. E.D. Mo. 1987).

161. 11 U.S.C. § 1202(d) (amended 1986). *See In re* Danelson, 77 B.R. 261 (Bankr. D. Mont. 1987); *In re* Janssen Charolais Ranch, Inc., 73 B.R. 125 (Bankr. D. Mont. 1987).

time of decision.[162] Nor did any of these cases discuss the significance of sections 1225(a)(5)(B)(ii) and 1226(c) for the debtor's ability to make direct payments.

In those districts where the amendments were effective by November 26, 1987, the courts essentially ignored the relevant statutory provisions. The bankruptcy court in *In re Rott*,[163] for example, stated the following with respect to the trustee's compensation:

> [T]he trustee's major objection appears to be that trustee's fees are not provided for under the plan. *The Chapter 12 standing trustee is entitled to a percentage fee of all payments made under a Chapter 12 plan.* 28 U.S.C. § 586(e)(1)(B)(ii). Thus, the trustee's fees must be provided for under the plan. This court is presently of the opinion that *all payments to impaired claimholders,* made during the three to five-year term of a Chapter 12 plan, *whether disbursed by the debtor or the trustee, are considered to be payments made under the plan and are thus subject to the trustee's percentage fees. See In re Hagensick* [citation omitted]. Of course, this treatment is subject to agreement between Chapter 12 debtors and the standing trustees for different treatment. This court is also of the position that these payments are not necessarily subject to the maximum [10%] fee rate allowed the trustee.[164]

The court's discussion here is clearly wrong. The main problem is that the court did not look at the correct section. The Chapter 12 trustee's fee is calculated, not under section 586(e)(1)(B)(ii) (setting the maximum compensation), but instead under section 586(e)(2) and is limited to payments received by the trustee. The court's confusion is further demonstrated with the statement that the fee is not necessarily ten percent, citing *Hagensick*.[165] Apparently, the court was not aware of the different standard prevailing in the "phase-in" districts.[166]

In *In re Citrowske*,[167] the initial confusion can be traced to the debtor. The debtor's plan had designated the United States trustee as the "disbursing agent," using, in all likelihood, a form plan from Chapter 11. This, of course, was inappropriate. The debtor also asked the court to use its "equitable powers" to adjust the trustee's fee. The bankruptcy court declined, correctly noting that in a United States trustee district, the court was without authority to set or adjust the fee.[168] The court then discussed the trustee's objection to certain payments "outside the plan":

> Since all payments must be made according to the terms of the plan, there is really no such thing as payments being made outside the plan. What the phrase "outside the plan" has come to mean is that the debtors will make the payments to a creditor directly rather than having such

162. For a discussion of the "phase-in" of the judicial districts, see *Erickson Partnership*, 77 B.R. at 749-50, *Hagensick*, 73 B.R. at 714 n.1.
163. 73 B.R. 366, 375 (Bankr. D.N.D. 1987).
164. *Id.* at 375. (emphasis added).
165. 73 B.R. 710.
166. *See supra* notes 148-153 and accompanying text.
167. 72 B.R. 613 (Bankr. D. Minn. 1987).
168. *Id.* at 615.

> payments made by the trustee, presumably thereby avoiding payment of the the trustee's percentage fee. With the possible exception of unaltered regular contractual payments on long term debts, which are much the same as other regular current monthly expenses, *all payments to creditors or administrative expense claimants are paid under the plan and thus subject to the trustee's percentage fee. This is so even if the plan provides that the payment will actually be made by the debtors or from some other source.* Since there is no financial advantage to the debtors distributing direct payments under the plan, there is little reason not to require all income dedicated for plan payments to be paid to the trustee to be distributed pursuant to the plan.[169]

This quotation is the court's complete analysis of the problem. It is evident that the court did not look at the statutes. The lack of statutory citation only reinforces this surmise. Under 28 U.S.C. § 586(e)(2), it obviously makes a difference if the debtor makes the payment directly, rather than through the Chapter 12 trustee.

Similarly, the bankruptcy court in *In re Hildebrandt*[170] cited section 1226(c), but failed to note its authorization for direct payments by debtors. It did, however, correctly cite 28 U.S.C. § 586(e)(2) as the governing provision for trustee compensation. The court concluded that the "format of chapter 12 and 28 U.S.C. § 586 contemplate that most if not all of the payments made by chapter 12 debtors will be made under a plan of reorganization."[171] As the principal basis for its conclusion, the court stated:

> 11 U.S.C. § 1222(a)(1) states that the debtor will provide in his plan for "the submission of all or such portion of future earnings or other future income of the debtor to the supervision and control of the trustee as is necessary for the execution of the plan." *11 U.S.C. § 1225(b) requires that all "disposable income"* not necessary for "maintenance or support of the debtor" or for "payment of expenditures necessary for the continuance [sic], preservation and operation of the debtor's business" *be paid into the plan.* Payments to prepetition creditors do not fit under either exception above.[172]

Section 1225(b), however, does not require that all disposable income be paid into the plan. It requires that all disposable income "will be applied to make payments under the plan." As noted above, section 1222(a)(1) does not require the debtor to submit all income to the trustee, only such portion as is necessary for the execution of the plan. This preserves the debtor's control over the direct payments pursuant to section 1226(c). The characterization of a payment as "outside," "inside," "into" or "under" the plan, in any event, is not the crucial inquiry. Too many courts have confused the issue by trying to solve the problem through labeling. It is a "red herring."[173] All payments in

169. *Id.* at 615-16 (emphasis added).
170. 79 B.R. 427 (Bankr. D. Minn. 1987).
171. *Id.* at 428.
172. *Id.* (emphasis added).
173. *See* Matter of Foster, 670 F.2d 478, 485-86 (5th Cir. 1982). Nevertheless, the outside/inside distinction was determinative for the district court in *In re* Greseth, 78 B.R. 936 (D. Minn. 1987). The court stated: "Neither chapter 12 nor [section] 586(e) contemplates payments being made

Chapter 12 are "in" or "under" the plan.[174] Some payments are direct; some are made through the trustee.

One of the few courts to directly take on the statutory analysis of *Erickson Partnership* is *Matter of Logemann*.[175] This court found the *Erickson Partnership* reliance on the reference in section 1225(a)(5)(B)(ii) to property being "distributed by the trustee or the debtor" to be misplaced. The *Logemann* court suggested that the language "simply anticipate[d] the direct payments that will be made by the debtor once the plan . . . is otherwise completed."[176] This interpretation might be a fair reading if the statute said "distributed by the trustee *and* the debtor" (or better yet "distributed by the trustee or the trustee and the debtor") but it is hard to square with the statute as written. When the objects are placed in the disjunctive, the requirement may be satisfied through either alternative.[177]

The *Logemann* court also rejected the reliance on section 1226(c) as authority for direct payments on impaired claims. It did not address how section 1226(c) could be read any other way. It simply relied upon the legislative history (from Chapter 13) to the effect "that the trustee typically should make the distribution to creditors under the plan."[178] This reliance is misplaced, however, because Chapter 13, unlike Chapter 12, does not contemplate any payments by debtors on secured claims. Moreover, in the face of the clear language of section 1226(c), how is it that the court believes resort to legislative history (involving Chapter 13) is appropriate? It should be noted that this bankruptcy judge was a judge, who on the Chapter 12 conversion issue, rejected the resort to even relevant legislative history when the statute was said to be "clear on its face."[179]

Finally, the *Logemann* court rejected the argument based on the language of 28 U.S.C. § 586(e)(2) relating to the calculation of the fee on "all payments received by such individual [trustee]," relying instead upon section 586(e)(1)(b)(ii).[180] This section, however, does not deal with the debtor's obli-

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outside the plan." *Id.* at 940. This is misleading because the debtors in *Greseth* sought to make direct payments to a taxing authority to redeem land, an action not contemplated by §§ 1222 or 1225. *Id.* at 939. The court, possibly relying on the debtors' own terminology, termed these payments as "outside" and hence impermissible in Chapter 12. *Id.* at 940.

174. 11 U.S.C. § 1226(c).

175. 88 B.R. 938 (Bankr. S.D. Iowa 1988).

176. *Id.* at 940.

177. *See* 1A SUTHERLAND'S STATUTES AND STATUTORY CONSTRUCTION § 21.14 (Norman J. Singer ed., 4th ed. 1985); United States v. Behnezhad, 907 F.2d 896, 898 (9th Cir. 1990) ("[W]e generally construe a statute written in the disjunctive as setting out separate and distinct alternatives."); Knutzen v. Eben Ezer Lutheran Housing Ctr., 815 F.2d 1343, 1349 (10th Cir. 1987) ("[U]nless the context or congressional intent indicates otherwise, the use of a disjunctive in a statue and regulations indicates that alternatives were intended."); George Hyman Constr. Co. v. Occupational Safety, 582 F.2d 834, 840 n.10 (4th Cir. 1978) ("Normally, use of a disjunctive indicates alternatives and requires they be treated separately unless such a construction renders the provision repugnant to the Act.").

178. *Logemann*, 88 B.R. at 941.

179. *See Spears*, 69 B.R. at 514-15. This was not the only bankruptcy judge to do so. *Compare Tomlin Farms*, 68 B.R. at 42, and *Rott*, 73 B.R. at 375; *Willis*, 78 B.R. at 380, and *Sutton*, 91 B.R. at 186.

180. *Logemann*, 88 B.R. at 941.

gation to pay a trustee's commission. Section 586(e)(1) deals with the power of the Attorney General to fix the maximum compensation for trustees. In addition to citing the wrong section for authority on the calculation of the trustee's compensation, the court's reading simply cannot account for the language in section 586(e)(2), which was added at the same time that Chapter 12 was enacted. Another familiar canon of construction is that the interpretation shall attempt, if at all possible, to give effect to all parts of the statute.[181] In short, the techniques of statutory interpretation utilized by the *Logemann* court appear to be guided more by result-orientation, rather than by principled analysis.

In rejecting the conclusion of *Erickson Partnership*, some courts have emphasized the importance of providing adequate compensation for trustees. The *Logemann* court, for example, found policy reasons in support of its holding that all payments were subject to the trustee's commission:

> Even if this court found the [*Erickson Partnership*] line of cases persuasive, policy grounds would mandate the court frequently exercising its discretion to determine and to direct what payments are received by the trustee. Clearly, concern over providing reasonable compensation for standing trustees in order to attract qualified and dedicated individuals can not be overemphasized.[182]

This policy argument was also articulated in *Matter of Finkbine*:[183]

> Congress, in enacting Chapter 12 was clearly concerned with the plight of the family farmer and the alarming rate at which such farms were failing—hence the proposed favorable treatment to be accorded a debtor's reorganization in Chapter 12. [citation omitted]. Bankruptcy Courts should evidence this same concern in apply and defining the provision of Chapter 12; however, in the absence of a specific statutory requirement, no Congressional enactments should be construed in a manner that disables other Congressionally created components of the bankruptcy court system. Should this court give *Erickson* the deference the debtors request, the inevitable result will be undue interference with a Congressional enactment in the absence of a Congressional directive, and a departure from two long standing components of bankruptcy law present under all other chapters of the code—similar treatment for similar claims and the payment of the expenses of administration from the assets of administration.[184]

181. *See* 2A SUTHERLAND'S STATUTES AND STATUTORY CONSTRUCTION § 46.06 (Norman J. Singer ed., 5th ed. 1992); United States v. Menasche, 348 U.S. 528, 538-39 (1955) ("It is our duty 'to give effect, if possible, to every clause and word of a statute' rather than to emasculate an entire section, as the Government's interpretation requires."); *In re* Nantucket, Inc., 677 F.2d 95, 98 (C.C.P.A. 1982) ("the [proposed] test violates a cardinal rule of statutory construction, i.e., that a legislature is presumed to have use no superfluous words."); Tabor v. Ulloa, 323 F.2d 823, 824 (9th Cir. 1963) ("The construction of [the section] adopted by the District Court would appear to render the words 'at law' functionless, and "a legislature is presumed to have used no superfluous words." ").

182. *Logemann*, 88 B.R. at 941.

183. 94 B.R. 461 (Bankr. S.D. Ohio 1988).

184. *Id.* at 466-67. *See In re* Fulkrod, 126 B.R. 584, 586-88 (Bankr. 9th Cir. 1991); *In re* Mouser, 99 B.R. 803, 806 (Bankr. S.D. Ohio 1989); Matter of Sutton, 91 B.R. 184, 186 (Bankr. M.D. Ga. 1988).

First, the picture for the trustee who does not receive a full ten percent commission on all payments made under the Chapter 12 plan is not quite so bleak as suggested by the *Finkbine* court. Those courts that have allowed the debtor to make direct payments on modified secured claims have usually determined that there is adequate compensation for the trustee.[185] Moreover, given the size of the average Chapter 12 debt service, a ten percent commission on all payments is clearly too high, in light of the amount of work to be performed.[186]

VIII. Disposable Income

For the holders of unsecured claims, there is normally a two-part standard that the debtor's plan must meet. Not only must the holders of unsecured claims be paid at least as much as they would receive in a liquidation under Chapter 7, but they are also entitled, in most cases,[187] to receive a pro rata share of the debtor's "projected disposable income" to be received during the period of the plan.[188] The liquidation test often produces little, if anything, for the holders of unsecured claims because by the time the debtor files for bankruptcy most property will be encumbered or exempt.[189] Thus, the disposable income test is usually the only realistic opportunity for the unsecureds to recover a portion of their claims. Disposable income is defined as: "[I]ncome which is received by the debtor and which is not reasonably necessary to be expended—(A) for the maintenance or support of the debtor or a dependent of the debtor; or (B) for the payment of expenditures necessary for the continuation, preservation, and operation of the debtor's business." The apparent purpose of the disposable income requirement is to deal with the "good faith" problem which was raised by the experience in Chapter 13 with "zero payment" plans,[190] as well as to give holders of unsecured claims "a fair level of protection" when the plan is being confirmed over their objection.[191]

An initial issue concerns the commitment to pay "projected" disposable

185. *See, e.g.*, *Teigen*, 142 B.R. at 402; *In re* Beard, 134 B.R. 239, 244 (Bankr. S.D. Ohio 1991); *In re* Martens, 98 B.R. 530, 541 (Bankr. D. Colo. 1989); *Pianowski*, 92 B.R. at 234. *See also Erickson Partnership*, 77 B.R. at 752 ("In the instant case, the Court is also mindful that the debtors have proposed to make payments each year totaling approximately $16,000 through the Trustee and subject to a fee . . . .").

186. It is quite possible that the drafters in Congress did not think this one through completely. The impact of a full 10% commission on the average amount of debt service in a Chapter 12 either makes the reorganization less feasible or is paid at the direct disadvantage of the unsecured creditors, or both. *See In re* Overholt, 125 B.R. 202, 208 (S.D. Ohio 1990); *Erickson Partnership*, 77 B.R. at 752.

187. The debtors are not required to commit disposable income to payments under the plan if the plan proposes to pay the unsecured claims in full. Matter of Billman, 93 B.R. 657, 661 (Bankr. S.D. Iowa 1988).

188. 11 U.S.C. § 1225(b)(1)(B). This entitlement is triggered by objection of the Chapter 12 trustee or any holder of an allowed unsecured claim (which is usually done as a matter of course) and will apply if the plan proposes to pay less than 100% of the amount of the allowed unsecured claims (which is usually the case). 11 U.S.C. §§ 1225(b)(1), 1225(b)(1)(A).

189. *See supra* note 104.

190. *In re* Willingham, 83 B.R. 552, 553 (S.D. Ill. 1988); *In re* Kjerulf, 82 B.R. 123, 126-27 (Bankr. D. Ore. 1987).

191. *In re* Rowley, 143 B.R. 547, 555 (Bankr. D. S.D. 1992); *Willingham*, 83 B.R. at 553.

income. Some debtors have argued that this requirement is satisfied at confirmation by the debtor promising to pay the disposable income projected at the time of confirmation and thereafter keeping that promise. For example, if the debtor's projections show no disposable income, then the requirement is met upon confirmation of the plan. This argument is based upon a literal interpretation of the language of section 1225(b)(1)(B). The courts, however, have rejected this argument, holding that payment of disposable income is a commitment that extends for the period of the plan.[192] Projections alone will not be sufficient to satisfy the requirement.[193] Evidence of actual income and expenses will be used to calculate disposable income.[194] The review for disposable income may take place on an annual basis[195] and upon completion of the plan payments when the debtor moves for a discharge.[196]

The determination of disposable income is recognized as being inherently subjective.[197] The calculation identifies income, then subtracts "reasonable" support of the debtor and dependents[198] and "reasonable" expenditures in connection with the farming operation. Most of the questions have dealt with the reasonableness of the "expenditures necessary for the continuation, preservation, and operation of the debtor's business."[199] One of the principal questions has been whether the debtor could apply the profit from one year's operation to the payment of expenses for the next year. Because section 1225(b)(2)(B) includes within reasonable expenditures, amounts necessary for the "continuation" of the business, the courts have refrained from adopting a per se rule against retention of a cash reserve to be applied to the next year's expenses.[200] This holding is crucial to maintaining feasibility because debtors in bankruptcy have great difficulties obtaining outside financing for their operation, which often entails considerable expense before any income is realized.

If the debtor was required to pay all net income from each year's operation under the disposable income requirement, this would create an inherent conflict with the feasibility provision. Several courts have denied confirmation under the feasibility requirement because the plan did not contain a "cushion"

192. *Rowley*, 143 B.R. at 556. *See In re* Martin, 130 B.R. 951, 966 (Bankr. N.D. Iowa 1991) (proceeds of life insurance policy paid on account of death of the debtor were potentially includable in disposable income, depending upon the outcome of a further evidentiary hearing); Matter of McKeag, 77 B.R. 716, 718 (Bankr. D. Neb. 1987) (failure of debtors to apply "exempt" income from annuity to disposable income commitment was evidence of "bad faith").

193. Matter of Schwarz, 85 B.R. 829, 831 (Bankr. S.D. Iowa 1988).

194. *In re* Fleshman, 123 B.R. 842, 845 (Bankr. W.D. Mo. 1990); *In re* Wood, 122 B.R. 107, 115 (Bankr. D. Idaho 1990).

195. *Schwarz*, 85 B.R. at 832.

196. *Rowley*, 143 B.R. at 555; Matter of Roberts, 133 B.R. 1004, 1007 (Bankr. N.D. Ind. 1991); *Wood*, 122 B.R. at 115.

197. *Rowley*, 143 B.R. at 555; *In re* Bowlby, 113 B.R. 983, 989 (Bankr. S.D. Ill. 1990); *In re* Coffman, 90 B.R. 878, 884 (Bankr. W.D. Mich. 1988).

198. The language of § 1225(b)(2)(A) would appear to credit reasonable expenditures for non-debtor dependents. The bankruptcy court in *In re* Foos, 121 B.R. 778 (Bankr. S.D. Ohio 1990), however, required the debtor to include his non-debtor spouse's income within the plan's definition of disposable income or her share of the family's expenses could not be paid by the debtor. *Id.* at 781.

199. 11 U.S.C. § 1225(b)(2).

200. *Wood*, 122 B.R. at 115; *Bowlby*, 113 B.R. at 988; *Coffman*, 90 B.R. at 884; *Janssen Charolais Ranch*, 73 B.R. at 128.

or "reserve" for unexpected expenses.[201] *A fortiori*, there is a feasibility problem if the plan does not provide for the expected expenses of the following year's crop.[202] This predicament was discussed by the bankruptcy court in *In re Coffman*.[203] The debtor faces a choice in continuing the operation: either the debtor must use net income for the next year's expenses or the debtor must obtain a loan secured by crops or livestock.

The *Coffman* court held that the determination of whether there is disposable income must be made on a case-by-case basis in light of the "totality of the circumstances."[204] Guiding the determination in the particular case would be the following factors:

> 1. The source of a debtor's annual net income; *i.e.*, is it derived from actual farming operations or from government programs or from other sources. As a part of this inquiry, the [c]ourt may need to hear proof on the reasonableness of and actuality of business expenses for the prior year. For example, this [c]ourt questions whether paper losses such as depreciation are proper expenses for purposes of calculating "disposable income," which is a different calculation than one for tax purposes.
> 2. Whether a debtor was able to obtain current crop financing or made any effort to do so. This is not to say that the debtor must obtain such financing, but it is a part of the total "reasonably necessary" inquiry.
> 3. Whether a debtor reduced, maintained, or expanded the pre-Chapter 12 farming operation. In this regard, it would be a critical question whether any expansion of the farming business would be compatible with [s]ection 1225(b)(2)(B).[205]

Thus, the debtor may not reduce the disposable income through improper expenditures, retention of an reasonably large reserve of funds, or overall expansion of the size of the operation.[206] But, the debtor should not be hindered from achieving the purpose of Chapter 12, which is to "assist those farmers who have the true potential to reorganize and to allow them relief from heavy debt burden . . . ."[207]

The choice between self-financing and outside financing was discussed by the bankruptcy court in *In re Bowlby*.[208] The debtors sought to use income generated from the last year of the Chapter 12 plans "to pay the entire cost of

201. *See infra* notes 259-60 and accompanying text. *But see* Matter of Dues, 98 B.R. 434, 443 (Bankr. N.D. Ind. 1989) (suggesting that a plan which used a contingent cash reserve may be in violation of the disposable income requirement); *Rott*, 94 B.R. at 167 (provision for "cushion" in plan deprived unsecured creditors of disposable income).

202. One court has held as a matter of law that disposable income does not include net operating income "reasonably necessary to pay the upcoming year's expenses without obtaining credit." *In re* Young, 103 B.R. 1021, 1022 (Bankr. S.D. Ind. 1988).

203. 90 B.R. 878, 884-85 (Bankr. W.D. Mich. 1988).

204. *Id.* at 885.

205. *Id.* at 885-86.

206. *Id.* at 886.

207. *Id.* at 885 (quoting 132 CONG. REC. S15075 (daily ed. Oct. 3, 1986) (comments of Senator Thurmond)).

208. 113 B.R. 983, 989-92 (Bankr. S.D. Ill. 1990).

planting, maintaining, and harvesting their next year's crop following completion of their plans."[209] The court noted that although the purpose of Chapter 12 was to give debtors a "fresh start," it was not intended to leave Chapter 12 debtors in a more advantageous position than other farmers not in bankruptcy: "A Chapter 12 debtor, therefore, should not be allowed to profit from the experience, but should be placed on an equal footing with other farmers upon successful completion of his plan."[210] It is common for farmers to borrow the operating expenses for the next crop or livestock cycle. A crop season or livestock cycle that is entirely prepaid may be too much of an advantage. On the other hand, the cost of borrowing might make the operation unable to generate a profit. Thus, the question will be resolved in light of the particular circumstances of each debtor as part of the court's "reasonably necessary" inquiry.[211]

In making this determination, the *Bowlby* court placed the ultimate burden of proof on the debtor,[212] relying primarily on a Chapter 13 case, *In re Fries*.[213] The *Fries* court analyzed the disposable income requirement in Chapter 13 and split the burdens so that the creditor had the initial burden of producing evidence that the debtor was not applying all of the disposable income to payment of unsecured claims and the debtor had the ultimate burden of persuasion that the disposable income requirement had been satisfied.[214] Splitting the burden in this fashion was said to be appropriate because knowledge of income and expenses is peculiarly within the debtor's possession.[215] In *Bowlby*, the debtors failed to sustain their burden and discharge was denied.[216]

The *Bowlby* court's holding on respective allocation of the burden of proof was followed in *In re Kuhlman*.[217] In *Kuhlman*, Bankruptcy Judge Irvin Hoyt noted the connection between the particular procedural context of the disposable income issue and the burden of proof.[218] If raised in connection with a motion for modification,[219] then the burden fell on the party proposing the modification. This meant the Chapter 12 trustee or the unsecured creditor would have the burden of proof on disposable income.[220] If raised in the context of the section 1225(b)(1) requirement that the debtor apply all of the disposable income to payment of unsecured claims, then the burden of proof will be on the debtor.[221] Judge Hoyt concluded that modification was not the

209. *Id.* at 989.
210. *Id.*
211. *Id.*
212. *Id.* at 991.
213. 68 B.R. 676 (Bankr. E.D. Pa. 1986).
214. *Id.* at 685.
215. *Id.*
216. *Bowlby*, 113 B.R. at 992.
217. 118 B.R. 731, 738 (Bankr. D. S.D. 1990).
218. *Id.* at 737.
219. The debtor may not, at the end of the plan, move to modify in order to direct the disposable income received during the plan period to the secured creditors. *See Fleshman*, 123 B.R. at 847.
220. *See, e.g.*, Farm Credit Bank v. Hurd, 105 B.R. 430, 432 (W.D. Tenn. 1989); *Rott*, 94 B.R. at 167; *Coffman*, 90 B.R. at 885; *Schwarz*, 85 B.R. at 832.
221. *Bowlby*, 113 B.R. at 991.

appropriate means of raising the disposable income issue because the issue was an integral part of plan compliance.[222] The debtor must bear the ultimate burden of showing that all requirements of the plan have been fulfilled.[223]

The burden of proof issue is important because the "reasonably necessary" standard is inherently subjective. Close calls will go against the party who has the burden. An examination of the *Bowlby* and *Kuhlman* reasoning is therefore justified. The *Kuhlman* court recognized that ordinarily the party objecting to discharge has the burden of proving the merits of their motion or objection, but the court's characterization of the issue as one of plan compliance put the burden on the debtor.[224] It is important at this point to recall that section 1225(b)(1) requires the plan to provide "that all of the debtor's *projected* disposable income to be received [during the plan period] . . . will be applied to make payments under the plan."[225] The court's reading of this requirement as a commitment to pay *actual*, not *projected* disposable income, is a necessary gloss on the statute. But having created the gloss, does it follow that the debtor should bear the ultimate burden on this gloss? The *Kuhlman* court said yes, because "the debtor has all of the necessary financial information to do the task [of calculating disposable income]."[226] But doesn't this circumstance relate more appropriately to the burden of producing sufficient evidence, not the burden of persuasion?[227] It seems to this author that *Bowlby* and *Kuhlman* have it backwards with respect to the burden of producing sufficient evidence and the burden of persuasion. Given the inherently subjective nature of the ultimate determination, the burden of persuasion should be on the objecting party once the debtor has made a prima facie case for payment of all disposable income. Making the debtor prove a prima facie case of plan compliance, including the disposable income commitment, is fair because the debtor has the financial information more readily available. Making the objecting party bear the burden of persuasion on the close calls is fair in light of the underlying purpose of Chapter 12 to promote the financial rehabilitation of family farmers.

Probably the primary area of judgment calls concerns capital expendi-

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222. *Kuhlman*, 118 B.R. at 738.

223. *Id.* The court stated the respective allocation of burdens:

> [The trustee and interested creditor] must . . . : (1) independently calculate the amount of disposable income available; (2) timely object to discharge or move to dismiss the case if the debtor has not made appropriate disposable income payments; and (3) if an objection to discharge or motion to dismiss is filed, make a satisfactory showing that the debtor has failed to comply with his plan by not making appropriate payments of disposable income. In the end, however, the Court will look to the debtor to show that all disposable income payments have been timely made. Discharge will not be entered until the Court, Chapter 12 trustee, and all interested parties are satisfied that the Chapter 12 debtors have complied with their confirmed plan, including turning over of all disposable income.

Id. at 738-39 (footnote omitted).

224. *Id.* at 738 (citing Bankruptcy Rule 4005 and Education Assistance Corp. v. Zellner, 827 F.2d 1222, 1226 (8th Cir. 1987)).

225. 11 U.S.C. § 1225(b)(1) (emphasis added).

226. *Kuhlman*, 118 B.R. at 738.

227. See the discussion of the distinction between the two types of burdens in *Fries*, 68 B.R. at 683-84.

tures. Is the purchase of new machinery or equipment a "reasonably necessary" expenditure? If the call goes against the debtor, the debtor must liquidate and pay the proceeds plus any deficiency to the unsecured claims.[228] Short of a statutory requirement that all capital expenditures must have prior approval of the bankruptcy court,[229] this seems unduly harsh, particularly because the consequence may well be dismissal of the case without any discharge. A debtor's decision to depart from the projections cannot be immune from review, but a margin of error provided by putting the burden of persuasion on the objecting party would seem to be appropriate. If the debtor is required to make a prima facie justification for increased expenditures made during the course of the plan, then there should be sufficient evidence upon which to make the judgment call.[230]

Similarly, the question of whether the debtor may use the proceeds of the prior cycle to finance the new cycle or should be required to obtain outside financing can be determined after an examination of the projections for the next year and a showing of what efforts the debtor made to obtain outside financing. Because the debtor will usually have no equity at the beginning of the plan, the only available collateral will be the anticipated future crops or livestock. Sometimes the court can determine that the debtor may be self-financing without extensive factual inquiry.[231]

One final aspect of the disposable income requirement needing examination is the duration of this requirement. Section 1225(b)(1)(B) provides "all of the debtor's projected disposable income *to be received in the three-year period, or such longer period as the court may approve under section 1222(c), beginning on the date that the first payment is due under the plan* will be applied to make payments under the plan."[232] The *Kuhlman* court held that this means that "the three years that Debtors have obligated themselves to pay disposable income did not begin until 'the date that the first payment is due under the [P]lan.' "[233] The effect of this holding is to allow the Chapter 12 trustee or unsecured creditors to examine an additional year of the debtor's operation because the obligation is said not to begin until the first plan payment, which

228. *See, e.g.*, *Fleshman*, 123 B.R. at 847 (debtors required to pay $38,545 to the trustee of in part because of "excess" charitable contributions, plus the cost of a cabin construction, a new vehicle and a tiller purchased for the family garden).

229. *Cf.* 11 U.S.C. § 363(b)(1).

230. *See, e.g.*, *Wood*, 122 B.R. at 118 (debtors' increased expenditures for chemicals, fertilizer, and repairs were reasonable in light of the circumstances).

231. *See, e.g.*, *Wood*, 122 B.R. at 118, which states:

> Although they made no actual loan applications, the Court is satisfied from the testimony of the witnesses that because the [debtors] lack the ability to grant a lender a priority lien on their personal property assets, such as crops and equipment, they lack an essential ingredient to obtaining credit. In addition, Debtors' projected margin of expenses to income (even without regard to any expense for any new loan interest) would place an operating lender in an extremely precarious position. Even assuming a new lender would embrace a creditworthy Chapter 12 farm operation, something which is less than clear, this does not appear to be such an operation.

Id.

232. 11 U.S.C. § 1225(b)(1)(B) (emphasis added).

233. *Kuhlman*, 118 B.R. at 740 (quoting, in pertinent part, 11 U.S.C. § 1225(b)(1)(B)).

is usually at the end of the first year of the plan.[234] A more accurate reading of the statute, however, is that the disposable income commitment runs concurrent with the three year plan period, or such longer period approved by the court.[235] The first year's payment includes disposable income received by the debtor prior to the payment. The emphasis on the word "beginning" distorts the overall structure of the disposable income commitment, much like the emphasis of some debtors on the word "projected." It is particularly important not to read portions of the same statute literally while glossing over other parts of the same provision. The only consistency in the *Kuhlman* decision is that all of the calls go against the debtors.

IX. FEASIBILITY

The final confirmation requirement of section 1225(a) is that "the debtor will be able to make all payments under the plan and to comply with the plan."[236] This requires the bankruptcy court to determine whether the plan is feasible. Although, like valuation, the determination of feasibility is intensely factual, the analysis has been shaped by several judicially created guidelines.

To determine feasibility, "the court must ascertain the 'probability of actual performance of the provisions of the plan.' "[237] It is important that the debtor identifies the problems that led to the bankruptcy filing and proposes a realistic plan for dealing with them.[238] The debtor will have the burden of proof on this issue.[239] The debtor is not required to guarantee the ultimate success of the reorganization, but must show a "reasonable assurance of success."[240] The court must not indulge in highly speculative or unduly optimistic assumptions[241] and is compelled to limit its findings on the evidence presented.[242] Bearing in mind that the purpose of Chapter 12 is to promote

234. Applied literally, this would mean that the first year's payment would include no disposable income payments because the obligation does not "begin" until the first plan payment and all prior disposable income has not been "received" within the period of obligation. The indication from the *Kuhlman* case itself is that disposable income received prior to the first plan payment is also covered by the disposable income obligation. 118 B.R. at 740. Thus, the effect of *Kuhlman* is to add an additional year to the commitment.

235. *See In re* Gossett, 86 B.R. 941, 944 (Bankr. S.D. Ohio 1988) ("[A]bsent a voluntary extension or some showing of cause, the debtors cannot be forced to submit their disposable income to the plan for a period longer than three years.").

236. *See generally* Flaccus & Dixon, *supra* note 97.

237. *In re* Hopwood, 124 B.R. 82, 86 (E.D. Mo. 1991) (quoting *In re* Clarkson, 767 F.2d 417, 420 (8th Cir. 1985)).

238. *See In re* Douglass, 77 B.R. 714, 716 (Bankr. W.D. Mo. 1987) (problem of flooding had not been solved by debtors).

239. *In re* Rape, 104 B.R. 741, 748 (W.D. N.C. 1989); *In re* Snider Farms, Inc., 83 B.R. 1003, 1015 (Bankr. N.D. Ind. 1988)

240. *In re* Butler, 101 B.R. 566, 567 (E.D. Ark. 1989); *Snider Farms*, 83 B.R. at 1011 (quoting *In re* Trail's End Lodge, Inc., 54 B.R. 898, 904 (Bankr. D. Vt. 1985)). *See Dues*, 98 B.R. at 443 ("[T]he debtor need only demonstrate a reasonable assurance of economic viability or a reasonable probability that the plan can be successfully implemented and performed.").

241. *In re* Konzak, 78 B.R. 990, 994 (Bankr. D. N.D. 1987) ("Market projections must be supported by some factual basis in order for them to be regarded by the court as anything more than wishful thinking.").

242. *See Snider Farms*, 83 B.R. at 1014; *In re* Land, 82 B.R. 572, 577 (Bankr. D. Colo. 1988); *In re* Eber-Acres Farm, 82 B.R. 889, 894 (Bankr. S.D. Ohio 1987); *Konzak*, 78 B.R. at 994.

the reorganization of family farmers, the court should give the debtors the benefit of the doubt so long as feasibility is reasonably probable.[243]

"Reasonable probability" does not require certainty, but must be based on evidence, not speculation or unproven assumption.[244] "[T]he feasibility test is firmly rooted in prediction based on objective fact."[245] As stated by the bankruptcy court in *In re Kloberdanz*:

> The Court must be persuaded that it is *probable*, not merely possible or hopeful, that the Debtors can actually pay the restructured debt and perform all obligations of the plan. This requires consideration of the farm's earning power, capital structure, economic conditions, managerial efficiency, and whether the same management will continue to operate the farm.[246]

Projections of both income and expense are best supported by actual figures from the debtor's own operation.[247] It should be noted, however, that this approach, if strictly adhered to, makes feasibility a difficult hurdle because the immediate past experience of a debtor in bankruptcy cannot be good. Nevertheless, in order to justify figures that are better than the past experience, the debtor must account for the prior problems and must have specific solutions

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243. *Hopwood*, 124 B.R. at 86; *Rape*, 104 B.R. at 748; *Butler*, 101 B.R. at 567; *Snider Farms*, 83 B.R. at 1013; *In re* Reitz, 79 B.R. 934, 938 (Bankr. D. Kan. 1987); *In re* Hansen, 77 B.R. 722, 727 (Bankr. D. N.D. 1987).

244. *In re* Novak, 102 B.R. 22, 24 (Bankr. E.D. N.Y. 1989); *Snider Farms*, 83 B.R. at 1014. The observations of the district court in *Rape* indicate that some balance between objective and subjective factors is necessary:

> The bankruptcy judge did make some findings of fact regarding the [debtors'] credibility, ability, and candor, but such factual findings are perfectly appropriate. FCB and FmHA argue, in effect, that a court should not in any way base its determination of the feasibility issue upon intangible or subjective factors. Yet, the simple fact is that family farming is not an exact science; the success or failure of any one farm is largely dependent upon luck and upon the farmer's skill, resourcefulness, spirit, and grit. No one knows with any real certainty what tomorrow will bring. Many perils face family farmers: Recessions, depressions, droughts, hail storms, and even locusts. In the face of such possible perils, certainly it is not error for a court to consider, along with the hard numbers, the human factor, which may be the deciding factor when fortune-or nature-works against the efforts of the farmer.

Rape, 104 B.R. at 751. *See Bluridg Farms*, 93 B.R. at 656:

> Labile markets, unpredictable weather and changes in government programs preclude precise forecasting. . . . The role of market conditions in the agricultural economy is one reason farming is an inherently risky venture. If the court found that the debtor's plan was not feasible because the debtor's feeding operation is dependent on market conditions, few farm plans would ever be confirmed.

Id.

245. *Clarkson*, 767 F.2d at 420. Although *Clarkson* is a Chapter 11 farm case, it is often cited in Chapter 12 cases. *See, e.g.*, *Hopwood*, 124 B.R. at 86; *Butler*, 101 B.R. at 567; *Bluridg Farms*, 93 B.R. at 656; *In re* Kloberdanz, 83 B.R. 767, 773 (Bankr. D. Colo. 1988); *Konzak*, 78 B.R. 990, 993.

246. *Kloberdanz*, 83 B.R. at 773 (quoting *Clarkson*, 767 F.2d at 420).

247. *In re* Branch, 127 B.R. 891, 895 (Bankr. N.D. Fla. 1991) (projected yield was within historical average); *Rape*, 104 B.R. at 748; *Rott*, 94 B.R. at 170; *In re* Townsend, 90 B.R. 498, 502 (Bankr. M.D. Fla. 1988) ("The debtor's projection of income for 1988 is inconsistent with their experience during the period they have operated with their son for the past three years. Furthermore, those projections are based in part upon generous and optimistic projections concerning the effect of new, but previously untried, farming operations."); *In re* Fowler, 83 B.R. 39, 44 (Bankr. D. Mont. 1987); *Kloberdanz*, 83 B.R. at 773; *Konzak*, 78 B.R. at 994 ("A debtor should not premise future plan cash flows upon heightened yield or market data for successive plan years unless there is some objective base for such data. The plan must, to the extent possible, be based on known inputs including yields, farm prices and programs as presently existing.").

for same.[248] Of course, the debtor will have substantial problems if there are no credible figures relating to past performance.[249]

On the income side of the projections, it is essential that the debtor's projections show a positive cash flow.[250] If yield predictions are higher than the immediate past experience, there must be some justification of such optimism.[251] It is also important during the pre-confirmation period for the debtor to meet the projections made in obtaining cash collateral[252] or made in connection with the plan itself.[253] Similarly, any request for modification of a confirmed plan should account for why the original projections did not materialize as expected.[254] If increased income is dependent upon expansion of the size of the present operation, then the source of funds to facilitate the expansion must be identified.[255] The courts allow debtors to include government program payments, even though they are not guaranteed for the indefinite future, but it helps if the debtor can show that loss of program payments would be offset by increased acreage devoted to crops.[256]

On the expense side of the projections, is it especially important to show that the projected expenses are consistent with the debtor's actual experience. This is because expenses prior to a bankruptcy filing tend to be lower than the debtor's "normal" operating experience. Provision should be made for ma-

248. *See In re* Crowley, 85 B.R., 76, 79 (W.D. Wis. 1988) ("The bankruptcy court acted properly in considering the reasons for past low production in assessing the feasibility of a plan which hinged on greatly improved yields."); *Douglass*, 77 B.R. at 716.

249. *See Butler*, 101 B.R. at 567; *In re* Adam, 92 B.R. 732, 737 (Bankr. E.D. Mich. 1988); *Reitz*, 79 B.R. at 938.

250. *See In re* Braxton, 124 B.R. 870, 874 (Bankr. N.D. Fla. 1991) (debtors' plan produced a deficit when the increased debt service due to court's valuation determination was figured in plan); *Richardson*, 113 B.R. at 30 (debtor's error on cash flow statement corrected to demonstrate a negative cash flow); *Rott*, 94 B.R. at 171-72; *In re* Bartlett, 92 B.R. 142 (E.D. N.C. 1988) (district court reversed a bankruptcy court order confirming a Chapter 12 plan because the debtor's own figures showed that the income would be insufficient to cover all plan payments in the first year); *Crowley*, 85 B.R. at 79 (production level required for feasibility could not be reached until at least two years after confirmation); *Reitz*, 79 B.R. at 938 (court found a budget deficit after adjusting the secured claim of FmHA to correspond to the value of the collateral as determined by the court); *Konzak*, 78 B.R. at 994 (even accepting the debtors' projections, the plan produced a deficit after adjustment by the court for a market rate of interest to be paid on the major secured claim).

251. *See In re* Euerle Farms, Inc., 861 F.2d 1089, 1091 (8th Cir. 1988) ("the debtor's income and expense projections present were so inconsistent with past performance to indicate no possibility that the projections would be met"); *In re* Luchenbill, 112 B.R. 204, 218 (Bankr. E.D. Mich. 1990) (debtors assumption of four consecutive excellent years was not reasonable); *Bluridg Farms*, 93 B.R. at 656 ("[T]he debtor's yield predictions are very optimistic in light of past averages and the possible impact of this year's drought throughout much of the [District]. However, the concomitant rise in grain prices over the past few months might offset any failure to meet the projected yields."); *Adam*, 92 B.R. at 737 ("In the absence of any evidence to the contrary, we must presume that future years' prices and yields will approximate historical averages."); *In re* Edwardson, 74 B.R. 831, 835 (Bankr. D. N.D. 1987) (debtor excluded hail damage years from average yield figures because crops would be fully insured against future hail damage).

252. *See Butler*, 101 B.R. at 567.

253. *See, e.g.*, *Douglass*, 77 B.R. at 716 (plan projected income from wheat harvest, but evidence showed there would be none; plan also projected income from soybeans, but evidence of late planting demonstrated that the projected yield was unrealistic).

254. *See In re* Dittmer, 82 B.R. 1019, 1022 (Bankr. D. N.D. 1988) (motion for modification denied because new projections substantially exceed the experience under the confirmed plan).

255. *See In re* Lupfer Bros., 120 B.R. 1002, 1005 (Bankr. W.D. Mo. 1990); *In re* Big Hook Land & Cattle Co., 77 B.R. 793, 795 (Bankr. D. Mont. 1987).

256. *Kloberdanz*, 83 B.R. at 773.

chinery replacement costs.[257] If there will be liquidation of some of the equipment and machinery, the debtor must demonstrate that the remaining equipment and machinery is sufficient to handle the "down-sized" operation.[258]

In addition to the specifics of the debtor's operations, it is understood that the farm economy is subject to cycles over the long run. Projections which do not allow for some "cushion" to carry the farmer through the low periods are subject to question.[259] The cushion may be in the form of a cash reserve[260] or in the form of conservative estimates.[261] The court may also rest its determination, in part, upon its assessment of the debtor's skill, management, and integrity in running the operation.[262]

The restructuring of the debt will also have a substantial impact on feasibility. The longer a debtor can stretch out the payments on the secured claims, the better the cash flow position will be. The question thus arises—are there any limits to the duration of the repayment on the secured claims? Chapter 12 itself imposes no express limitations.[263] The courts have recognized an underlying policy of ensuring the creditors receive a "fair repayment."[264] It is important to note that the restructuring is not limited to the term of the original loan.[265] Generally, the debtor cannot stretch the payments longer than the usual term for loans secured by similar collateral.[266] The bankruptcy court in *In re Koch*,[267] for example, found that agricultural loans in the work-out situations commonly had a long-term amortization with a balloon payment at the end of an earlier period. The court allowed the debtor to amortize a land debt over thirty years with a balloon payment at the end of fifteen years. The bankruptcy court in *Matter of Bluridg Farms, Inc.*[268] allowed a seven-year amortization for a debt secured by a lien on machinery.

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257. *Bluridg Farms*, 93 B.R. at 656; *Big Hook Land & Cattle*, 77 B.R. at 795.

258. *Euerle Farms*, 861 F.2d at 1091.

259. *Butler*, at 101 B.R. 568; *Snider Farms*, 83 B.R. at 1013-14; *Big Hook Land & Cattle*, 77 B.R. at 795.

260. *See, e.g.*, *Bluridg Farms*, 93 B.R. at 656.

261. *See, e.g.*, *In re* Chaney, 87 B.R. 131, 138 (Bankr. D. Mont. 1988).

262. *See, e.g.*, *Hansen*, 77 B.R. at 727; *Edwardson*, 74 B.R. at 835.

263. *In re* Koch, 131 B.R. 128, 130 (Bankr. N.D. Iowa 1991): "In Chapter 12 '[t]he only time limits on payment of secured debt are those which are implied by the present value language of 1225(a)(5) and the feasibility test of 1225(a)(6)'." (quoting *Janssen Charolais Ranch*, 73 B.R. at 127).

264. *In re* Fisher, 930 F.2d 1361, 1362 (8th Cir. 1991).

265. *See, e.g.*, Travelers Ins. Co. v. Bullington, 878 F.2d 354, 357 (11th Cir. 1989) (court approved a thirty-year term under the plan whereas the original loan had a balloon payment after five years); *Billman*, 93 B.R. at 660 (seven-year note stretched to twenty-five years with a balloon payment after fifteen years); *Snider Farms*, 83 B.R. at 999 ("stretchout" of loan to thirty years was not "unreasonable given the fact that conventional farm mortgages are often lengthy"); *In re* Dunning, 77 B.R. 789, 792 (Bankr. D. Mont. 1987) (notes which were mature on date of filing were restructured to a fifteen year term).

266. *See, e.g.*, *Koch*, 131 B.R at 133; *LLL Farms*, 111 B.R. at 1022; *In re* Foster, 79 B.R. 906, 910-11 (Bankr. D. Mont. 1987); *In re* Smith, 78 B.R. 491, 494 (Bankr. N.D. Tex. 1987). *See also* COLLIER ON BANKRUPTCY, *supra* note 118, ¶ 1225.03[b] at 1225-18.

267. *Koch*, 131 B.R. at 133.

268. 93 B.R. at 654.

X. DEBTOR'S ATTORNEY'S FEES

The principles governing the payment of attorney's fees of the debtor's counsel in Chapter 12 are applicable to all bankruptcies. A brief review of these principles is necessary before turning to the specific cases in Chapter 12.[269]

In order to be entitled to receive compensation from the debtor, the debtor's estate, or persons related to the debtor, the employment of the attorney must be approved by the bankruptcy court pursuant to section 327.[270] The attorney cannot be compensated for post-petition services unless approval of employment has been granted and then only from the date on which the approval was obtained.[271] Many attorneys have discovered this, to their chagrin, when trying to cure the problem by a request for a *nunc pro tunc* order.[272]

Section 327 authorizes the employment of professional persons, including attorneys, if the person does not hold or represent an interest adverse to the estate and is "disinterested."[273] A common situation involves counsel who represented the debtor before the filing of the bankruptcy petition. The representation may have been related to the financial distress prompting the bankruptcy filing or it may have been unrelated. Congress has recognized a limited exception to the disinterestedness requirement by providing that "a person is not disqualified for employment under section 327 of this title by a debtor in possession solely because of such person's employment by or representation of

269. *See generally* John D. Ayer, *How to Think About Bankruptcy Ethics*, 60 AM. BANKR. L.J. 355 (1986); Patti Williams, *Bankruptcy Code Section 327(a) — New Interpretation Forces Attorneys to Waive Fees or Wave Good-Bye to Clients*, 53 MO. L. REV. 309 (1988); Karen J. Brothers, Comment, *Disagreement Among the Districts: Why Section 327(a) of the Bankruptcy Code Needs Help*, 138 U. PA. L. REV. 1733 (1990).

270. 11 U.S.C. § 330(a). In addition to the power to award debtor's counsel reasonable compensation from the estate, the bankruptcy court has jurisdiction to review the reasonableness of prepetition payments made by the debtor (11 U.S.C. § 329; *In re* Dixon, 143 B.R. 671 (Bankr. N.D. Tex. 1992) (all but $35,000 of a $300,000 prepetition retainer for defending a Chapter 11 debtor in criminal proceedings had to be disgorged); *In re* Office Prods. of Am., Inc., 136 B.R. 964, 970-71 (Bankr. W.D. Tex. 1992) (bankruptcy court "has the authority to review prepetition fees paid to debtor's counsel, regardless of their source and regardless of the terms of any agreement pursuant to which such fees are paid."); *In re* Montgomery Drilling Co., 121 B.R. 32 (Bankr. E.D. Cal. 1990) ($149,000 "security retainer" paid to counsel one day prior to the bankruptcy filing was property of the estate); *In re* D.L.I.C., Inc., 120 B.R. 348 (Bankr. S.D. N.Y. 1990) ($17,000 retainer was held to be property of the estate)) as well as payments received by counsel from third parties on the debtor's behalf (*In re* Land, 943 F.2d 1265 (10th Cir. 1991)).

271. 11 U.S.C. §§ 327(a), 330(a); Bankruptcy Rule 2014 (1984).

272. *See, e.g.*, *In re* Sound Radio, Inc., 145 B.R. 193 (Bankr. D. N.J. 1992); *In re* Lillian Laurence Ltd., 136 B.R. 1 (Bankr. D. D.C. 1992); *In re* Shirley, 134 B.R. 940 (Bankr. 9th Cir. 1992); *In re* Hazen Agr. Prods. Serv., 109 B.R. 602 (Bankr. W.D. N.Y. 1990); *In re* Martin, 102 B.R. 653 (Bankr. W.D. Tenn. 1989); *In re* Aladdin Petroleum Co., 85 B.R. 738 (Bankr. W.D. Tex. 1988); *In re* Twinton Properties Partnership, 27 B.R. 817 (Bankr. M.D. Tenn. 1983).

273. A disinterested person is defined by the Code as one who is not (a) a creditor, equity security holder, or insider of the debtor; (b) an investment banker for any outstanding security of the debtor; (c) within three years before the date of filing, not an investment banker for a security of the debtor nor the attorney for the investment banker in connection with the offer and sale of the security of the debtor; (d) within two years before the date of filing, a director, officer, or employee or the debtor or investment banker described above; and (e) the holder of an interest materially adverse to the interest of the estate, or any class of creditors, or equity security holders. 11 U.S.C. § 101(14).

the debtor before the commencement of the case."[274] However, if the attorney has performed professional services which have not been paid by the time of filing (whether or not the client has been billed), then the attorney is the holder of a "claim" and is not "disinterested."[275] A finding that an attorney is not disinterested at the time of filing may be the basis for the denial of the application for appointment as counsel,[276] or for disqualification of counsel,[277] or for denial of fees for professional services rendered post-filing.[278] If the applicant holds or represents an interest which is materially adverse to the estate, then the applicant is not "disinterested."[279] Disqualification may also be based on the applicant's former representation of one of the parties.[280] The receipt of a prepetition retainer does not disqualify an applicant so long as the retainer is disclosed to the court.[281] One subpart of the problem of disinterestedness concerns the representation of multiple debtors. There may be conflicts between the debtors so as to warrant disqualification of counsel.[282]

Award of reasonable compensation pursuant to section 330 requires the filing of an application with the bankruptcy court "setting forth a detailed statement of (1) the services rendered, time expended and expenses incurred, and (2) the amounts requested."[283] In evaluating the application, bankruptcy courts generally use the "lodestar" method, i.e., they multiply a reasonable hourly rate times the number of hours worked.[284] This "lodestar" may then be adjusted either up or down in accordance with the twelve-factor approach of *Johnson v. Georgia Highway Express*.[285]

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274. 11 U.S.C. § 1107(b).

275. *See In re* Pierce, 809 F.2d 1356 (8th Cir. 1987); *In re* Watervliet Paper Co., Inc., 96 B.R. 768 (Bankr. W.D. Mich. 1989), *aff'd*, 111 B.R. 131 (W.D.Mich. 1989); Matter of Pulliam, 96 B.R. 208 (Bankr. W.D. Mo. 1986); *In re* WMPK, 42 B.R. 157 (Bankr. D. Hawaii 1984).

276. *See In re* Huntmar Beaumeade I Ltd. Partnership, 127 B.R. 363 (Bankr. E.D. Va. 1991).

277. *See, e.g.*, Matter of Roger J. Au & Son, Inc., 65 B.R. 322 (Bankr. N.D. Ohio 1984), *aff'd*, 64 B.R. 600 (N.D. Ohio 1986)

278. *See, e.g.*, *Pierce*, 809 F.2d 1356; *In re* Georgetown of Kettering, Ltd., 750 F.2d 536 (6th Cir. 1984); *Pulliam*, 96 B.R. 208; Matter of Patterson, 53 B.R. 366 (Bankr. D. Neb. 1985); *In re* Roberts, 46 B.R. 815 (Bankr. D. Utah 1985), *aff'd in part, mod. in part, rev'd in part*, 75 B.R. 402 (D. Utah 1987); *WMPK*, 42 B.R at 157; *In re* Chou-Chen Chem., Inc., 31 B.R. 842 (Bankr. W.D. Ky. 1983).

279. *See, e.g.*, *In re* Vann, 128 B.R. 285 (Bankr. D. Colo. 1991); *In re* Thompson, 116 B.R. 679 (Bankr. W.D. Ark. 1990); *In re* Hathaway Ranch Partnership, 116 B.R. 208 (Bankr. C.D. Cal. 1990); *In re* Grabill, 113 B.R. 966 (Bankr. N.D. Ill. 1990); *Patterson*, 53 B.R. 366; *Chou-Chen Chem.*, 31 B.R. 842.

280. *See, e.g.*, *In re* Blinder, Robinson & Co., Inc., 123 B.R. 900 (Bky. D. Colo. 1991); *In re* Amdura Corp., 121 B.R. 862 (Bky. D. Colo. 1990). *See also* Regina Stango Kelbon, et al., *Conflicts, the Appointment of "Professionals," and Fiduciary Duties of Major Parties in Chapter 11*, 8 BANKR. DEV. J. 349 (1991)

281. *See, e.g.*, *In re* Creekside Landing Ltd., 116 B.R. 106 (Bankr. M.D. Tenn. 1990).

282. *See, e.g.*, *In re* W.F. Dev. Corp., 905 F.2d 883 (5th Cir. 1990), *cert. denied*, 111 S. Ct. 1311 (1991); *Amdura Corp.*, 121 B.R. 862; *In re* Vanderbilt Assocs., 111 B.R. 347 (Bankr. D. Utah. 1990).

283. Bankruptcy Rule 2016(a) (1984).

284. *See, e.g.*, *In re* Alderson, 114 B.R. 672 (Bankr. D. S.D. 1990); *In re* Yankton College, 101 B.R. 151 (Bankr. D. S.D. 1989).

285. 488 F.2d 714 (5th Cir. 1974). The 12 factors set forth in *Johnson* are: (1) the time and labor required; (2) the novelty and difficulty of the questions; (3) the skill required to perform legal services properly; (4) the preclusion of employment due to acceptance of the case; (5) the customary fee; (6) whether the fee is fixed or contingent; (7) time limitations imposed by the client or the circumstances; (8) the amount involved and the results obtained; (9) the experience, reputation, and ability of the attorneys; (10) the undesirability of the case; (11) the nature and length of the professional relationship with the client; and (12) awards in similar cases. *Id.* at 717-19.

The Chapter 12 cases involving appointment of counsel and approval of attorney's fees have not departed from the foregoing principles. In *In re Watson*,[286] the debtor's attorney held a prepetition security interest in the debtor's assets to secure payment of fees for prepetition nonbankruptcy services and was therefore disqualified from appointment as counsel for the Chapter 12 debtors.[287] In *Matter of Samford*,[288] an attorney was retained post-petition by Chapter 12 debtors to represent them in nonbankruptcy proceedings. The hiring and payment of a retainer was done without the knowledge or approval of the bankruptcy court. The district court affirmed the bankruptcy court's ruling that the retainer paid to the attorney was property of the estate required to be turned over to the trustee.[289] In *In re Williams*,[290] the bankruptcy court exercised its power of review to reduce the fees of both for the debtor's attorney as well as for the attorneys representing an oversecured creditor. The debtors were not required to pay for the education of their counsel.[291] Under section 506(b), they were only required to pay *reasonable* attorney's fees incurred by the oversecured creditor, meaning that the creditor's counsel could not "run up" the bill through multiple office conferences between several attorneys.[292]

Probably the most significant case concerning attorney's fees in Chapter 12 is *In re Alderson*.[293] In *Alderson*, Bankruptcy Judge Irvin Hoyt held that debtor's counsel was not entitled to any fees or expenses after the date the attorney knew or should have known that conversion of the case to Chapter 7 was inevitable.[294] Although there was justification for a finding that this particular Chapter 12 was doomed because of the debtor's fabrications, fraudulent transactions, and inability to present a realistic plan of reorganization, this holding might cause problems in other cases. It may drive a "wedge" between the debtor and debtor's counsel, if counsel is required to consider "abandoning the ship" when the reorganization is beginning to unravel. The attorney, of course, is subject to Bankruptcy Rule 9011 which requires that all pleadings have a basis in fact, law, or equity.[295] However, depending on how a bankruptcy court chooses to draw the "should have known" line, this may encourage the attorney to apply prematurely to withdraw from representation. The application to withdraw itself would send a clear signal to all, including

286. 94 B.R. 111 (Bankr. S.D. Ohio 1988).
287. *Id.* at 118.
288. 125 B.R. 230 (E.D. Mo. 1991).
289. *Id.* at 234. *See In re* Fox, 140 B.R. 761 (Bankr. D. S.D. 1992) (bankruptcy court had jurisdiction over final application for approval of attorney's fees notwithstanding dismissal of case); State Bank of Waubay v. Bisgard, 80 B.R. 491 (D. S.D. 1987) (bankruptcy court should not have authorized the payment of debtor's attorney's fees when there was an outstanding super priority claim in excess of the amount authorized as attorney's fees).
290. 97 B.R. 330 (Bankr. N.D. Tex. 1989).
291. *Id.* at 333.
292. *Id.* at 332-33.
293. 114 B.R. 672 (Bankr. D. S.D. 1990).
294. *Id.* at 679-80.
295. For a case involving significant sanctions against the attorney and Chapter 12 debtor pursuant to Bankruptcy Rule 9011, *see* Weiszhaar Farms, Inc. v. Livestock State Bank, 113 B.R. 1017 (Bankr. D. S.D. 1990).

the bankruptcy judge, that the reorganization is doomed. Although counsel is certainly not obliged to go down with the ship, it is troubling to see a rule that encourages counsel to be the first to jump. One hopes that *Alderson* is a fact-specific case and that a bankruptcy court will not deny fees for services performed in good faith and in furtherance of the attorney's duty to provide zealous representation of the client's interests.

XI. CONCLUSION

As indicated by the GAO Study[296] and by the testimony before Congress,[297] the fears regarding passage of a special reorganization chapter for family farmers have not materialized. Chapter 12 has proven to be a more feasible and less costly alternative to Chapter 11. Its repeal at this point would be a mistake. Even though the unusual economic conditions that led to the passage of Chapter 12 are no longer with us, it was not the economic distress of farmers that justified Chapter 12. Those circumstances only called attention to the real problem—the lack of a feasible reorganization chapter for small businesses in the existing Bankruptcy Code.

There is no inherent flaw in the structure of Chapter 11 which makes it unworkable in the context of a large business reorganization. Such cases involve much negotiation and often there are compromises leading to the eventual resolution. However, the relatively level playing field of Chapter 11 is more a function of the relative equal bargaining strength of the major players. When the players do not have relatively equal bargaining strength, the negotiations which normally occur, either in bankruptcy or outside of bankruptcy against the backdrop of the Bankruptcy Code, do not take place.[298] The existence of a reorganization chapter with the ground rules adjusted to achieve a relative balance between small business and major creditor fosters more negotiated workouts, both within and outside of bankruptcy.[299] It is a measure of Chapter 12's success that Congress is seriously considering adding another chapter to provide a feasible reorganization chapter for other small businesses.[300]

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296. *See supra* note 5.

297. *See supra* notes 10-16 and accompanying text.

298. Why is this more of a problem in the farm context? Perhaps because small town banks like the control inherent in the situation where the debtor must do what the lender wishes. The only other realistic lender in many rural areas is the Farmers Home Administration. The existence of Chapter 12 means that the bank does not have exclusive control of the farm debtor's future. With Chapter 11, the banker could say to the debtor, with considerable justification: "Bankruptcy is no solution to your situation. Bankruptcy doesn't work for the farmer." It is important from this perspective that there be no success stories from bankruptcy court. It keeps the debtor, and all other borrowers, in line. The loss of control may explain why some bankers continue to oppose Chapter 12 even when there is evidence of its positive benefits to the banker. The testimony of the representative of the American Bankers Association at the House of Representatives Hearing may be illustrative of this point. *See House Hearing on Extension of Chapter 12*, *supra* note 10, at 47-48.

299. *See generally* Mark Bromley, *The Effects of the Chapter 12 Legislation on Informal Resolution of Farm Debt Problems*, 37 DRAKE L. REV. 197 (1987-88); Sonja T. Eayrs, Comment, *Protecting America's Farmers Under State Mediation Laws and Chapter 12: Who's Being Protected?*, 72 MARQ. L. REV. 466, 488-90 (1989).

300. *See supra* note 17 and accompanying text.

If Congress chooses to extend Chapter 12, then it should consider the following changes.

A. *Eligibility*

The *Tobin Ranch*[301] case which denied Chapter 12 relief to a farming operation with two equal owners highlights the more than fifty percent ownership problem. The simplest solution is to amend section 101(18)(B) to delete "more than" and to substitute "at least." In addition, as also indicated by the *Tobin Ranch* situation where fifty percent of the stock was held by a family and fifty percent by a closely held corporation consisting of family members, section 101(18)(B) should be revised to state:

> ["family farmer" means—]
>
> (B) corporation or partnership in which at least fifty 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 any corporation or partnership which is wholly owned by such family and the relatives of the members of such family, and such family or such relatives conduct the farming operation . . . .

Congress should also give serious consideration to the appropriateness of the $1.5 million debt limitation. There are strong indications in the GAO Study that the limits are too low.[302] Finally, the fifty percent income from farming rule should be examined. There are indications in the GAO Study that exclusive focus on the last tax year is too narrow.[303] In this regard, it would be beneficial if Congress gave explicit support to the "totality of the circumstances" approach of such cases as *Mikkelson Farms*[304] in order to avoid inappropriate denial of Chapter 12 relief. This is especially important with the cash rent issue where a per se exclusion of such income from farm income has unjustifiably denied Chapter 12 relief to certain long-time family farmers.[305]

B. *Disposable Income*

The disposable income requirement is a fair requirement. It should not be implemented so as to strip down the farmer and make another bankruptcy filing a likelihood. The burden of producing evidence of prima facie compliance with this requirement should be on the debtor, but the ultimate burden of persuasion should rest with the party objecting to discharge. The duration of the disposable income commitment should be concurrent with the stated plan period.

C. *Liberal Construction and Implementation of the Statute*

A virtually inevitable result of any legislation, no matter how comprehen-

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301. 80 B.R. at 167.
302. *See* GAO Study, *supra* note 5, at 31.
303. *Id.* at 39.
304. 74 B.R. at 285.
305. *See supra* notes 82-87 and accompanying text.

sive, is the need for interpretation and implementation by the courts. There may be "gaps" or even mistakes in the statute. There may be issues which could not be foreseen at the time of enactment. There are other issues which give the courts flexibility to exercise judgment in light of the facts of the particular case, such as "reasonably necessary expenditures." How the courts carry out these functions is an important part of the overall effectiveness of any legislation. In this author's opinion, the courts have generally done a good job in implementing the wishes of Congress with respect to family farmer reorganization. However, there is evidence of some questionable interpretations and judgment calls. This is not surprising. What is of concern is that the decisions, more often than not, have gone against the debtor. Perhaps it would be beneficial if, in the course of reaffirming Chapter 12, Congress would add a preamble or findings so as to make clear that the courts are to interpret the statute or implement its provisions, wherever possible, so as to foster the financial rehabilitation of the family farmer.[306]

These suggestions for revision are relatively minor in light of the positive accomplishments of Congress through Chapter 12. By setting the ground rules for family farmer reorganization to achieve a relatively level playing field, the benefits of negotiated workouts both in and out of bankruptcy will continue to be realized. Congress now needs to do the same for other small businesses.

306. A recent example of explicit Congressional direction to the courts may be found in the inclusion of language in §§ 2 and 3 of the Civil Rights Act of 1991 indicating its disapproval of Wards Cove Packing Co. v. Atonio, 490 U.S. 642 (1989). *See* Pub. L. No. 102-166, 105 Stat. 1071 (1991).