Chapter 12 After the First Year: An Analysis of the Issues

by

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I. INTRODUCTION

"Neither a borrower, nor a lender be; for loan oft loses itself and friend, and borrowing dulls the edge of husbandry" was the sage advice of Hamlet.[1] Many farmers and rural lenders wish they had followed that axiom in the past fifteen years as the farm economy first went through an inflationary period, then collapsed by fifty percent by the mid-1980s.[2] The strain on the existing system was so great that Congress enacted Chapter 12 to the United States Bankruptcy Code, to deal specifically with farm bankruptcies effective on November 26, 1986.[3] For the practitioner familiar with bankruptcy, this Note will examine the background of Chapter 12 and compare some aspects with Chapter 11[4] and Chapter 13.[5] The body of the Note will discuss the basic provisions of Chapter 12 and how case law has interpreted this new law as it has evolved since late 1986. Potential tax problems associated with Chapter 12 will be discussed and finally the role of the trustee in a Chapter 12 proceeding will be examined.

The Joint Explanatory Statement of the Committee of Conference stated the overall public purpose of Chapter 12 as follows:

> Under current law, family farmers in need of financial rehabilitation may proceed under either Chapter 11 or Chapter 13 of the Bankruptcy

1. FAMILIAR QUOTATIONS 219 (J. Bartlett ed. 1980)(quoting W. SHAKESPEARE, HAMLET, Act I, Scene iii, Line 75).

2. *See* Walter, *Management Report-Land*, SUCCESSFUL FARMING, Feb. 1987, at 8, 8. An Iowa State University survey indicates that Iowa land values declined 63% since 1981. *Id.*

3. *See* 11 U.S.C. §§ 1201-1231 (Supp. 1986). The new Code is titled Chapter 12-Adjustment of Debts of a Family Farmer with Regular Annual Income. *Id.*

4. *Id.* §§ 1101-1174 (1982).

5. *Id.* §§ 1301-1330.

> Code. Most family farmers have too much debt to qualify as debtors under Chapter 13 and are thus limited to relief under Chapter 11. Unfortunately, many family farmers have found Chapter 11 needlessly complicated, unduly time-consuming, inordinately expensive and, in too many cases, unworkable. Accordingly, this subtitle creates a new chapter of the Code—Chapter 12—to be used only by family farmers. It is designed to give family farmers facing bankruptcy a fighting chance to reorganize their debts and keep their land. It offers family farmers the important protection from creditors that bankruptcy provides while, at the same time, preventing abuse of the system and ensuring that farm lenders receive a fair repayment.[6]

II. BACKGROUND AND COMPARISON WITH CHAPTERS 11 AND 13

The historical basis for Chapter 12 dates back to the Frazier-Lemke Act of 1934.[7] The Great Depression forced thousands of farmers out of business and created political pressure to help "fix" the crisis. The original Frazier-Lemke Act of 1934, designed to stop a torrent of farm foreclosures, was ruled unconstitutional as violative of the lender's right of due process.[8] The revised Frazier-Lemke Act of 1934 modified the prior Act to allow more protection for the lender and was upheld in the Supreme Court.[9] The revised Act expired in 1944.[10] This prior experience formed the basis for Chapter 12.[11]

Prior to the passage of Chapter 12, farm business reorganizations were limited to Chapters 11 and 13.[12] Chapter 11, designed primarily for large corporate reorganizations, proved unworkable for most farm reorganizations.[13] Chapter

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6. H.R. CONF. REP. NO. 958, 99th Cong., 2nd Sess. 45, 48, *reprinted in* 1986 U.S. CODE CONG. & ADMIN. NEWS 5227, 5246, 5249.

7. Ch. 869, 48 Stat. 1289 (1934). The original Frazier-Lemke Act, enacted as part of the federal bankruptcy law, provided for a five-year stay of all foreclosure proceedings. *Id.* at 1291. At the end of the five years the farmer could pay into the court the appraised value at the beginning of the five-year period, or, on motion by a lienor, pay the appraised value at the end of the time frame. *Id.* During the stay, the debtor had to pay a reasonable rent to the mortgagee. *Id.* All debts over the appraised value were discharged. *Id.*

8. *See* Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555, 602 (1935). The Court held that Congress had the power to enact legislation to assist farmers. *Id.* at 564. However, the Act in turn was held unconstitutional because five important substantive rights of the mortgagee were not protected: (1) the right to retain the lien until the debt is paid; (2) the right to realize upon the security by a judicial sale; (3) the right to determine when a judicial sale can be held, subject to the court's discretion; (4) the right to bid at a competitive sale; and (5) the right to control the property during the period of default. *Id.* at 594. The federal government is not bound by the contract clause of the Constitution regarding modification of existing contracts, but must comply with due process under the fifth amendment. *Id.* at 589; *see also* Benton, *Iowa's Mortgage Moratorium Statute: Constitutional Analysis*, 33 DRAKE L. REV. 303, 317 (1983)(general discussion of due process and the *Radford* case).

9. 49 Stat. 943 (1935); *see* Wright v. Vinton Branch of the Mountain Trust Bank, 300 U.S. 440, 470 (1935). The new version of the Frazier-Lemke Act preserved the mortgagees' rights in three of the five enumerated rights defined in *Radford*. *Id.* at 464. The mortgagee may pursue a judicial sale, determine when to hold the sale, and bid at the sale. For discussion of the five enumerated rights of a mortgagee in *Radford*, see *supra* note 8. Additionally, the stay was reduced from five years to three. *Wright*, 300 U.S. at 460. A key feature of the Act was the payment of "reasonable" rent by the mortgagor during the moratorium. *Id.* at 461.

10. Ch. 39, 54 Stat. 40 (1940).

11. Taylor, *New Hope for Hard-Pressed Farmers*, 110 FARM J., Dec. 1986, at 22, 22.

12. *Id.* at 23.

13. *Id.* Chapter 11 created large legal fees (often $10,000 to $15,000), and was subject to veto by creditors. *Id*; *see also* Small, *Chapter 12 — The Family Farmer Bankruptcy Act of 1986*, ANN. SURV. BANKR. L. 3, 5-6 (1987 W. Norton ed.). Each class of creditors requires a two-third vote by

13, on the other hand, contained a debt limitation[14] which prevented most commercial farms from qualifying under its more flexible terms.[15] When Congress began deliberations on a new bankruptcy chapter specifically for farmers,[16] they patterned the proposed legislation after Chapter 13.[17] However, the final version of Chapter 12 has some substantial differences from Chapter 13.[18] The total debts under Chapter 12 cannot exceed $1,500,000,[19] up substantially from the potential total of $450,000 of combined secured and unsecured debt allowed under Chapter 13.[20] While Chapter 13 allows fifteen days to file a plan,[21] Chapter 12 allows ninety days.[22] Section 361, which provides adequate protection for the lienholder, does not apply in Chapter 12 as it does in other bankruptcy chapters.[23] Secured claims can be repaid over a longer period of time pursuant to a plan in Chapter 12, whereas Chapter 13 has a time limit on payments.[24] Chapter 12, unlike Chapter 13, also allows the sale of estate property if within the plan.[25]

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amount and over one-half by number to accept the debtor's plan. *Id.* The absolute priority rule of Chapter 11 often makes the reorganization plan unworkable. *Id.* Additionally, secured claimants can elect to be fully secured even if the value of the collateral is less than the debt. *Id.* This can often destroy the debtor's ability to reorganize. *Id.* The Hon. A. Thomas Small is United States Bankruptcy Judge for the Eastern District of North Carolina and was specifically recognized by Senator Charles Grassley (Chapter 12's main Senate sponsor) for his assistance in developing Chapter 12.

14. *See* 11 U.S.C. § 109(e) (1976)(Chapter 13 limited to individuals with less than $100,000 of unsecured debt and $350,000 secured debt); Small, *supra* note 13, at 4.

15. *See* Taylor, *supra* note 11, at 23.

16. *See* Small, *supra* note 13, at 9. House Bill 2211 was passed on June 24, 1985 by the House. *Id.* This bill was a combination of House Bills 1397 and 1399 introduced on March 5, 1987. *Id.*

17. *See In re* Janssen Charolais Ranch, Inc., 73 Bankr. 125, 126 (Bankr. D. Mont. 1987). "Chapter 13 case precedents thus provide a valuable tool for interpretation of Chapter 12 provisions because of the similar or identical language of each chapter." *Id.*

18. *See* Small, *supra* note 13, at 14-18.

19. *See* 11 U.S.C. § 101(17) (Supp. 1987); *see, e.g., In re* Johnson, 73 Bankr. 107, 109 (Bankr. S.D. Ohio 1987)(husband and wife with total debts exceeding $1,500,000 could not file separate petitions to circumvent Chapter 12 debt limit); *In re* Labig, 74 Bankr. 507, 510 (Bankr. S.D. Ohio 1987)(debt limit tested at filing, listing debts as "disputed" will not bring a debtor within the $1,500,000 limit); *see also In re* Henderson Ranches, 75 Bankr. 225, 226 (Bankr. D. Idaho 1987). The debt exclusion on a residential property is only for purpose of 80% farm debt requirement and must be included in determination of total farm debt. The court strictly construed the $1,500,000 debt limit by denying eligibility for Chapter 12 relief when the debt was $1,505,130. Federal Land Bank stock cannot be deducted from amount of debt. *In re* Stedman, 72 Bankr. 49, 53 (Bankr. D.N.D. 1987).

20. *See* 11 U.S.C. § 109(e) (1982).

21. *See* BANKR. PROC. R. 3015.

22. *See* 11 U.S.C. § 1221 (Supp. 1986)(filing of plan). Motions to extend the time to file a new plan will not be routinely granted. *See In re* Bentson, 74 Bankr. 56, 58 (Bankr. D. Minn. 1987). The debtor is required to make a good faith effort when filing the first plan. Additionally, when the first plan was filed, the comprehensiveness of the first plan, reasons for the denial of confirmation of first plan, likelihood of success of the new plan and length of extension requested all should be considered. *See In re* Raylyn Agric., Inc., 72 Bankr. 523, 524 (Bankr. S.D. Iowa 1987)(motion to dismiss filed one day after plan filed on 92d day—failure to file not jurisdictional, motion overruled); *see also In re* Lubbers, 73 Bankr. 440, 441-42 (Bankr. D. Kan. 1987) (incomplete plan filed 100 days after filing of Chapter 12 not "substantially justified").

23. *See* 11 U.S.C. § 1205 (Supp. 1986). Adequate protection can be provided under Chapter 12 by paying reasonable rent; therefore, lost opportunity costs are not protected under Chapter 12, only the value of the property at the moment of confirmation. *See* Small, *supra* note 13, at 104. For discussion of adequate protection, see *infra* notes 47-62 and accompanying text.

24. *See* 11 U.S.C. § 1322(c) (1982). Chapter 13 allows payments over a three-year plan unless the court, for cause, allows a five-year plan. *Id.*

25. *Id.* § 1222(b)(8) (Supp. 1986).

Chapter 12 has distinct advantages over Chapter 11 for many farmers.[26] A major stumbling block in Chapter 11 was often the creditor's ability to vote on the plan.[27] Correspondingly, there is no absolute priority rule in Chapter 12 as in Chapter 11.[28] Creditors must still file a proof of claim in a Chapter 12 proceeding, even if their claim is listed on the debtor's schedule, unlike Chapter 11 in which the claim would be automatically filed.[29] Finally, there are no creditor committees in Chapter 12 as there are in Chapter 11.[30]

A. *When Chapter 11 May Apply*

There are, of course, some reasons for very large farms to reorganize under Chapter 11.[31] Primarily, these farms are not eligible for Chapter 12 because of debt exceeding the $1,500,000 limit or because they do not fit under the percentage guidelines of Chapter 12.[32] A Chapter 11 debtor can essentially manage the business as a "debtor in possession"[33] without the trustee requirements of Chapter 12.[34] The high Chapter 12 trustee fees are a sore subject for many debtors[35] when compared to potential Chapter 11 trustee fees,[36] although the attorney fees, filing fee and quarterly fees of Chapter 11 can still be expensive.[37] Addi-

26. For discussion of the major stumbling blocks of Chapter 11 for farmers, see *supra* note 13.

27. Chapter 11 creditors have to accept the plan as a class by over two-thirds in amount and more than one-half in number. *See* 11 U.S.C. § 1126 (1982).

28. *See id.* § 1129(b)(2)(B)(ii). The absolute priority rule does not allow a holder of a junior claim to retain any property until all senior holders are paid. *Id.*

29. *See id.* § 1111(a). This section, in which a proof of claim is deemed automatically filed when it appears on the debtor's schedule, is not included in Chapter 12. *Id.*

30. *See id.* §§ 1102-1103. The creditor committee may consult with the trustee, investigate the debtor's business, participate in the formulation of and voting on the plan, request the appointment of a trustee, and perform any other acts necessary to protect the creditor's interest. *Id.*

31. *See* Small, *supra* note 13, at 22-24.

32. *See* 11 U.S.C. § 101(17) (Supp. 1986)(definition of a "family farmer" for purposes of bankruptcy regarding debt limit and income guidelines); *see, e.g., In re* Guinnane, 73 Bankr. 129, 132 (Bankr. D. Mont. 1987)(liberal interpretation of livestock hauling for third parties as "farm income"); *In re* Mikkelsen Farms, Inc., 74 Bankr. 280, 284 (Bankr. D. Ore. 1987)(court liberally construed definition of family farmer and determined debtor must meet definition at the time of filing); *In re* Rinker, 75 Bankr. 65, 66-68 (Bankr. S.D. Iowa 1987)(debts incurred during lawsuit to determine ownership of farmland were "debts arising out of farming operation"); *In re* Wolline, 74 Bankr. 208, 211 (Bankr. E.D. Wis. 1987)(farming and riding business eligible under income and debt tests; separately, riding business failed); *cf. In re* Mary Freeze Farms, Inc., 73 Bankr. 508, 511 (Bankr. N.D. Iowa 1987)(corporate landlord receiving only cash rental income from farmland is not a "family farmer" for purposes of Chapter 12); *In re* McKillips, 72 Bankr. 565, 569 (Bankr. N.D. Ill. 1987)(horse breeding, training and showing colts belonging to third parties did not qualify as "farming operations").

33. *See* 11 U.S.C. § 1101 (1982)(defines "debtor in possession" as the debtor except when a person that has qualified under § 322 replaces the debtor and is serving as trustee). A debtor in possession in a Chapter 11 plan essentially operates as his or her own trustee.

34. *See id.* § 1202 (Supp. 1986)(a trustee shall be appointed in every Chapter 12 case). For a discussion of the trustee, see *infra* notes 315-43 and accompanying text.

35. *See In re* Hagensick, 73 Bankr. 710, 714 (Bankr. N.D. Iowa 1987)(§ 1202(d)(1)(B) provides trustee's fees shall not exceed 10% on first $450,000 and three percent over $450,000). The court has much discretion over the setting of fees. *Id.* The debtor in *Hagensick* wanted to be the disbursing agent for payments made directly to secured creditors under the plan, but not through the trustee so as to save trustee fees. *Id.* at 711. The court held that the fees must be paid nevertheless. *Id. But cf. In re* Erickson Partnership, 77 Bankr. 738, 753 (Bankr. D.S.D. 1987)(trustee not entitled to fee on direct payment by debtor to creditor); *In re* Lenz, 74 Bankr. 413, 415-16 (Bankr. C.D. Ill. 1987)(payments made directly to creditor were within the plan but exempt from trustee fees).

36. *See* 11 U.S.C. § 1104 (1982)(appointment of trustee not mandatory in Chapter 11 except for cause or in best interests of creditors). For a discussion of trustee fees, see *infra* notes 332-43 and accompanying text.

37. *See* Small, *supra* note 13, at 19. Quarterly fees in a Chapter 11 proceeding can range from

tionally, there is a longer time to file a plan under Chapter 11,[38] and a farmer's Chapter 11 plan cannot be involuntarily converted to Chapter 7[39] as it can in a Chapter 12 proceeding.[40]

A farmer's ability to reorganize under a Chapter 11 plan has been severely limited by the recent Supreme Court decision in *Norwest Bank Worthington v. Ahlers*.[41] The *Ahlers* decision reversed the Eighth Circuit's holding that a farmer's "sweat equity"[42] could be substituted for "money or money's worth"[43] and thereby allow the farmer to retain an equity interest in the farm.[44] The Court held that the absolute priority rule[45] applied and that the farmer's labor and experience were not a sufficient protection for the creditor.[46] The bottom line for farmers who contemplate filing Chapter 11 is that there cannot be a confirmation of the plan if any undersecured creditor objects. In addition, the farmer cannot keep exempt property because it constitutes retention of an interest. The net effect, at least in the short run, will be a reduction in farm-related Chapter 11 filings.

B. *Adequate Protection*

Unlike Chapters 11 and 13, Chapter 12 does not require adequate protection, as defined under section 361 of the Bankruptcy Code.[47] Adequate protection guarantees that the creditor's security will not decline in value based on the protection of property rights guaranteed by the fifth amendment.[48] Adequate protection can be provided in a number of ways under section 361,[49] but because the "indubitable equivalent" language of section 361(3) has been interpreted to include "lost opportunity costs" for undercollateralized creditors in some juris-

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$150 up to $3,000 based on the amount of disbursements. In addition, the Chapter 12 filing fee is $200 versus $500 for Chapter 11. *Id.*

38. *See* 11 U.S.C. § 1121(b) (1982)(debtor alone can file plan for first 120 days, any party in interest can file plan later). The court may, for cause, modify the time allowed for the plan to be filed. *Id.* § 1121(d).

39. *See id.* § 1112(c)(specific provision prohibits involuntary conversion of Chapter 11 to Chapter 7 if debtor is a farmer).

40. *See id.* § 1208 (Supp. 1986). Only the debtor can convert to Chapter 7 unless the debtor has committed fraud, in which case a party in interest can request conversion to Chapter 7. *Id.*

41. No. 86-958, slip op. (U.S. March 7, 1988).

42. "Sweat equity" is the general term used to describe the combination of the farmer's talents: labor, management ability, experience and other nonmonetary contributions. *Id.* at 4225.

43. *See In re* Ahlers, 794 F.2d 388, 401 (8th Cir. 1986). The Eighth Circuit cites Case v. Los Angeles Lumber Prod. Co., 308 U.S. 106 (1939), as authority for the concept of using "money or money's worth" as a method for the insolvent debtor to retain an equity interest over the objection of certain creditors. *Ahlers*, 794 F.2d at 401.

44. *Ahlers*, 794 F.2d at 403.

45. For reference to the absolute priority rule, see *supra* note 28.

46. *See Ahlers*, No. 86-958, slip op. at 4227 (Court believes statutory language and legislative history are clear regarding absolute priority rule).

47. *See* 11 U.S.C. § 1205(a) (Supp. 1986).

48. Small, *supra* note 13, at 102. The classic cases on the fifth amendment protection of property rights remain Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555 (1934) and Wright v. Vinton Branch of the Mountain Trust Bank, 300 U.S. 444 (1935). For a discussion of the *Radford* decision, see *supra* note 8. For discussion of the *Wright* decision, see *supra* note 9.

49. Under §§ 362-364, adequate protection can be provided by: (1) regular payments; (2) a replacement lien; or (3) other relief that will result in the "indubitable equivalent of such entity's interest in such property." Small, *supra* note 13, at 103. Further, adequate protection is basically a factual determination. *See In re* Martin, 761 F.2d 472, 474 (8th Cir. 1985).

dictions,[50] Congress specifically eliminated section 361 from Chapter 12.[51] This avoided the battle over "lost opportunity costs"[52] raging among the Fifth, Eighth and Ninth Circuits that threatened many farm reorganizations under Chapter 11.[53]

In *In re American Mariner Industries*,[54] the Ninth Circuit interpreted the "indubitable equivalent"[55] clause in section 361(3) to allow for the payment of lost opportunity costs to undercollateralized creditors. However, the Fifth Circuit in *In re Timbers*[56] dismissed the indubitable equivalent language, contending that section 361 is clear in not allowing this protection to undercollateralized creditors.[57]

Under Chapter 12, the debtor need not adequately protect undersecured lienholder's lost opportunity costs, and adequate protection for farmland was replaced by a provision allowing the payment of the fair rental value for the farmland.[58] Even though land values were declining rapidly at the time Chapter 12 was enacted, true adequate protection is not given to the creditor.[59] The fair rental value of the land[60] is based on the customary land rent in the community, location, rental value, net income and the earning capacity of the property.[61] It is not *required* that the rental payments be applied to the indebtedness, but this

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50. *See In re* American Mariner Indus., Inc., 734 F.2d 426, 433 (9th Cir. 1984)(creditors had to receive interest payments on their collateral); *see also In re* Ahlers, 794 F.2d 388, 395 (8th Cir. 1986), *cert. granted*, 107 S. Ct. 1279 (1987), *rev. on other grounds, Ahlers*, No. 86-958, slip op. (U.S. March 7, 1988). The Eighth Circuit found that adequate protection payments need only be paid after the date when the creditor could have repossessed the collateral and resold it to earn a return. *Id.* at 396. *Contra In re* Timbers, 808 F.2d 363 (5th Cir. 1987), *reinstating*, 793 F.2d 1380 (5th Cir. 1986). According to the Fifth Circuit, § 361 is clear in denying adequate protection payments to undersecured creditors. *Id.* at 364.

51. *See* 11 U.S.C. § 1205(a) (Supp. 1986)(§ 361 specifically exempted).

52. Norton, *The New Family Farmer Bankruptcy Act*, 3 PRAC. REAL ESTATE LAW., July 1987, at 37, 39. "Lost opportunity costs" are defined as: periodic payment of interest equivalent to what a creditor would receive from the value of the collateral secured. *Id.*

53. *See generally* Eastwood & Ross, *Adequate Protection in Large Farm Bankruptcies*, ANN. SURV. BANKR. L. 277 (W. Norton ed. 1987)(explains problem of adequate protection with farm-related Chapter 11 bankruptcies).

54. 734 F.2d 426 (9th Cir. 1984).

55. *See generally* McCollough, *Bankruptcy — The Most "Indubitable Equivalent" of the Creditor's Bargain: Interest Compensation as Adequate Protection in Bankruptcy*, 15 MEM. ST. U. L. REV. 297 (1985)(excellent discussion of the *Mariner* case and adequate protection in general). Judge Learned Hand, in a now famous quote, first discussed the "indubitable equivalent" in *In re* Murel Holding Co., 75 F.2d 941 (2d Cir. 1935).

> It is plain that "adequate protection" must be completely compensatory; and that payment ten years hence is not generally the equivalent of payment now. Interest is indeed the common measure of the difference, but a creditor who fears the safety of his principal will scarcely be content with that; he wishes to get his money or at least the property. We see no reason to suppose that the statute was intended to deprive him of that in the interest of junior holders, unless by a substitute of the most indubitable equivalence.

Id. at 942.

56. 808 F.2d 363 (5th Cir. 1987).

57. *Id.* at 364.

58. *See* Haber, *The New Chapter 12 of the Bankruptcy Code: Special Provisions for Family Farmers*, 56 J. KAN. B.A. 8, 9 (1987).

59. *In re* Raylyn Agric., Inc., 72 Bankr. 523, 524 (Bankr. S.D. Iowa 1987).

60. *See* 11 U.S.C. § 1205 (Supp. 1986). The difference between fair value and adequate protection is that "under Chapter 12 the value of the property is protected, not the creditors 'interest' in the property. As a result, the cost of recent deflation of farmland will be shouldered by the lending community, not the farmer." Haber, *supra* note 58, at 9.

61. 11 U.S.C. § 1205(b)(3) (Supp. 1986).

would be consistent with the 1986 Act.[62]

III. The Early Stages of a Chapter 12 Proceeding

During the time when a farm debtor is contemplating the filing of a Chapter 12 petition, and immediately after, both the debtor and the creditors need to be aware of the procedural framework that can be utilized. This section will address some of the major areas that counsel representing either side in a Chapter 12 bankruptcy needs to recognize. This discussion will include the examination of the debtor, effective challenges to confirmation, and the ability to get Chapter 12 petitions dismissed. Finally, a brief sketch of the makeup of the Chapter 12 plan will be discussed.

A. *Examination of the Debtor*

After the Chapter 12 petition is filed, the trustee shall convene and preside at a meeting of creditors.[63] This meeting serves several purposes. It allows the creditors an opportunity to examine the debtor concerning the debtor's financial affairs and to learn the details of any proposed plan.[64] The meeting, commonly referred to as the 341 hearing, also provides a forum where all parties in interest can meet and perhaps resolve some of their disputes.[65] While Chapter 11 requires disclosure statements to be provided by the debtor to creditors,[66] Chapter 12 is silent unless required by local rule or court order.[67]

Additionally, Bankruptcy Rule 2004 also allows for examination of the debtor.[68] The scope of the examination is limited to acts, conduct, property, liabilities and the financial condition of the debtor.[69] This examination is often used to delve further into the debtor's business and can be a formal deposition or an informal examination.[70]

B. *Challenging Confirmation and Dismissal of the Plan*

Although the debtor can move for dismissal of a Chapter 12 case at any time,[71] a party in interest[72] can move for dismissal "for cause," which is defined

62. Small, *supra* note 13, at 105. Since rental replaces adequate protection, the application of payments to the debt amount is consistent with purpose of § 1205. *Id.*

63. *See* 11 U.S.C. § 341 (1982)(describes format of creditor's meeting); *see also id.* § 342 (requires adequate notice); BANKR. PROC. R. 4002(1) (requires mandatory debtor appearance at creditor meeting).

64. Small, *supra* note 13, at 100.

65. *Id.* The creditor meeting is a more important event in a Chapter 12 than a Chapter 11 because less information is available to a Chapter 12 creditor. *Id.*

66. *See* 11 U.S.C. § 1125 (1982).

67. Small, *supra* note 13, at 100.

68. *See* BANKR. PROC. R. 2004 (any party in interest can request examination, debtor can be compelled to attend).

69. *Id.*

70. Small, *supra* note 13, at 101.

71. *See* 11 U.S.C. § 1208(b) (Supp. 1986). "On request of the debtor at any time, if the case has not been converted . . . the court *shall* dismiss a case under this chapter. Any waiver of the right to dismiss under this section is unenforceable." *Id.* (emphasis supplied).

72. A "party in interest" is a party that has a legal interest in the bankrupt's estate, including creditors, the debtor and the trustee. *See, e.g., id.* § 502(a).

in section 1208(c).[73] The Code specifically sets forth reasons for dismissal.[74] A great number of cases in which the courts consider a party in interest's motion for dismissal is at the time of confirmation.[75] The Code specifically provides that a court may dismiss a Chapter 12 petition if the debtor's plan was denied confirmation.[76] The Code also specifies the requirements for confirmation of the Chapter 12 debtor's plan.[77] In addition to payment of the required filing fees,[78] the plan must conform to all Chapter 12 requirements[79] and be proposed in good faith.[80] The plan must also assure that it meets certain requirements as to the value of both secured and unsecured claims.[81] Finally, the court must determine that the plan is feasible in that the debtors can make all payments under the plan.[82]

Lack of good faith is a basis for challenging confirmation of a debtor's plan or for a party in interest's motion for dismissal.[83] The court in *In re Turner*[84] set forth three main factors the bankruptcy courts have considered to determine whether the plan was filed in good faith. The factors are: (1) when the petition was filed; (2) the debtor's motive when filing the petition; and (3) the accuracies of the debtor's petition and schedule.[85] If the court determines that a lack of

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73. *Id.* § 1208(c). For an extreme example of application of Code definition "for cause," see *infra* notes 74-96 and accompanying text.

74. *See* 11 U.S.C. § 1208(c)(1)-(9) (Supp. 1986).

75. *Id.* § 1208(c); *see, e.g., In re* Janssen Charolais Ranch, Inc., 73 Bankr. 125 (Bankr. D. Mont. 1987); *In re* Mikkelsen Farms, Inc., 74 Bankr. 280 (Bankr. D. Ore. 1987).

76. *See* 11 U.S.C. § 1208 (c)(5) (Supp. 1985). Congress also provided for dismissal on motion by a party in interest. *Id.*; *see, e.g., In re* Lubbers, 73 Bankr. 440 (Bankr. D. Kan. 1987)(case dismissed for denial of confirmation and general abuse of the Code); *In re* Mary Freese Farms, Inc., 73 Bankr. 508 (Bankr. N.D. Iowa 1987)(case dismissed for failure to meet definition of family farmer); *In re* McKillips, 72 Bankr. 565 (Bankr. N.D. Ill. 1987)(same); *cf. In re* Labig, 74 Bankr. 507 (Bankr. S.D. Ohio 1987)(dismissal without prejudice for failure to meet aggregate debt requirement); *In re* Stedman, 72 Bankr. 49 (Bankr. D.N.D. 1987)(same).

77. *See* 11 U.S.C. § 1225 (Supp. 1985).

78. *See id.* § 1225(a)(2).

79. *See id.* § 1225(a)(1); *In re* Wobig, 73 Bankr. 292, 293 (Bankr. D. Neb. 1987).

80. 11 U.S.C. § 1225(a)(3) (Supp. 1986); *see, e.g., In re* Lubbers, 73 Bankr. 440 (Bankr. D. Kan. 1987)(plan not in good faith); *In re* Turner, 71 Bankr. 120 (Bankr. D. Mont. 1987)(same).

81. 11 U.S.C. § 1225(a)(4)-(5) (Supp. 1987). Sections 1225(a)(4) and (5) state:

(a) Except as provided in subsection (b), the court shall confirm a plan if . . .

(4) the value, as of the effective date of the plan, of property to be distributed under the plan on account of each allowed unsecured claim is not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under chapter 7 of this title on such date;

(5) with respect to each allowed secured claim provided for by the plan—

(A) the holder of such claim has accepted the plan;

(B)(i) the plan provides that the holder of such claim retainthe lien securing such claim; and

(ii) the value, as of the effective date of the plan, of property to be distributed by the trustee or the debtor under the plan on account of such claim is not less than the allowed amount of such claim; or

(C) the debtor surrenders the property securing such claim to such holder . . .

Id.

82. *Id.* § 1225(a)(6).

83. *In re* Turner, 71 Bankr. 120, 122 (Bankr. D. Mont. 1987). "There is in the Code an implied requirement of good faith in the filing of any bankruptcy petition . . . . Good faith is not defined in the Code, but rather requires an examination of all the particular facts and circumstances in each case." *Id.*; *see also In re* S Farms One, Inc., 73 Bankr. 103, 106 (Bankr. D. Colo. 1987)(automatic stay lifted on basis of lack of good faith).

84. 71 Bankr. 120 (Bankr. D. Mont. 1987).

85. *Id.* at 123 (citing *In re* Block K. Ass'n, 55 Bankr. 630, 633 (Bankr. D. Colo. 1985)). *But cf.*

good faith exists, the court may dismiss the debtor's case.[86]

In *In re Lubbers*[87] the court dismissed the debtor's case for general abuse of the Code. In *Lubbers*, the debtors filed an inadequate petition for bankruptcy relief,[88] were delinquent in filing their schedules,[89] and failed to file a plan within ninety days.[90] Further, the untimely plan neither named the creditors nor did it specify the amount of money to be paid to each creditor.[91] Several of the creditors objected to the confirmation of the plan.[92] The court dismissed the debtors' case for cause, stating that the debtors "violated nearly every applicable rule."[93]

Other common areas where parties in interest object to confirmation are when the debtor does not appear to meet the stringent definitional requirements of a "family farmer,"[94] or when the creditor perceives that the rate of interest is inadequate.[95] Another common area is when the trustee, also a party in interest, disagrees with the trustee's fee provision in the debtor's schedule.[96]

The court will consider the objection to confirmation and deny confirmation if the objection is valid.[97] This is true even if one aspect of the plan does not meet the requirements of Chapter 12, as the court will not rewrite the plan and will either accept or reject the plan in its entirety.[98] However, the court may give the debtor time to rewrite the plan.[99]

In re Labig, 74 Bankr. 507 (Bankr. S.D. Ohio 1987)(court did not consider debtor's 27% understatement of debt on basis of good faith).

86. Haber, *supra* note 58, at 9.

87. 73 Bankr. 440 (Bankr. D. Kan. 1987).

88. *Id.* at 441. The debtors filed a petition without accompanying schedules on existing debt or listing of creditors on November 26, 1986. The petition consisted of only a cover page. *Id.*

89. *Id.* The debtors failed to file schedules when they petitioned the court on November 26, 1986. The 15-day period for filing schedules allowed under the Bankruptcy Rules had lapsed. On January 6, 1987, a creditors meeting was held, despite the lack of schedules. Finally, on January 9, 1987, the debtors filed their schedules. *Id.* The court noted that the debtors failed to file a motion for extension of the 15-day period. *Id.*

90. *Id.* The debtors filed a motion to extend the time within which to file a plan two days after the period expired. No objection was made to the motion, and the court never ordered leave for the debtors to amend. Despite the lack of court approval, the debtors filed their plan on March 5, 1987. *Id.*

91. *Id.*

92. *Id.* Some creditors objected to confirmation on the basis that it was impossible to determine whether the plan was feasible. *Id.* Another objected on the basis that the plan was not proposed in good faith. *Id.*

93. *Id.* at 442. The court specifically granted dismissal on the basis of unreasonable and prejudicial delay to creditors, failure to file the plan in a timely fashion, for denial of confirmation and for the denial of a request to file either an additional or modified plan. *Id.*

94. For a discussion of the requirements to meet the qualifications of a "family farmer," see *infra* notes 129-203 and accompanying text.

95. For a discussion of the requirements of the discount rate, see *infra* notes 247-57 and accompanying text.

96. For a discussion of the requirements of trustee's fee provisions, see *infra* notes 332-43 and accompanying text.

97. *See, e.g., In re* Edwardson, 74 Bankr. 831 (Bankr. D.N.D. 1987)(creditor's objection to confirmation on discount rate valid, confirmation denied); *In re* Rott, 73 Bankr. 366 (Bankr. D.N.D. 1981)(same).

98. *In re* Janssen Charolais Ranch, Inc., 73 Bankr. 125, 128 (Bankr. D. Mont. 1987).

99. *See, e.g., In re* Hagensick, 73 Bankr. 710 (Bankr. N.D. Iowa 1987)(court gave debtors 15 days to amend plan); *In re* Janssen Charolais Ranch, Inc., 73 Bankr. 125 (Bankr. D. Mont. 1987)(court gave debtors 10 days to amend plan).

C. *Statutory Provisions of the Chapter 12 Plan*

From the perspective of the farmer-debtor, Chapter 12 is a tremendous weapon to fend off creditors who would have previously been able to foreclose.[100] The main advantage for the debtor is the ability to "write down" the debt to the fair market value, thereby eliminating the land value deflation of the 1980s.[101] This "write-down" of debt is much more difficult in a Chapter 11 with the creditor committee and the absolute priority rule. A major problem in Chapter 12, however, has been the method of valuation used to appraise the fair market value of the property.[102] The debtor and creditor often arrive in court with widely differing values presenting a serious problem for the judge.[103] The Chapter 12 plan can include many features, including both mandatory and permissive provisions.

1. *Mandatory Provisions*

The reorganization plan[104] submitted by the debtor must provide for the submission of all disposable income necessary for the execution of the plan to the trustee;[105] full payment of priority claims;[106] and equal treatment of all claims within a class *if* the plan classifies claims, unless a particular holder agrees to different treatment.[107]

2. *Permissive Provisions*

The plan *may* contain a number of other provisions.[108] The ability to designate different classes of unsecured creditors, if done fairly and in good faith, can allow the debtor limited ability to tailor the plan to favor specific creditors necessary to the debtor's continued farming operation.[109]

The modification of the rights of holders of secured and unsecured claims is the heart of Chapter 12.[110] This modification allows the reduction of debt to the fair market value and places the excess debt into unsecured status.[111] Any unsecured debt remaining after the plan period is discharged.[112]

A Chapter 12 plan can cure defaults but the debtor must respond in a timely fashion or risk permanently losing any prefiling rights, such as redemp-

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100. *See* Taylor, *supra* note 11, at 23.

101. *See* Walter, *supra* note 2, at 8 (short note detailing farmland deflation in 1980s).

102. *See* Bahls, *Working It Out — Law Section* 15 FARM FUTURES, Nov. 1897, at 26, 26. A major problem in many plans has been the wide variance in the appraisal values of land, equipment and other assets. This points to the need for a more uniform method of appraisal. *Id.*

103. *Id.*

104. 11 U.S.C. § 1222 (Supp. 1986)(describes contents of plan).

105. *Id.* § 1222(a)(1) (debtor agrees to submit all earnings necessary to fund plan to trustee).

106. *Id.* § 1222(a)(2). This section provides full payment to priority claims under § 507 such as administrative expenses, unsecured claims allowed under § 502(f), wages, pensions and other priority items. *Id.*

107. *Id.* § 1222(a) (3) (holder of a claim can agree to less favorable treatment).

108. *Id.* § 1222(b) (text contains reference to most of 11 permissive provisions to the plan).

109. *See id.* § 1222(b)(1).

110. *See id.* § 1222(b)(2).

111. *See* Small, *supra* note 13, at 131 (general discussion of options available to debtor when modifying claims in Chapter 12 plan).

112. *See* 11 U.S.C. § 1228 (Supp. 1986) (discharge of all debts provided for in the plan after the payment period).

tion.[113] The debtor can sell or distribute any or all of the estate property if it is beneficial to reorganization.[114] Repayment schedules can be modified to exceed the three- or five-year period, thus allowing large, long-term land debts to be amortized over many years to allow for reasonable repayment.[115] Property of the estate vests free and clear with the debtor upon confirmation of the plan unless otherwise stated.[116]

The claims may be paid, in whole or in part, from the property of the estate or from property of the debtor.[117] The debtor can make other modifications, such as granting a replacement lien in exchange for the original collateral[118] or "cashing out" by paying the creditor cash equal to the value of the property.[119]

The plan may also provide for subordination of allowed claims,[120] or concurrent payments for secured and unsecured claims.[121] Under either of these provisions, priority among creditors is not affected.[122]

The debtor's plan may divide similarly situated unsecured creditors into different classifications.[123] Such proposed classification is subject to three limitations: (1) the "same treatment requirement," in which each claim within the class must be treated the same, unless the holder of the claim agrees to be treated less favorably;[124] (2) the "substantially similar requirement," which mandates that all claims within the class be "substantially similar";[125] and (3) the "unfair discrimination requirement," which disallows any unfair discrimination against the class designated.[126] There are four standards the courts have applied to determine if the discrimination in the classification is unfair:[127] does the discrimination have a reasonable basis; can the plan be carried out without discrimination; is the proposed discrimination in good faith; and finally, what is the

113. *See id.* § 1222(b)(3)(5) (provides for curing of a default); *id.* § 108(b) (debtor allowed no longer than 60 days to cure default if based on nonbankruptcy remedy); *see, e.g., In re* Monforton, 75 Bankr. 121, 123 (Bankr. D. Mont. 1987)(petition filed with two days remaining in redemption period extended redemption period to 60th day after filing); *In re* Welborn, 75 Bankr. 243, 244 (Bankr. D. Mont. 1987)(Chapter 12 debtor's real estate interest terminated before filing of petition, real estate contract not reinstated); *see also In re* Schmidt, 71 Bankr. 618 (Bankr. D.N.D. 1987). Debtors have 60 days from the date of petition to redeem property previously foreclosed upon but still in redemption period at time of bankruptcy filing. *Id.* at 619-20.

114. 11 U.S.C. § 1222(b)(8) (Supp. 1986).

115. *Id.* § 1222(b)(9). This is an improvement over Chapter 13 which required the entire repayment to be performed within the plan period and thereby restricted long-term debt repayment. *Id.*

116. *Id.* § 1222(b)(10) (property can also vest with another entity beside the debtor).

117. *Id.* § 1222(b)(7).

118. Small, *supra* note 13, at 131.

119. *Id.* Claims may also "be satisfied by a transfer of collateral to the creditor, . . . or may be modified in any number of imaginative ways proposed by the debtor. Any modification, however, must meet the confirmation standards of Code § 1225." *Id.*

120. 11 U.S.C. § 510 (1982) (subordination, including "equitable subordination," can allow distribution of allowed claim in whole or part to another).

121. *Id.* § 1222(b)(4) (Supp. 1986)(payment of unsecured claims need not be deferred until all secured claims are paid).

122. Small, *supra* note 13, at 132.

123. 11 U.S.C. § 1222(b)(1) (Supp. 1986).

124. *Id.* § 1222(a)(3)(this section limits debtor's privilege to divide classes granted by § 1222(b)(1)).

125. *Id.* § 1222(a) ("substantially similar" language is derived from § 1122(a) of Chapter 11).

126. *Id.* § 1222(b)(1) (derived from § 1322(b)(1)).

127. Small, *supra* note 13, at 130; *see In re* Hill, 4 Bankr. 694, 696 (1980)(this Chapter 13 case from Kansas examined the classification of unsecured creditors); *see also In re* Sutherland, 3 Bankr. 420 (1980)(future needs of debtor were rational basis for discrimination between creditors).

treatment of the class discriminated against.[128]

IV. The Judicial Impact on Chapter 12

In the months since Chapter 12 became law there has been, and continues to be, much confusion regarding certain provisions of the Act. Substantial litigation has defined many areas while others remain unclear. Major topics have included: the definition, by bankruptcy courts, of a "family farmer"; whether pending bankruptcies could be converted to a Chapter 12; what constitutes a fair discount rate; and whether real estate sales contracts are mortgages or executory contracts.

A. *Definition of the Family Farmer*

Chapter 12 is an exclusive chapter in the Bankruptcy Code, designed specifically for the family farmer.[129] In sections 101(17) through 101(20), Congress set forth the requirements that the debtor must meet in order to qualify for Chapter 12 relief.[130] Essentially, these require that the individual or spouse engaged in the farming operation have an aggregate debt which does not exceed

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128. Small, *supra* note 13, at 130.

129. *Id.* at 3.

130. The Code defines family farmer as an

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

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

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

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

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

(18) "family farmer with regular annual income" means family farmer whose annual income is sufficiently stable and regular to enable such family farmer to make payments under a plan under chapter 12 of this title;

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

(20) "farming operation" includes farming, tillage of the soil, dairy farming, ranching, production or raising of crops, poultry, or livestock, and production of poultry or livestock products in an unmanufactured state.

11 U.S.C. § 101(17)-(20) (Supp. 1986); *see also In re* Labig, 74 Bankr. 507, 510 (Bankr. S.D. Ohio 1987)(debtor must meet the requirements even though the debtor appears to be a farmer under layperson's terms); *In re* Stedman, 72 Bankr. 49, 54 (Bankr. D.N.D. 1987)(Congress established specific criteria for Chapter 12 relief which must be met).

$1,500,000.[131] Further, not less than eighty percent of the "aggregate, non-contingent liquidated debts" must arise from the farming operation.[132] Another requirement is that the debtor must receive at least fifty percent of the gross income from the farming operation.[133]

Congress also extended the umbrella of protection provided by Chapter 12 over private corporations and partnerships formed by families and their relatives for farming operations.[134] Again, the $1,500,000 aggregate debt limit applies to such entities, as well as an eighty-percent rule similar to individual family farmer requirements.[135] In addition, Congress requires that these family corporations and partnerships have more than eighty percent of the value of their assets relate to the farm.[136]

Often, creditors and the trustee move for dismissal of the debtor's petition based on the debtor's failure to meet the stringent definitional requirements for Chapter 12.[137] Congress did not make Chapter 12 available to all farmers with farms of any size.[138] The specific purpose of enacting the Chapter 12 provisions was to assist the family farm in its financial crisis.[139] Although family corporations and partnerships may meet the definition, Congress had no intent to protect those who engage in land speculation and sheltering of nonfarm income.[140] With these factors in mind, the courts tend to examine carefully each debtor and to apply strictly the Code requirements.

1. *The Family Farmer and the Farming Operation*

To be eligible for Chapter 12 relief, the debtor must be a family farmer.[141] The Code defines family farmer as one who is engaged in a farming operation.[142] It appears that most courts use a risk analysis to determine whether or not the farmer operates a "farming operation."[143]

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131. 11 U.S.C. § 101(17)(A) (Supp. 1986).
132. *Id.*
133. *Id.*
134. *Id.* § 101(17)(B).
135. *Id.* § 101(17)(B)(ii).
136. *See id.* § 101(17)(B)(i). For example, a corporation merely investing in the farm industries is not entitled to relief. *See, e.g., In re* Mary Freese Farms, Inc., 73 Bankr. 508 (Bankr. N.D. Iowa 1987).
137. *See, e.g., In re* Rinker, 75 Bankr. 65 (Bankr. S.D. Iowa, 1987)(motion to dismiss by the trustee and secured creditors); *In re* Rott, 75 Bankr. 366 (Bankr. D.N.D. 1987)(same); *In re* Wolline, 74 Bankr. 208 (Bankr. E.D. Wis. 1987)(motion to dismiss filed by secured creditor); *see also In re* Guinnane, 73 Bankr. 129 (Bankr. D. Mont. 1987)(motion to dismiss by creditor); *In re* Mary Freese Farms, Inc., 73 Bankr. 508 (Bankr. N.D. Iowa 1987)(same).
138. *In re* Labig, 74 Bankr. 507, 510 (Bankr. S.D. Ohio 1987).
139. *Id.*
140. *In re* Tim Wargo & Sons, 74 Bankr. 469, 474 (Bankr. E.D. Ark. 1987).
141. The legislative requirements for a family farmer who would be eligible for Chapter 12 relief mentions the "farming operation." *See* 11 U.S.C. § 101(17)(A), (B) (Supp. 1986). "Farming operation" is specifically defined. *Id.* § 101(18); *In re* Tim Wargo & Sons, 74 Bankr. 469, 472-73 (Bankr. E.D. Ark. 1987)(must meet requirements of both family farmer, or corporate family farmer *and* "family operations."); *In re* Wolline, 74 Bankr. 208, 209 (Bankr. E.D. Wis. 1987)(court must construe Code definition of farming operation, which is a "necessary ingredient in defining 'family farmer' "); *see also In re* Armstrong, 812 F.2d 1024, 1026 (7th Cir. 1987)(implicit in the meaning of family farmer is the means necessary to perpetuate the farm).
142. For the text of the codified definition of farming operation, see *supra* note 130.
143. *See, e.g., In re* Armstrong, 812 F.2d 1024 (7th Cir. 1987)(risk analysis of debtor's sale of farm machinery and cash rent to determine whether within definition of "farming operation"); *In re* Tim Wargo & Sons, 74 Bankr. 469 (Bankr. E.D. Ark. 1987)(risk analysis to decide if lease payments

This analysis was expressed in *In re Armstrong*,[144] where the court determined whether the debtor's sale of farm machinery and the receipt of cash rent from a tenant farmer was included as part of the total "farming operation."[145] The court reasoned that the Code was designed to protect family farmers due to the special risks farmers must endure, from weather to crop failure and falling land prices.[146] Each aspect of the farming operation must meet the risk analysis. The court held the debtor's sale of farm machinery met the risk test because the "Armstrong's farm machinery was inescapably interwoven with [their] farming operation."[147] The machinery had been used for farming, and the debtor was not in the business of selling farm equipment.[148] The court's inclusion of the sale of the farm equipment in the farming operation is entirely logical, as farm equipment is an integral part of the entire farming operation, and the debtor sold the equipment in an attempt to save the farm.

The *Armstrong* court excluded the cash rent as income from a farming operation based on the same risk analysis.[149] The court reasoned that the debtor would receive the rent whether or not the tenant farmer succeeded or failed, analogizing the relationship between the debtor and tenant farmer to that of a landlord and tenant.[150]

In *In re Mary Freese Farms, Inc.*,[151] the court further analyzed the landlord-tenant relationship. The court reasoned that if the tenant failed to pay the rent, the debtor, as landlord, would have a lien on the tenant's crops.[152] If the crops failed, then the tenant would be personally liable to the landlord/debtor.[153] The court held that the nature of this relationship negated the assertion that the debtors were family farmers.[154] The court further recognized that a family corporation could not qualify as operating a farm by the Code's definition merely by collecting rent, as it would spread the protective umbrella of Chapter 12 to investment landlords, which is clearly in derogation of the legisla-

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were part of the "farming operation"); *In re* Wolline, 74 Bankr. 208 (Bankr. E.D. Wis. 1987)(risk analysis to determine what aspects of dairy farm constitutes "farming operation"); *see also In re* Mary Freese Farms, Inc., 73 Bankr. 508, 510-11 (Bankr. N.D. Iowa 1987)(risk analysis to cash rent to determine if it fell within definition of "farming operation").

144. 812 F.2d 1024 (7th Cir. 1987). The *Armstrong* court was not faced with a Chapter 12 debtor. Instead, the court had to determine whether or not the debtor was a family farmer because the debtor's creditors were trying to force the debtor into involuntary bankruptcy under Chapter 11. If the debtor in this situation could prove he or she met the requirements of a family farmer, then the debtor, under the old Code, could not be forced into bankruptcy involuntarily. *Id.* at 1027.

145. *Id.* at 1026. The court determined that the sale of farm machinery was a last-ditch effort by the debtor to save the farm. *Id.*

146. *Id.* at 1027. *But cf. In re* McKillips, 72 Bankr. 565, 569 (Bankr. N.D. Ill. 1987)(under risk analysis, horse breeding farm not farming operation because debtors receive a fee and not a share of the profits at some future sale). *Id.*

147. *Armstrong*, 812 F.2d at 1026.

148. *Id.* Further, the *Armstrong* court eloquently stated that the debtor "bought the machinery so the farm could exist and prosper. But for the machinery, there would be no farm." *Id.*

149. *Id.* at 1028. The court opined that by allowing the tenant to farm the land and accepting the cash rent, this income was assured, and "insulated [Armstrong] . . . from the traditional risks of farming." *Id.*

150. *Id.* The court stated that "the arrangement [between Armstrong and the tenant farmer did not expose Armstrong] to '. . . the irregular nature and the potential ups and downs' " of a farming operation. *Id.* (citing H.R. Doc. No. 137, 93d Cong., 1st Sess. pt. I, at 224 (1973)).

151. 73 Bankr. 508 (Bankr. N.D. Iowa 1987).

152. *Id.* at 510.

153. *Id.*

154. *Id.* at 511.

tive intent.[155] Many courts have followed this decision.[156] In *In re Tim Wargo & Sons*,[157] the court agreed with the risk analysis applied to the corporate family farmer in *Mary Freese Farms*, but lessened the severity of the *Mary Freese* holding. The *Tim Wargo* court accomplished this by stating that farm rental payments may be considered income from a farming operation if the payments are integral to the debtors' own farm.[158]

However, in *In re Rott*,[159] the court held that rent received by the debtors from their son qualified as income from a farming operation.[160] The court determined that the *Armstrong* rule was merely a guideline and not "an inflexible rule to be applied in every situation."[161] The *Rott* case distinguished *Armstrong* on its facts, stating that the lease in *Rott* was not for cash upfront and that the facts gave no indication that the rental agreement did not subject the debtors to the risks in farming.[162]

In lieu of the risk factor, other courts have considered whether certain operations, which by themselves may not be farming operations, are so intertwined with traditional farming operations that the two cannot be separated.[163] For example, in *In re Wolline*[164] the debtor owned a dairy farm and approximately sixty-five horses which were used for horseback riding, trail rides and hay rides, and some of the horses were also sold.[165] The court held that the two operations could not be bifurcated.[166] The court considered several factors to reach this conclusion. Among those factors were that the debtor breeds a substantial number of his horses;[167] the crops grown on his farmland were used solely to feed the horses and cattle; the horse manure was utilized for the debtor's crops; the horses were used in spreading this fertilizer; and the income from all of the debtor's operations were placed into one checking account.[168] This "unusual" arrangement, taken as a whole, constituted a single integrated, interdependent

155. *Id.* at 510.

156. *Id.*; *see In re* Tim Wargo & Sons, 74 Bankr. 469, 472 (Bankr. E.D. Ark. 1987). *But see In re* Rott, 73 Bankr. 366, 373 (Bankr. D.N.D. 1987)(temporarily renting is part of the farming operation).

157. 74 Bankr. 469 (Bankr. E.D. Ark. 1987).

158. *Id.* at 473. Specifically, the court stated "that for the rental payments to have been considered income from a farming operation, they must have been integral to the debtor's *own* farming operation." *Id.* (emphasis in original).

159. 73 Bankr. 366 (Bankr. D.N.D. 1987).

160. *Id.* at 373; *see also* Tim Wargo & Sons, 74 Bankr. at 472 (the court suggested that farm rental may not necessarily be excluded from the definition of a "farming operation").

161. *Rott*, 73 Bankr. at 372.

162. *Id.* at 373. In *Armstrong* the debtor's son paid cash rent, similar to a landlord-tenant relationship. *In re* Armstrong, 812 F.2d 1024, 1027 (7th Cir. 1987). In *Rott*, however, the court ascertained that the debtors received rent only when their son earned enough from the farm to pay them. *Rott*, 73 Bankr. at 373.

163. *See, e.g.*, *In re* Guinnane, 73 Bankr. 129 (Bankr. D. Mont. 1987)(debtors operated cattle ranch and trucking business to transfer their own and others' cattle); *In re* McKillips, 72 Bankr. 565 (Bankr. N.D. Ill. 1987)(debtor's business included horse breeding and horse training); *In re* Wolline, 74 Bankr. 208 (Bankr. E.D. Wis. 1987)(debtor operated dairy farm and owned horses used for horse riding, hay rides and trail rides).

164. 74 Bankr. 208 (Bankr. E.D. Wis. 1987).

165. *Id.* at 209.

166. *Id.* at 211.

167. *Id.* at 209. Approximately 15-20 horses of the total 65 were bred by the debtor. *Id.*

168. *Id.* The court also determined that the income from each of the operations was used to support the other. *Id.*

farming operation.[169]

The court in *In re Guinnane*[170] utilized a similar analysis. In *Guinnane* the debtors owned and operated a cattle ranch.[171] The creditors sought to disqualify the debtors on the basis that the debtors hauled cattle for third parties for a fee.[172] The court held that the hauling of cattle was part of the debtor's integrated farming operation.[173] The court opined that "the hauling of the cattle for third parties is tied directly to the efficiency of the debtors' farming operation because it aids and constitutes a part of the debtors' ranching operation."[174] Further, the court concluded that the income was due solely to the efforts of the debtor, not from third-party efforts, and that the trucking related directly to the debtors' own cattle.[175]

2. *Aggregate Debt and Farm Income*

In addition to the underlying requirement that there must be a farming operation, the debtor must meet the specific aggregate debt and income requirements set forth in the Code.[176] As the Bankruptcy Code states, the aggregate debt must not exceed $1,500,000, with a minimum of eighty percent of that debt arising out of farming operations.[177]

When debtors submit the schedule for confirmation and place values on the debts, they create a rebuttable presumption that the values are correct.[178] When the creditors claim a discrepancy between what they calculate as the debt and what the debtor claimed on the schedule, the court examines each item at issue.[179] The court then determines the aggregate debt valued at the time of the filing of the petition.[180]

In *In re Labig*[181] the debtors seriously understated their aggregate debt by twenty-seven percent. The debtors attempted to bring their aggregate debt down from over $2,000,000 to less than $1,500,000 because a major creditor was willing to forego a claim of over $500,000.[182] The creditor took the assignment

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169. *Id.* at 211.

170. 73 Bankr. 129 (Bankr. D. Mont. 1987).

171. *Id.* at 130. The debtors "farm income" was derived from the sale of cattle, custom haying and trucking cattle. *Id.*

172. *Id.*

173. *Id.* at 132.

174. *Id.*

175. *Id.*

176. For the text and summation of the Bankruptcy Code requirements, see *supra* notes 129-40 and accompanying text.

177. *See* 11 U.S.C. § 101(17) (Supp. 1986).

178. *See In re* Labig, 74 Bankr. 507, 509 (Bankr. S.D. Ohio 1987); *In re* Stedman, 72 Bankr. 49, 53 (Bankr. D.N.D. 1987). *But see In re* Rott, 73 Bankr. 366, 371 (Bankr. D.N.D. 1987)(party who files petition has burden of proof).

179. *See, e.g., In re* Stedman, 72 Bankr. 49 (Bankr. D.N.D. 1987).

180. *See* 11 U.S.C. § 101(17) (Supp. 1986); *In re* Labig, 74 Bankr. 507, 509 (Bankr. S.D. Ohio 1987); *In re* Mary Freese Farms, Inc., 73 Bankr. 508, 508 (Bankr. N.D. Iowa 1987); *In re* Mikkelson Farms, Inc., 74 Bankr. 280, 284 (Bankr. D. Ore. 1987); *In re* Tim Wargo & Sons, 74 Bankr. 469, 472 (Bankr. E.D. Ark. 1987).

181. 74 Bankr. 507 (Bankr. S.D. Ohio 1987).

182. *Id.* at 510. The court chastised the debtors by stating that although "it is not always possible to complete schedules in an exact and precise manner . . . , an understatement of the debts by at least 27% of the debtors' total liability, without any explanation by the debtors, is too excessive to be considered within the normal boundaries of estimation and approximation." *Id.* at 509-10.

of the debt *after* the debtor filed for Chapter 12 relief, yet the debt existed before the debtor filed. The court held that at the time the petition was filed, the debt existed and could not be deducted from the aggregate debt.[183] Therefore, whether or not the assignee was willing to forego the claim was irrelevant.[184] In *Labig*, it appears that the court may be willing to allow exclusion of some debt should the obligation be acquired on or before the date of the filing.[185]

As to other exclusions from the aggregate debt, the courts will not allow stock in the Federal Land Bank (FLB)[186] to offset any obligation owed. When a farmer borrows money from the FLB, that farmer must purchase a certain amount of stock in the FLB.[187] This is added onto the debtor's obligation.[188] After the customer pays the debt down to the value of the stock, the stock is used to offset the balance of that debt.[189] In *In re Stedman*, the debtors sought to subtract the value of the stock from their indebtedness to the FLB.[190] The court rejected this idea, reasoning that the debtors were obligated for the entire amount of the debt, and the FLB stock served only as an equity interest which customers have in the FLB.[191]

As mentioned earlier, eighty percent of the aggregate debt must arise out of the farming operation.[192] Typically, this debt is acquired from a commercial lender. In *In re Rinker*,[193] however, the debt arose from the settlement of a lawsuit.[194] The court determined that it was the subject matter of the lawsuit, here a family farm, that determined whether or not the debt arose from a farming operation.[195] The court reasoned that "[a]t the heart of the lawsuit and resultant settlement was the land . . . ."[196] It was undisputed that the Rinkers' purpose in settling the case was to preserve their farming operation.[197]

Each debtor must also meet the requirement that fifty percent of the gross income from the year preceding the date of filing the petition originates from farming operations.[198] The courts have taken a case-by-case approach to deter-

183. *Id.* at 510.

184. *Id.* at 511.

185. *Id.*

186. The court in *In re* O'Farrel explained that the FLB lends solely to farmers. 74 Bankr. 421, 424 (Bankr. N.D. Fla. 1987). Further, the *O'Farrel* court stated that the FLB was probably the largest farm lender in the country. *Id.*

187. *See In re* Stedman, 72 Bankr. 49, 51 (Bankr. D.N.D. 1987).

188. *Id.*

189. *Id.*

190. *Id.* at 51.

191. *Id.* at 53.

192. *See* 11 U.S.C. § 101(17)(A) (Supp. 1986).

193. 75 Bankr. 65 (Bankr. S.D. Iowa 1987).

194. *Id.* at 66. The suit arose as part of a will dispute. The parents in a joint will left the family farm to their four children equally. However, one of the children, Oliver, obtained a contract with the ailing mother for one-half of the farm. In an earlier suit, the court determined that the contract was a result of undue influence. *Id.* at 66. Before the appeal was heard, the children settled the dispute between themselves. *Id.* Each child received an undivided one-fourth share in the land. *Id.* Oliver then negotiated with his three siblings to purchase the land. Each of the three sisters received a down payment and the balance was amortized over a period of years at varying interest rates. *Id.*

195. *Id.* at 68.

196. *Id.*

197. *Id.*

198. *See* 11 U.S.C. § 101(17) (Supp. 1986).

mine a debtor's gross income.[199]

In *In re Rott*[200] the court determined that certain rental income and money from the sale of equipment constituted gross farm income.[201] The court reasoned 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."[202] The court further concluded that Congress did not intend to exclude farmers who made sound business decisions in efforts to avoid bankruptcy before filing a petition for relief.[203]

B. *Conversion*

One facet of the new bankruptcy law that has received a flurry of attention is the ability of a debtor to convert an existing bankruptcy filed under Chapter 7, 11 or 13 to a Chapter 12 proceeding.[204] It appears obvious that the Legislature, in committee action, intended the bankruptcy court to have discretion on the conversion to Chapter 12,[205] but the language of the Act specifically prohibits conversion if the bankruptcy petition was pending prior to November 26, 1986.[206] This apparent conflict between the legislative comments and the language of Chapter 12 is the crux of the conversion issue.

Section 302(c)(1) clearly states that subtitle B of title II amendments does not apply to cases pending in other chapters prior to the November 26, 1986 effective date.[207] Since all of Chapter 12 is contained in subtitle B, as well as the amendments to Chapters 11 and 13 regarding conversion, the plain language of section 302(c)(1) appears to prevent conversion of such cases.[208] However, the

199. *See In re* Rott, 73 Bankr. 366, 372 (Bankr. D. N.D. 1987); *In re* Wagner, 808 F.2d 542, 548 (7th Cir. 1986).

200. 73 Bankr. 366 (Bankr. D.N.D. 1987).

201. *Id.* at 372-73. For a discussion of *In re* Rott and the court's analysis of farming operation, see *supra* notes 141-75.

202. *Rott*, 73 Bankr. at 373 (emphasis in original).

203. *Id.*

204. *See* 11 U.S.C. § 706(a) (Supp. 1986)(conversion of a Chapter 7 to a Chapter 12); *id.* § 1307 (conversion of a Chapter 13 to a Chapter 12); *id.* § 1112 (conversion of a Chapter 11 to a Chapter 12).

205. *See* H.R. CONF. REP. NO. 958, *reprinted in* 1986 U.S. CODE CONG. & ADMIN. NEWS 5227, 5249. For text of the committee statement, see text accompanying note 207.

206. United States Trustees and Family Farmer Bankruptcy Act of 1986, 100 Stat. 3119 (1986)(codified at 28 U.S.C.A. 581 (Supp. 1987); *see also In re* Evans, 72 Bankr. 21, 25 (Bankr. D. Ore. 1987)(plain meaning of § 302(c) overrides the Committee statement, conversion of Chapter 11 case denied); *In re* Keinath Bros. Dairy Farm, 71 Bankr. 993, 1005 (Bankr. E.D. Mich. 1987)(plain language of § 302(c) forestalls conversion of Chapter 11 petition); *In re* Solomon, 72 Bankr. 506, 507 (Bankr. E.D. Ark. 1987)(statutory construction required application of plain meaning of § 302(c) to deny conversion of Chapter 11 case). *But see In re* Anderson, 70 Bankr. 883, 887 (Bankr. D. Utah 1987)(court relied upon Committee statement to determine congressional intent to allow conversion to Chapter 12); *In re* Erickson Partnership, 68 Bankr. 819, 827 (Bankr. D.S.D. 1987)(same).

207. United States Trustees and Family Farmer Bankruptcy Act of 1986, 100 Stat. 3119 (1986)(codified at 28 U.S.C.A. 581 (Supp. 1987)). This section provides that "[t]he amendments made by subtitle B of title II *shall not apply* with respect to cases commenced under title 11 of the United States Code before the effective date of this Act." *Id.* (emphasis supplied).

208. *See In re* Albertson, 68 Bankr. 1017, 1018 (Bankr. W.D. Mo. 1987); *In re* Carnahan, 77 Bankr. 207, 209 (Bankr. N.D. Ind. 1987); *In re* Tomlin Farms, Inc., 68 Bankr. 41, 42 (Bankr. N.D. 1986); *see, e.g., In re* Clarke, 78 Bankr. 1008, 1009 (Bankr. 9th Cir. 1987)(application of § 302(c)(1) to disallow conversion of Chapter 11 case pending prior to effective date to Chapter 12); *In re* Evans, 72 Bankr. 21, 25 (Bankr. D. Ore. 1987)(same); *In re* Keinath Bros. Dairy Farm, 71 Bankr. 993, 994

Joint Explanatory Statement of the Committee of the Conference clearly had the opposite intent.

> 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.[209]

Resolution of the issue of conversion is essentially divided between two camps. The minority view is to allow conversion, notwithstanding the plain language of the statute, based on the Committee's statement.[210] A leading case expressing the minority viewpoint is *In re Big Dry Angus Ranch, Inc.*,[211] where the court determined that because the plain language of the Act was inconsistent with the legislative purpose and history, the court should consider the language of section 302(c)(1) only as a starting point.[212] The court looked at congressional statements which expressed a desire to help the family farmer in the financial crisis and a concern that Chapter 11 was not working for these farmers.[213] The court held that section 302(c)(1) was to have prospective application in "questions or issues in Chapter 11 and 13 cases, such as in the area of adequate protection or sale of property . . . ."[214] Therefore, the court reasoned that there is no conflict between section 302(c)(1) and the congressional intent.[215]

Another major case in which the court allowed conversion was *In re Erickson Partnership*.[216] The court determined that the literal construction of section 302 would subvert and destroy the stated purpose of Congress.[217] The court

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(Bankr. E.D. Mich. 1987)(same); *In re* Solomon, 72 Bankr. 506, 507 (Bankr. E.D. Ark. 1987)(same); *In re* Willis, 78 Bankr. 378, 381 (Bankr. M.D. Ga. 1987)(same); *see also In re* Groth, 69 Bankr. 90, 91 (Bankr. D. Minn. 1987)(application of § 302(c) disallows conversion of Chapter 13 case pending prior to effective date of Chapter 12).

209. H.R. CONF. REP. NO. 958, *reprinted in* 1986 U.S. CODE CONG. & ADMIN. NEWS 5227, 5249.

210. *See, e.g., In re* Big Dry Angus Ranch, Inc., 69 Bankr. 695, 700-01 (Bankr. D. Mont. 1987)(conversion of Chapter 11 case, originally filed January 13, 1986, allowed in February, 1987); *In re* Erickson Partnership, 68 Bankr. 819, 822 (Bankr. D.S.D. 1987)(conversion of Chapter 13 case filed May 29, 1986, allowed on January 8, 1987); *In re* Mason, 70 Bankr. 753, 756 (Bankr. W.D.N.Y. 1987)(conversion of Chapter 11 case originally filed on August 22, 1986, allowed); *see also In re* Henderson, 69 Bankr. 982, 988 (Bankr. N.D. Ala. 1987). The *Henderson* decision involved consolidated cases arguing for conversion from Chapter 11 to Chapter 12. One case, filed under Chapter 11 one and one-half months, and another Chapter 11 case filed 10 months prior to the effective date of Chapter 12, were allowed. A third case filed two years before the effective date was disallowed. *Id.*

211. 69 Bankr. 695 (Bankr. D. Mont. 1987).

212. *Id.* at 699; *see also Henderson*, 69 Bankr. at 986 (language of statute is starting point in any case involving statutory construction).

213. *Big Dry Angus Ranch*, 69 Bankr. at 699. Examination of legislative history revealed grave concerns that Chapter 11 was not working to save the family farmers. *Id.*; *see also Henderson*, 69 Bankr. at 983-84 (legislative history reveals that Congress intended to rescue distressed farmers).

214. *Big Dry Angus Ranch*, 69 Bankr. at 700. The court continued by stating that when a case is converted by the court it creates a new case under Chapter 12, and the new provisions under Chapter 12 are then prospectively applied. *Id.*

215. *Id.* at 700-01.

216. 68 Bankr. 819 (Bankr. D.S.D. 1987).

217. *Id.* at 825. The *Erickson* court stated that the liberal interpretation of § 302(2) would produce an unreasonable result in light of the legislature's stated purpose, which is to provide a feasible method under which the family farmer can reorganize. *Id.*; *see also In re* Henderson, 69 Bankr. 982, 983 (Bankr. N.D. Ala. 1987)(purpose of Chapter 12 is to rescue nation's farmers); *In re* Mason, 70 Bankr. 753, 756 (Bankr. W.D.N.Y. 1987)(literal interpretation of § 302(c) would require court to disregard the purpose of Congress).

reasoned that to apply the literal meaning of that section, would force courts to accept the idea that Congress intended to divide financially distressed farmers into two groups.[218] The first group would be those farmers that filed a bankruptcy petition before the effective date, and the second group consisting of those who did not.[219] The *Erickson* court concluded that "[i]t 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."[220]

The majority of the decisions do not allow conversion of a Chapter 11 or 13 case which is pending prior to the effective date of the Act. These cases have uniformly held that the plain meaning of section 302(c)(1) prevents conversions, despite supposed legislative intent.[221] Most of the courts rely on the ancient rule of statutory construction that when the language in the statute is clear and unambiguous on its face, there is no need to look beyond the statute to the legislative history.[222]

In *In re Tomlin Farms, Inc.*,[223] the court unequivocally stated that section 302(c)(1) does not allow conversions of petitions filed before the effective date of the Act.[224]. The Chapter 11 debtors sought conversion to Chapter 12, arguing that the court should apply the congressional intent, and not the plain meaning.[225] The court responded to this argument by stating that "any uncertainty or ambiguity in the meaning of section 302(c)(1) is created not by the statute itself but by the language found in the joint explanatory statement of the Committee of the Conference."[226] The court further stated that it was bound by the

218. *Erickson*, 68 Bankr. at 823; *see also In re* Henderson, 69 Bankr. 982, 987 (Bankr. N.D. Ala. 1987). In *Henderson*, the court stated that it was "unconscionable" to think that Congress intended to discriminate against those family farmers forced to file for relief before the effective date of Chapter 12. *Id.*

The *Erickson* court also proposed that § 302(c)(1) was inadvertently written to include conversion provisions. *Erickson*, 68 Bankr. at 825. The court reasoned that the "misplacement" of § 302(c)(1) brought the conversion provision under restrictive timing provisions and therefore in "apparent conflict with congressional remarks." *Id. But see In re* Evans, 72 Bankr. 21, 24 (Bankr. D. Ore. 1987). The *Evans* court scathingly suggests that the minority who hold that Congress made a "mistake" are in effect stating that the courts can rectify a congressional mistake. *Id.*

219. *Erickson*, 68 Bankr. at 823.

220. *Id.* at 826.

221. *In re* Albertson, 68 Bankr. 1017, 1018 (Bankr. W.D. Mo. 1987); *In re* Carnahan, 77 Bankr. 207, 209 (Bankr. N.D. Ind. 1987); *In re* Tomlin Farms, Inc., 68 Bankr. 41, 42 (Bankr. N.D. 1986); *see, e.g.*, *In re* Clark, 78 Bankr. 1008, 1009 (Bankr. 9th Cir. 1987)(application of § 302(c)(1) to disallow conversion of Chapter 11 case pending prior to effective date to Chapter 12); *In re* Evans, 72 Bankr. 21, 23 (Bankr. D. Ore. 1987)(same); *In re* Keinath Bros. Dairy Farm, 71 Bankr. 993, 994 (Bankr. E.D. Mich. 1987)(same); *In re* Solomon, 72 Bankr. 506, 507 (Bankr. E.D. Ark 1987)(same); *In re* Willis, 78 Bankr. 378, 380 (Bankr. M.D. Ga. 1987)(same); *see also In re* Groth, 69 Bankr. 90, 91 (Bankr. D. Minn. 1987)(application of § 302(c) disallows conversion of Chapter 13 case pending prior to effective date of Chapter 12).

222. *See In re* Evans, 72 Bankr. 21, 23 (Bankr. D. Ore. 1987); *In re* Solomon, 72 Bankr. 506, 507 (Bankr. E.D. Ark. 1987); *see also In re* Keinath Bros. Dairy Farm, 71 Bankr. 993, 995 (Bankr. D. Ore. 1987).

The court in *In re Keinath* lamented the unsettled nature of statutory interpretation. "[T]he more ink that has been spilled on this issue over the past half century, the more muddled the answer has become." *Id.* at 995.

223. 68 Bankr. 41 (Bankr. D.N.D. 1986).

224. *Id.* at 42. The court stated that as the language in § 302(c) is clear and unambiguous, there can be no mistake as to its meaning. *Id.*

225. *Id.*

226. *Id.* The court reasoned that filling in gaps which were left by Congress is quite different than rewriting those provisions which Congress enacted. *Id.* (citing United States v. Locke, 471 U.S. 84, 87 (1985)). Indeed, as one court stated:

rules of statutory construction and must apply section 302 to conversion, as the statute is clear and unambiguous on its face.[227] Therefore, according to section 302(c)(1), cases pending in Chapters 11 and 13 prior to the effective date cannot be converted.[228]

The court in *In re Keinath Bros. Dairy Farms*[229] detailed the majority approach. In *Keinath Bros.*, the court elected to follow the statutory construction enunciated in *Tomlin*.[230] The *Keinath* court determined, through extensive analysis of United States Supreme Court decisions on statutory construction, that the courts should only look to the legislative history if the language of the statute is unclear.[231] The *Keinath* court also ascertained that although the Supreme Court left the door to legislative history "somewhat ajar,"[232] it in no way means that the Supreme Court has totally abandoned the plain meaning rule.[233] The court relied on the idea that, if the meaning of the statute is clear and unambiguous on its face, legislative history is at best inconclusive.[234]

One division within the majority rule opinions is whether or not to consider the legislative intent or history. The court in *Tomlin* completely rejected the idea that any consideration need be given to legislative intent, and relied solely on rules of statutory construction.[235] Many courts have followed this analysis.[236] Other courts, such as the *Keinath* court, attempted to examine and reconcile the Joint Explanatory Statement issued by the Committee on the Conference.[237] Usually, the courts conclude that it is common for Congress to

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> To accept the debtor's argument, we would indeed have to rule that when Congress *said* that pending cases *MAY NOT* be converted to Chapter 12, it *meant to say* that pending cases *MAY* be converted to Chapter 12. This would not involve the creation of an exception. It would be turning the English language upon its head.

In re Keinath Bros. Dairy Farm, 71 Bankr. 993, 1004 (Bankr. D. Ore. 1987)(emphasis in original).

One debtor presented some ingenuous evidence to indicate that the statute was ambiguous through the expert testimony by an English instructor who diagramed the statute to demonstrate a potential ambiguity. The court summarily rejected this contention. *See id.* at 995.

227. *Tomlin*, 68 Bankr. at 42.

228. *Id.*

229. 71 Bankr. 993 (Bankr. E.D. Mich. 1987).

230. *Id.* at 996. For a discussion of the *Tomlin* decision, see *supra* notes 223-28 and accompanying text.

231. *Keinath Bros.*, 71 Bankr. at 998.

232. *Id.*

233. *Id.*

234. *Id.*

235. *In re* Tomlin, 68 Bankr. 41, 42 (Bankr. D.N.D. 1986). For discussion of the *Tomlin* decision, see *supra* notes 223-28 and accompanying text.

236. *See In re* Albertson, 68 Bankr. 1017, 1018 (Bankr. W.D. Mo. 1987); *In re* Carnahan, 77 Bankr. 207, 210 (Bankr. N.D. Ind. 1987); *In re* Clarke, 78 Bankr. 1008, 1010 (Bankr. 9th Cir. 1987); *In re* Solomon, 72 Bankr. 506, 507 (Bankr. E.D. Ark. 1987); *In re* Tomlin Farms, 68 Bankr. 41, 42 (Bankr. D.N.D. 1986).

237. *See, e.g., In re* Keinath Bros. Dairy Farm, 71 Bankr. 993 (Bankr. D. Ore. 1987).

In *Keinath Bros.*, the court considered and analyzed three approaches to the application of § 302(c). The first approach was the "literalist approach," which ignored all legislative history. The court, although it eventually adopted a modification of this approach, determined that it could not disregard cases that direct the court not to adhere to the literal meaning of the statute when it subverted congressional intent or legislative history. *Id.* at 995. The second approach was the minority view to interpret the statute according to the legislative intent. The court rejected this approach because it ignored the statute to reach a result which was the "right" one. The third approach fell somewhere in between the two extremes. The court rejected this approach without discussion because it had no logical basis. Id. at 995-96.

For other cases that rely on the rules of statutory construction, see *In re* Evans, 72 Bankr. 21, 24 (Bankr. D. Ore. 1987); *In re* Willis, 78 Bankr. 379, 381 (Bankr. M.D. Ga. 1987).

put time limitations on newly enacted legislation.[238] Therefore, it is not absurd to construe strictly section 302(c) and to apply it to the conversion amendments.[239]

Postenactment conversions to Chapter 12 do not affect the change in the date of the filing of the petition, nor do they affect the commencement of the case or the order for relief.[240] Conversion to Chapter 12 would give the family farmer a better chance to reorganize successfully.[241] The creditors may respond by attempting to block the conversion, and such efforts appear most successful when the previous plan has been filed or confirmed.[242] The request for conversion from Chapters 7 and 13 may be made only by the debtor.[243]

As for conversion from Chapter 12 to another chapter, the legislature provided only for conversion from Chapter 12 to Chapter 7.[244] The debtor may request such conversion or a dismissal of a Chapter 12 case at any time.[245] The courts frown on the use of conversion to forestall or to delay proceedings.[246]

At this point in time, the issue of conversion is not likely to arise, because the statute clearly allows conversion of petitions for bankruptcy filed after the enactment date. The questionable conversions concerned bankruptcies initially filed before the enactment date of Chapter 12 and should not be a major source of contention in the future of this bankruptcy chapter.

C. *Discount Rate*

One of the most litigated issues in Chapter 12 is the discount rate. The purpose of the discount rate is to give the creditor the full value for claims and to protect the claims from losing additional value over the duration of the plan.[247] To achieve this end, sufficient interest is necessary for the simple reason that money received in the future is not worth as much as money received imme-

238. *See In re* Evans, 72 Bankr. 21, 24-25 (Bankr. D. Ore. 1987); *In re* Willis, 78 Bankr. 379, 381 (Bankr. M.D. Ga. 1987).

239. *In re* Evans, 72 Bankr. 21, 24 (Bankr. D. Ore. 1987); *In re* Willis, 78 Bankr. 379, 381 (Bankr. M.D. Ga. 1987).

240. *See* 11 U.S.C. § 348(a) (1982); *see also* Small, *supra* note 13, at 47 (discussion of conversion and its effects). If there is no change in the date of filing the petition, the debtor has 90 days within which to file a plan. 11 U.S.C. § 1221 (Supp. 1986). This time period may be extended by motion if that motion is made within the 90-day period. *Id.*

241. Haber, *supra* note 58, at 9.

242. *Id.* Creditors can argue against conversion by claiming reliance on existing law. *Id.* In other words, if conversion is disallowed, creditors familiar with current law know where they stand. Therefore, conversion should be limited. *Id.*

243. 11 U.S.C. § 706(c) (Supp. 1986). When the attempted conversion is from Chapter 13 to Chapter 12, the court may approve the request after notice and hearing. *Id.* § 1307(d). The request for conversion from Chapter 13 to Chapter 12 may be made by a "party in interest," but as a farmer may not be involuntarily converted, the farmer is the only real "party in interest." See *id.* § 1307(e).

244. 11 U.S.C. § 1208(a) (Supp. 1986); *see also* Haber, *supra* note 58, at 10 (discussion of conversion from Chapter 12); Small, *supra* note 13, at 48-50 (same). Congress did not include a provision for conversion from Chapter 12 to either Chapters 11 or 13 because Chapter 12, designed for the family farmer, provides more relief to that farmer than Chapters 11 and 13, and conversion would result in delays.

245. 11 U.S.C. § 1208(a), (b) (Supp. 1986); *see also* Haber, *supra* note 58, at 9 (debtor may convert or dismiss at any time).

246. Taylor, *supra* note 11, at 23.

247. *In re* Edwardson, 74 Bankr. 831, 835-36 (Bankr. D.N.D. 1987); *In re* Janssen Charolais Ranch, 73 Bankr. 125, 128 (Bankr. D. Mont. 1987).

diately.[248] For plan purposes, this interest rate is equivalent to the discount rate.[249]

Generally, this issue arises when a creditor objects to the confirmation of the debtor's proposed plan.[250] Only the court's approval is necessary to confirm a Chapter 12 plan.[251] Therefore, if a creditor finds the proposed discount rate objectionable, the creditor must object to the confirmation of the plan,[252] although the court can confirm the plan over the objections of some creditors.[253] The court must look at the creditor's arguments against confirmation, and then may only reject the plan in whole or accept the plan in its entirety—the court will not rewrite the plan.[254]

Courts have utilized many different methods to determine the discount rate.[255] The time at which the present value is to be determined is the date of confirmation—the effective date of the plan.[256] The two notable approaches are the "market rate" theory and the "cost of funds" approach.[257]

1. *Market Rate Theory*

A majority of the courts rely on the market rate to provide an adequate return.[258] Courts applying the market rate "must consider the prevailing market rate for a loan of equal value of a term equal to the payout period, with due consideration for the quality of the security and the risk of subsequent default."[259] Even though there may be some consensus as to the application of

248. *See In re* Hardzog, 74 Bankr. 701, 704 (Bankr. W.D. Okla. 1987).

249. *Id.* at 702.

250. For a discussion of the confirmation process, see *supra* notes 71-99 and accompanying text.

251. 11 U.S.C. § 1225(a) (Supp. 1986); Haber, *supra* note 58, at 10.

252. 11 U.S.C. § 1225(a)(5), (b) (Supp. 1986). At least one court determined that as to the amount of debt owed, the debtor's schedule created a rebuttable presumption as to that amount. Therefore, it is the responsibility of the creditors to object. *See In re* Labig, 74 Bankr. 507, 509 (Bankr. S.D. Ohio 1987). *But see In re* Janssen Charolais Ranch, Inc., 73 Bankr. 125, 128 (Bankr. D. Mont. 1987)(court suggested that the *debtor* has the burden of proof to show the discount rate is reasonable).

253. 11 U.S.C. § 1225(b) (Supp. 1986). The court can confirm the plan over the objection of the creditor as long as the creditor receives the present value of its property to be distributed under the plan. *Id.* § 1225(b)(1)(A); *see, e.g., In re* Doud, 74 Bankr. 865 (Bankr. S.D. Iowa 1987).

254. *See In re* Edwardson, 74 Bankr. 831, 836 (Bankr. D.N.D. 1987); *In re* Janssen Charolais Ranch, Inc., 73 Bankr. 125, 128 (Bankr. D. Mont. 1987).

255. *See In re* Hardzog, 74 Bankr. 701 (Bankr. W.D. Okla. 1987). The court in *Hardzog* listed a few of the bases courts have used to determine the appropriate discount rate:

> (1) the contract rate; (2) the tax rate; (3) state or federal legal rates; (4) the legal rate plus a premium; (5) the prime rate; (6) various United States treasury bill rates plus a premium; (7) an average of several rates; (8) the prevailing market rate; and (9) the rate at which the creditor could invest the funds.

Id. (footnotes omitted); *see also In re* Doud, 74 Bankr. 865 (Bankr. S.D. Iowa 1987). Other rates utilized include the rate determined under 26 U.S.C. § 6621 of the Internal Revenue Code and straight treasury bill rate without adjustments. *Doud*, 74 Bankr. at 867.

256. 11 U.S.C. § 1225(a)(5) (Supp. 1986); *see also In re* Martin, 78 Bankr. 598, 601 (Bankr. D. Mont. 1987)(court emphasizes § 1225(a)(5)).

257. For a discussion of the market rate approach, see *infra* notes 258-87 and accompanying text. For discussion of the cost of funds approach, see *infra* notes 288-93.

258. *See In re* Bartlesmeyer, 78 Bankr. 975, 976 (Bankr. W.D. Mo. 1987); *In re* Doud, 74 Bankr. 865, 867 (Bankr. N.D. Fla. 1987); *In re* Edwardson, 74 Bankr. 831, 836 (Bankr. D.N.D. 1987); *In re* Janssen Charolais Ranch, Inc., 73 Bankr. 125, 128 (Bankr. D. Mont. 1987); *In re* Martin, 78 Bankr. 598, 600 (Bankr. D. Mont. 1987); *In re* O'Farrell, 74 Bankr. 421, 424 (Bankr. N.D. Fla. 1987); *In re* Rott, 73 Bankr. 366, 374 (Bankr. D.N.D. 1987).

259. 5 COLLIER ON BANKRUPTCY 1129, 1129-65 (1988); *see In re* Doud, 74 Bankr. 865, 867 (Bankr. N.D. Fla. 1987); *In re* Edwardson, 74 Bankr. 831, 836 (Bankr. D.N.D.); *In re* Janssen

this theory, there remains considerable disagreement as to the elements of which the market rate is comprised.[260]

There are three main viewpoints as to the basis of the market rate. The first theory was set forth in *In re Doud*.[261] In *Doud* the court relied on the treasury bond rate plus a percentage for risk factors inherent in farm financing.[262] The court reasoned that the treasury bond rate can be matched to longer payout periods as yields on the bonds are reported on maturities from one to thirty years, and the debtor's plan amortizes debts over a similar period of years.[263] Further, the court noted the simplicity and accuracy of determining the current yields on treasury bonds.[264] The court reasoned that there are some fundamental differences between yield on treasury bonds and plan payments and these differences should be taken into account.[265] Therefore, the discount rate should include a slightly lower rate than the treasury bond yield.[266] The court in *In re Bartlesmeyer*[267] reiterated the use of the treasury bond yield as the market rate.[268] In *Bartlesmeyer*, however, the court rejected the addition or subtraction of a percentage representing the risk factor because no evidence was presented on the issue.[269]

In *In re Janssen Charolais Ranch, Inc.*,[270] the court determined that the prime rate, not the treasury bond rate, is the main consideration in the determination of the appropriate discount rate.[271] The prime rate is a major factor because prime has an impact on the market conditions.[272] Eight factors which influence the prime rate are: the average interest rates; the reserves available; the current business climate; the amount and length of the loan; geographic differences; the profit margin; and collection costs.[273]

Charolais Ranch, Inc., 73 Bankr. 125, 128 (Bankr. D. Mont. 1987); *In re* O'Farrell, 74 Bankr. 421, 424 (Bankr. N.D. Fla. 1987).

260. *Compare In re* Bartlesmeyer, 87 Bankr. 975, 976-77 (Bankr. W.D. Mo. 1987)(market rate determined as the treasury bond rate plus a risk factor) *and In re* Doud, 74 Bankr. 865, 869 (Bankr. S.D. Iowa 1987)(same); *with In re* Janssen Charolais Ranch, Inc., 73 Bankr. 125, 128 (Bankr. D. Mont. 1987)(prime rate of interest is major factor in computing market rate); *and In re* O'Farrel, 74 Bankr. 421, 424 (Bankr. N.D. Fla. 1987)(appropriate discount rate is "prevailing market rate for loans of a similar nature").

261. 74 Bankr. 865 (Bankr. S.D. Iowa 1987).

262. *Id.* at 869-70. The court stated that the discount rate is comprised of a "riskless" component and a risk component. *Id.* at 869. The treasury bond rate represents the riskless component of the discount rate. *Id.* For a discussion of the risks involved in farm lending, see *infra* notes 294-98 and accompanying text.

263. *Doud*, 74 Bankr. at 868.

264. *Id.* Because yields on treasury bonds are reported by a number of services, they are easy to ascertain. *Id.* It is also the current nature of the bonds that keep them free from manipulation. *Id.*

265. *Id.* The main difference is that a government security holder must wait longer than the bankruptcy creditor taking payments under a plan. *Id.* (quoting Carbiener, *Present Value in Bankruptcy: The Search For an Appropriate Cramdown Discount Rate*, 32 S.D. L. REV. 42, 64 (1986)). As a result, the treasury bond holder will have a higher rate than the bankruptcy code requires for the creditor under the plan. *Id.* (quoting Cabiener, Present Value in Bankruptcy: The Search for an Appropriate Cramdown Discount Rate, 32 S.D. L. REV. 42, 64 (1986)).

266. *Doud*, 74 Bankr. at 868.

267. 78 Bankr. 975 (Bankr. W.D. Mo. 1987)

268. *Id.* at 976.

269. *Id.* at 976-77 n.1. The court rejected the 2% risk factor enunciated in *Doud* as an arbitrary percentage for risks that do not merit compensation. *Id.* at 976.

270. 73 Bankr. 125 (Bankr. D. Mont. 1987).

271. *Id.* at 128.

272. *Id.* (quoting *In re* Welco Inds., 60 Bankr. 880, 883 (Bankr. 9th Cir. 1986)).

273. *Id.*

The court in *In re Martin*[274] followed the same reasoning as *Janssen Charolais*. In *Martin*, however, the court determined that the prime rate was the appropriate market rate, not merely a factor in the market rate.[275] The court held that the prime rate "encompasse[d] all the elements which affect the market rate of interest on a current basis in a commercial setting."[276] The *Martin* court also increased the rate by a small percentage to include the risk factors.[277]

Other courts have relied on prevailing market rates of similar loans to determine the market rate.[278] The leading case in this area is *In re Edwardson*.[279] In *Edwardson* the court concluded that the discount rate should be the same as the best interest rate for farm loans offered by the secured creditor.[280] Although the bank argued that the debtor of a Chapter 12 petition should not be afforded the same rate as its best customers, the court disagreed.[281] The court determined that a Chapter 12 debtor is not a severe credit risk, as Chapter 12 merely allows the debtor to shed thousands of dollars of unsecured credit.[282]

In *In re O'Farrell*,[283] the court relied upon the prevailing market rate for similar loans from the FLB. The court noted that there is no truly similar loan to a Chapter 12 pay out.[284] Nevertheless, the court determined that FLB rates would be the best measure for the discount rate for three reasons.[285] The first is that the FLB is solely a farm lender; second, it is one of the largest farm lenders in the nation; and finally, it has rates which are most favorable to the farmer.[286] The court also considered the risks inherent in farm lending that are absent under a bankruptcy plan and adjusted the rate accordingly.[287]

2. *Cost of Funds Approach*

Among the other determinations of the discount rate is most notably the cost of funds approach. The cost of funds approach is premised on the idea that

274. 78 Bankr. 598 (Bankr. D. Mont. 1987).

275. *Id.* at 601. *But cf. In re* Janssen Charolais Ranch, 73 Bankr. 125, 128 (Bankr. D. Mont. 1987)(prime rate is a factor in the market rate).

276. *Martin*, 78 Bankr. at 601.

277. *Id.* The *Janssen Charolais* court did not specifically address the risk factor. *In re* Janssen Charolais Ranch, Inc., 73 Bankr. 125, 128 (Bankr. D. Mont. 1987). For discussion on risk factors, see *infra* notes 294-98 and accompanying text.

278. *See In re* O'Farrell, 74 Bankr. 421, 424 (Bankr. N.D. Fla. 1987); *see also In re* Edwardson, 74 Bankr. 831, 836 (Bankr. D.N.D. 1987)(court looked at prevailing market rate for similar loan to determine market rate).

279. 74 Bankr. 831 (Bankr. D.N.D. 1987).

280. *Id.* at 836. The court reasoned that a debtor who can shed hundreds of thousands of dollars worth of unsecured debt under Chapter 12 guidelines is not a severe credit risk. Therefore, debtor is entitled to the discount rate equivalent to the creditor's base rate for farm loans. *Id.*

281. *Id.*

282. *Id.*

283. 74 Bankr. 421, 424 (Bankr. N.D. Fla. 1987).

284. *Id.* Despite the court's conclusion that realistically there can be no loans similar to the payout under a plan, it examined the interest rates charged by the FLB. *Id.*

285. *Id.*

286. *Id.*

287. *Id.* The court determined that the FLB was in effect making a new, fully collateralized loan with a reduced risk of default through payments under a plan. *Id.* The reduced risk stems from two factors. First, the court stated that the reduction of other debts allows the farmer to concentrate his or her efforts on making the payments. Second, the court determined that the debtor formulated the plan with the advice of a professional farm consultant and successful reorganization was possible. *Id.* For discussion of the risk factors, see *infra* notes 294-98 and accompanying text.

the discount rate should reflect the cost to the creditor to obtain replacement funds.[288] The court in *In re Hardzog* adopted this approach and stated that the cost of funds should be determined on a case-by-case basis.[289] The court reasoned that the cost of funds approach balances the interests of the debtor and of the creditors.[290] The debtor is afforded some relief because the cost of replacement funds is generally lower than the contract rate.[291] The creditor, on the other hand, is provided with sufficient interest to allow the creditor to reinvest the funds and therefore profit from another borrower.[292] The court concluded that the "cost of funds should reflect the actual rate the creditor must pay to obtain the replacement funds."[293]

3. *Risk Factor*

Regardless of the theory applied to determine the discount rate, courts often add to or subtract from the market rate a small percentage for the "risk factor."[294] There are increased and decreased risks associated with payments under a Chapter 12 plan.[295] One source of the heightened risks is the "unpredictable nature of the agricultural economy."[296] However, collection and administration costs normally associated with the loans are either reduced or eliminated because the Chapter 12 trustee is charged with the duty of overseeing the debtor's affairs.[297] Also, the risk is reduced because the plan, subject to a

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288. *In re* Hardzog, 74 Bankr. 701, 704 (Bankr. W.D. Okla. 1987).
289. *Id.*
290. *Id.* at 703.
291. *Id.*
292. *Id.* at 703-04.
293. *Id.* at 704.
294. *See, e.g., In re* Bartlesmeyer, 78 Bankr. 975, 977 (Bankr. W.D. Mo. 1987)(risk factor may be added to market rate, as determined by treasury bond yield, although inappropriate here); *In re* Doud, 74 Bankr. 865, 869-70 (Bankr. S.D. Iowa 1987)(two percent upward adjustment on treasury bond rate to compensate lender for risks); *In re* Hardzog, 74 Bankr. 701, 704 (Bankr. W.D. Okla. 1987)(court implied that risk factor should be a factual determination separate from the "cost of funds"); *In re* Martin, 78 Bankr. 598, 601 (Bankr. D. Mont. 1987)(risk factor considerations resulted in upward adjustment of 3/4% interest in addition to prime rate); *In re* O'Farrell, 74 Bankr. 421, 424 (Bankr. N.D. Fla. 1987)(average of similar loans adjusted downward to account for risk factors). *But see In re* Edwardson, 74 Bankr. 831, 835-36 (Bankr. D.N.D. 1987)(court did not consider risk factors but relied on rates available for similar loans to best customers); *In re* Konzak, 78 Bankr. 990, 992-93 (Bankr. D.N.D. 1987)(risk factor not expressly discussed, but inherent in considering rates for similar loans).

295. Factors which may increase the risk factor in the discount rate formula for a Chapter 12 plan are related to the farm economy. *In re* Doud, 74 Bankr. 865, 869-70 (Bankr. N.D. Fla. 1987). For example, yields anticipated in the spring may not match up with the reality of the fall harvest, and the variables which affect the commodity prices, such as the weather, the cost of money, foreign exchange rates, global food production and governmental actions, make predictions difficult even for the most knowledgeable. *Id.* at 869. The risk to creditors is also increased by the agricultural depression, as farmers are finding it increasingly difficult to service debt, and those who do so typically realize thin profit margins. *Id.* The risk factor is further increased to guard against the potential of unexpected depreciation. *Bartlesmeyer*, 78 Bankr. at 977.

Factors which may decrease the risk include the reality that the creditor need not expend resources typically associated with a debtor, such as collection costs. *Doud*, 74 Bankr. at 869. Collection costs would normally include those expenditures necessary for locating the debtor, for obtaining a judgment and for executing on that judgment. *Id.* Also, because the court in Chapter 12 petitions must make a feasibility determination, "creditors therefore are afforded a statutory presumption . . . of repayment upon confirmation." *Id.* For a thorough discussion of the various risk factors inherent in the agricultural system, see *Doud*, 74 Bankr. at 869-70.

296. *Doud*, 74 Bankr. at 869.
297. *Id.*

feasibility determination before confirmation, affords the creditor a statutory presumption of repayment.[298] In all, the impact of the risk factor on the discount rate creates even more ambiguity in this already inconsistently analyzed area.

D. *Executory Contracts*

Seller financing of farmland became widespread during the 1970s as land values soared and conventional mortgages became more difficult to obtain.[299] Many farmers who expanded heavily in the 1970s with land contract financing are now in bankruptcy, and this has focused considerable attention on the treatment of executory contracts in bankruptcy.[300]

Executory contracts are those in which both parties have not yet fulfilled all of the bargain.[301] In the case of a farmland sales contract, the buyer still owes money to the seller and the seller has not yet conveyed the title.

The traditional bankruptcy approach to executory contracts is found in section 365.[302] Section 365 states that the trustee in Chapter 12 must assume or reject an executory contract before the plan is confirmed.[303] Federal bankruptcy courts can treat a land contract as an executory contract or as a mortgage, depending on state law.[304] If the bankruptcy court determines that a land contract is equivalent to a mortgage under state law, the contract amount can be reduced to fair market value in a Chapter 12 plan, and the creditor's rights are modified.[305] Creditors, of course, often resist the reduction to fair market value and argue that the contract should be accepted or prior payments forfeited along with a return of the real estate.[306] Additionally, it is often difficult for the bankruptcy courts to discern state law regarding executory land contracts. A good example of a state where the law has been interpreted both ways is Illinois.[307]

In *In re Bertelsen*[308] the Bankruptcy Court for the Central District of Illinois held that land contracts are equivalent to mortgages. In *Bertelsen*, the debtors had purchased eighty acres of farmland in 1976 and had paid regularly for ten years.[309] This court reasoned that executory contracts should be handled to "assist in the debtor's rehabilitation"[310] and can be modified in the plan, if

298. *Id.*

299. *See* Note, *Land Contracts and Bankruptcy*, IX SMALL FARM ADVOCATE, Fall 1987, at 4, 4. Farmland contracts generally call for forfeiture of all payments upon default. *Id.* Title does not pass to the buyer until all payments are made, unlike a mortgage sale, although many states treat a buyer who has made substantial payments in an equitable manner. *Id.*

300. *Id.*

301. *Id.*

302. *See* 11 U.S.C. § 365 (1982).

303. *Id.* § 365(d)(2).

304. *See In re* Speck, 798 F.2d 279, 280 (8th Cir. 1986).

305. *See* Note, *Chapter 12 took my retirement money*, 112 FARM J., Jan. 1988, at J-5, J-5 (seller's land contract was deemed a mortgage in Chapter 12 proceeding). As the article demonstrates, severe emotional turmoil is often associated with those involved in all sides of a bankruptcy. *Id.*

306. *Id.*

307. *See* Note, *supra* note 299, at 4.

308. 65 Bankr. 654 (Bankr. C.D. Ill. 1986).

309. *Id.* at 655.

310. *See* H.R. REP. NO. 595, 95th Cong., 1st Sess. 348, *reprinted in* 1977 U.S. CODE CONG. & ADMIN. NEWS 6304 (congressional intent is to rehabilitate debtor).

treated as a mortgage, to extend payments.[311]

Within months after the *Bertelsen* decision, the Bankruptcy Court for the Northern District in Illinois reached the opposite conclusion in *In re Buchert*.[312] In contradicting *Bertelsen*, the *Buchert* court held that land contracts were executory contracts because there was a separate state statute dealing with contract sales that differed from the mortgage foreclosure law.[313] Because there is a definite split across the United States in the approach to executory contracts, it seems inevitable that a clarification from a higher court is needed.[314]

V. THE CHAPTER 12 TRUSTEE

The Chapter 12 trustee plays a supervisory role in the distribution of the bankrupt's estate, from the date of the petition to the date of discharge.[315] In every Chapter 12 case, a trustee must be appointed.[316] The trustee's duties are set forth in 11 U.S.C. section 1202(b).[317] This section incorporates code sections from Chapters 7 and 11.[318] For example, pursuant to section 704, the trustee is charged with the duty to investigate the financial affairs of the debtor,[319] and

311. *Bertelsen*, 65 Bankr. at 656. The bankruptcy court felt the debtor's rehabilitation would be improved by treating the contract as a mortgage. *Id.* at 656. The court felt that the sale on contract was equivalent to a secured transaction, with the title to the land held as security, and therefore closely resembled a mortgage. *Id.*; *see also In re* Faiman, 70 Bankr. 74 (Bankr. D.N.D. 1987)(contract for deed essentially equivalent to a mortgage under North Dakota law); *In re* Fahnders, 66 Bankr. 94 (Bankr. C.D. Ill. 1986)(contract for sale of real estate not executory contract because deed was in escrow).

312. 69 Bankr. 816 (Bankr. N.D. Ill. 1987).

313. *Id.* at 820; *see* ILL. REV. STAT. ch. 110, para. 9-110 (1982). This section treats land sales contracts as executory contracts and does not give purchaser the same protection they would receive with a mortgage. *Id.*; *see also id.* ch. 110, para. 15-101 to -117. These sections deal with mortgages and grant the buyer full due process protection. *Id.*

314. *See* Note, *supra* note 299, at 4.

315. Small, *supra* note 13, at 57.

316. 11 U.S.C. § 1202(a) (Supp. 1986). The language of the statute clearly states that a trustee will be appointed in any Chapter 12 case. *Id.*

317. *Id.* § 1202(b). The code provides:

> (b) The trustee shall—
>
> (1) perform the duties specified in sections 704(2), 704(3), 704(5), 704(6), 704(7), and 704(9) of this title;
>
> (2) perform the duties specified in section 1106(a)(3) and 1106(a)(4) of this title if the court, for cause and request of a party in interest, the trustee, or the United States trustee, so orders; (3) appear and be heard at any hearing that concerns—
>
> (A) the value of property subject to a lien;
>
> (B) confirmation of a plan;
>
> (C) modification of the plan after confirmation; or
>
> (D) the sale of property of the estate;
>
> (4) ensure that the debtor commences making timely payments required by a confirmed plan; and
>
> (5) if the debtor ceases to be a debtor in possession, perform the duties specified in sections 704(8), 1106(a)(1), 1106(a)(2), 1106(a)(6), 1106(a)(7), and 1203.

Id.

318. *Id.* Section 1202(b)(1) incorporates some of the trustee's duties specified in Chapter 7. *See, e.g.*, *id.* § 704(2) (accountable for all property received); *id.* § 704(4) (must investigate the financial affairs of the debtor); *id.* § 704(6) (oppose the discharge of the debtor if advisable). As one author points out, the duty to oppose the debtor's discharge could never be advisable because the recognized grounds for discharge under § 727 do not include objections to discharge. Small, *supra* note 13, at 60 (citing *In re* Farmer, 786 F.2d 618, 620 (4th Cir. 1986)). Further, a trustee does not have standing to request the determination that a debt is nondischargeable. *Id.*; *see also* 11 U.S.C. § 704(7) (Supp. 1986)(furnish certain information to a party in interest when requested); *id.* § 704(9) (make a final accounting of the estate).

319. 11 U.S.C. § 704(4) (Supp. 1986).

must furnish information about the estate at the request of a "party in interest."[320] Essentially, the trustee supervises the debtor's affairs and makes disbursements unless otherwise provided within the plan.[321] Once the discharge is entered, the Chapter 12 trustee's duty terminates.[322]

The Code does provide for interchangeability of the debtors' and the trustees' roles. A debtor in possession has the right and the obligation to perform the functions of a Chapter 11 trustee.[323] This includes the duty to file a schedule of debts and a plan[324] and the authority to operate the family farm.[325] A debtor in possession may assume the role of the Chapter 12 trustee, through a plan provision, by acting as "disbursing agent" for payments to creditor's under the plan.[326] In other words, the debtor and not the trustee makes the payments. This option is available only in the court's discretion and is "subject to a demonstration of the debtor's ability to make direct payments . . . and to the Court's power to later vacate this provision if it proves unworkable."[327]

Conversely, if a debtor in possession is removed after notice and a hearing,[328] the trustee must assume the debtor's Chapters 7 and 11 duties, such as filing the schedule and operating the family farm.[329] The debtor in possession will be removed "for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor . . . ."[330] However, if the trustee operates the farm, the trustee will need to hire both a farm manager and employees. There is no Code prohibition to prevent the trustee from hiring the debtor in this capacity.[331]

One of the most controversial issues concerning the Chapter 12 trustee is the trustee's fee. Code provisions state that the fee is based on a percentage not to exceed ten percent of the first $450,000 of the aggregate debt under the plan

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320. *Id.* § 704(7) (Supp. 1986).

321. *Id.* § 1226(c). For a discussion of payments within the plan, see *infra* notes 332-41 and accompanying text.

322. 11 U.S.C. § 1228(e) (Supp. 1986). More specifically, the code states that "[a]fter the debtor is granted a discharge, the court shall terminate the services of any trustee serving in the case." *Id.*

323. *Id.* § 1203. Section 1203 provides:

> Subject to such limitations as the court may prescribe, a debtor in possession shall have all the rights, other than the right to compensation under section 330, and powers, and shall perform all the functions and duties, except the duties specified in paragraphs (3) and (4) of section 1106(a), of a trustee serving in a case under chapter 11, including operating the debtor's farm.

Id.

324. *Id.* § 1106(a)(2), (5) (1982).

325. *Id.* § 1203.

326. *Id.* § 1226(c). Section 1226(c) provides that the trustee makes all payments to creditors under the plan, unless a plan provision authorizes the debtor to make certain payments. *Id.*; *In re* Hagensick, 73 Bankr. 710, 713 (Bankr. N.D. Iowa 1987)(debtor made own payments); *In re* Tartaglia, 61 Bankr. 439, 441-42 (Bankr. D.R.I. 1986)(Chapter 13 debtors attempted payments outside the plan).

327. *In re* Hagensick, 73 Bankr. 710, 713 (Bankr. N.D. Iowa 1987)(citations omitted).

328. *See* 11 U.S.C. § 1204(a) (Supp. 1986). The debtor in possession may be reinstated after notice and a hearing, upon request of a party in interest. *Id.* § 1204(b).

329. *Id.* § 1202(5). Further, "[t]he limitation in Code § 1203 which prohibits the debtor from being compensated as debtor in possession would not limit the trustee's right to compensation." Small, *supra* note 13, at 62.

330. 11 U.S.C § 1204(a) (Supp. 1986). For a discussion of the confirmation process and dismissal of the debtor, see *supra* notes 70-99 and accompanying text.

331. Small, *supra* note 13, at 62.

and three percent of the aggregate debt over $450,000.[332] Unfortunately, this is only a guideline, and the courts have devised the means to set the percentage for the fee.[333] The Iowa court in *In re Hagensick*[334] thoroughly examined this issue, and the decision forms a comprehensive framework to analyze the nature of the fee. In *Hagensick*, the debtors made certain payments to creditors through plan provisions.[335] Through these provisions the debtors sought to avoid part of the trustee's fee. The court rejected the argument that these payments were not paid through the trustee and therefore were not under the plan.[336] The trustee objected to the confirmation of the plan based on the trustee's fee provision.[337]

The court determined that there are two issues presented in the computation of the trustee's fee.[338] The threshold issue is the determination of which payments were subject to the fee. Once this is resolved, the court must determine which percentage rate to apply.[339]

The *Hagensick* court sought to differentiate between payments outside the plan and those payments where a debtor acted as disbursing agent under the plan.[340] Essentially the court determined that if the creditor's rights were modified under the plan, the payments for purposes of the trustee's fee would be "under the plan."[341]

The court also held that the ten percent rate in the Code was a maximum, and that five percent, the median, would be an appropriate measure for the percentage up to $450,000.[342] The court reasoned that five percent would be adequate compensation because it would alleviate the debtor's concern that Chapter 12 would become too expensive and would provide adequate compensation for the trustee's services.[343]

VI. Special Tax Problems Associated with Chapter 12

Chapter 12, as enacted, does not have the same tax characteristics as Chap-

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332. *See* 28 U.S.C. § 586(e)(1)(B)(ii) (Supp. 1986).

333. *In re* Hagensick, 73 Bankr. 710, 714 (Bankr. N.D. Iowa 1987)(courts have the discretion to set the percentage of the trustee's fee).

334. 73 Bankr. 710 (Bankr. N.D. Iowa 1987).

335. *Id.* at 711. For an explanation of the debtor acting as disbursing agent, see *supra* note 326 and accompanying text.

336. *Hagensick*, 73 Bankr. at 713.

337. *Id.* at 712. The trustee objected to the confirmation solely on the basis of the fee even though she "felt the plan was feasible, was proposed in good faith, and was in compliance with Chapter 12 . . . . " *Id.*

338. *Id.* at 713.

339. *Id.*

340. *Id.* Specifically, the court determined that the following types of payments were under the plan: present payments on a mortgage when the plan cures the arrearage on the claim and payments on claims which are limited by a court's determination of the value under § 1325(a)(5)(B). *Id.* Conversely, payments outside the plan were those payments where the debtors did not try to modify the creditor's rights by curing arrearages or otherwise; where the debtors arrange for automatic wage deductions to pay for a fully secured car; and where the debtors, who were neither delinquent nor curing a default, make mortgage payments directly to the creditor. *Id.*

341. *Id.* at 714.

342. *Id.* The court determined that setting the percentage at the median would leave some flexibility for the parties to negotiate a different rate, or for the court to reset the rate should the trustee's efforts appear disproportionate to the fee. *Id.*

343. *Id.*

ter 7 or 11.[344] There is no separate taxable estate created in Chapter 12 as in Chapter 7 or 11.[345] The lack of a separate taxable estate for federal tax purposes allows all of the debtor's prior tax attributes[346] to be carried forward into the Chapter 12 plan.[347] Section 1231 does provide that a debtor will have similar treatment in state and local taxation to a Chapter 11 plan, but no mention is made of federal taxes.[348] The tax year for the farmer in Chapter 12 ends for state and local taxes on the date of filing and the trustee must then file a tax return for the estate.[349]

A major question is when debt forgiveness actually occurs in a Chapter 12—at confirmation or at the end of the plan? Section 1228 states that discharge occurs after completion of the plan.[350] The prior tax attributes are not lost in bankruptcy until the discharge occurs, so the logical view is that these tax attributes can be used to reduce the debtor's income tax during the life of the plan. These prior tax attributes could create a tax burden in some cases but the more normal situation would probably be the ability to use prior net operating loss carryovers to offset net income generated by the debt reduction available in Chapter 12.[351]

Cancellation of indebtedness does not generate income in any of the bankruptcy chapters, including Chapter 12.[352] Bankruptcy and tax practitioners believe that Congress may modify the Code to bring Chapter 12 in line with the other bankruptcy chapters.[353]

VII. CONCLUSION

Chapter 12, much like the Frazier-Lemke Act of the Great Depression Era,[354] is designed as a temporary measure to deal with a short-term crisis and will expire in 1993.[355] If the farm economy continues to improve, Chapter 12

344. Welsh, *Chapter 12: It Helps, But it Hurts*, 112 FARM J., Jan. 1988, at J-5, J-5 (much confusion regarding the tax implications of Chapter 12).

345. *See* 11 U.S.C. § 728 (1982) (Chapter 7 special tax provisions); *id.* § 1146 (Chapter 11 tax provisions); Blodgett, *Chapter 12: No Farmer's Panacea*, 74 A.B.A. J., Feb. 1988, at 36, 36.

346. Two examples of tax attributes are net operating loss carryovers and investment tax credit carryovers. *See* Kalcik, *Taxation Problems of Farmers in Chapter 12 Bankruptcy*, IX SMALL FARM ADVOC., Fall 1987, at 2, 2.

347. *See* 11 U.S.C. § 1231 (Supp. 1986)(taxable period for individual terminates on date of order for relief).

348. *See* Kalcik, *supra* note 346, at 2.

349. *See* 11 U.S.C. § 1231(b) (Supp. 1986) (the trustee has responsibility to file returns for each taxable period while case is pending).

350. *See id.* § 1228.

351. *See id.* § 1231(b).

352. *Id.*; *see also* Beard, *Discharge of Indebtedness Income—Changes in the Rules for Solvent Farmers*, 5 AGRIC. L. UPDATE, Dec. 1987, at 2, 2. Nonbankruptcy forgiveness of debt in a farm operation can be tax-free if certain exceptions apply. *Id.* First, the discharge is not taxable if it occurs when the taxpayer is insolvent. I.R.C. § 108(a) (Supp. 1987). Second, farmers are given an additional special exemption if they are a "qualified" person (defined in § 46(c)(8)(D)(iv)) who is not solvent at the time of discharge as long as: (A) the debt was incurred from farming; and (B) 50% or more of the annual gross income for the 3 taxable years preceding the year of discharge was attributable to farming. *Id.* § 108(g). This also applies to § 1017—Discharge of Indebtedness. *Id.*

353. *See* Welsh, *supra* note 344, at J-5.

354. For a discussion of the Chapter 12 roots in the Frazier-Lemke Act, see *supra* notes 8-9 and accompanying text.

355. *See* PUB. L. NO. 99-554, Title III, § 302(f), 100 Stat. 3124, 3124 (1986)(repeals Chapter 12 on Oct. 1, 1993). There is a saving provision that extends the law to cover all cases filed and pending prior to Oct. 1, 1993 until those cases are finally concluded. *Id.*, 100 Stat. at 3124.

will probably die quietly, but another downturn could allow for an extension. Congress and the court system might also recognize that farming is a unique industry and make Chapter 12 a permanent section of the Bankruptcy Code.

It appears, in summary, that the courts have rather strictly construed the definition of a "family farmer" regarding income and debt amount guidelines, but are more liberal when defining a "farming operation." The conversion issue has divided into two camps, a majority of the courts will not allow conversions of cases in other chapters pending on the effective date of Chapter 12, based on the plain meaning of section 302(c). Other courts have allowed conversions based on legislative committee comments and the overall intent of the Legislature as expressed in Chapter 12. Regarding discount rates, the courts have not reached a consensus. The decisions are ambiguous and subject to the court's whim. The Chapter 12 trustee is seen by some as a "paternalistic" figure inserted by an urban Congress to help "manage" the debtor's farm much as a Chapter 11 debtor in possession manages the Chapter 11 estate. The high fee structure could be addressed by separate legislation. Finally, potential tax problems hang over the heads of farms currently in Chapter 12. A clarification of the exact tax status of Chapter 12 is needed.

Many other questions about Chapter 12 remain unanswered but perhaps the biggest question is whether anyone is really being helped in the long run.[356] If a farmer comes out of the Chapter 12 plan 100% leveraged in the middle of another recession, the farmer's chances of survival and ability to borrow will probably be less than other similarly situated farmers who did not take the bankruptcy route.[357] Additionally, the lenders may eventually foreclose on property worth even less than today, particularly depreciable assets. Creditors could then justifiably argue that they were *not* adequately protected by Chapter 12.

Another question just surfacing is the procedure involved to determine how much disposable income will be paid to unsecured creditors. How much depreciation, equipment replacement and normal farm improvements can be deducted from the disposable income? If the farm recovery continues, many farmers operating in a Chapter 12 plan will generate much more income than originally projected. These plans will be subject to attack by unsecured creditors seeking a modification of the plan.[358] Additionally, when is the disposable income paid, on a regular basis or in a lump sum at the end of the plan? One other major bone of contention in Chapter 12 is the wide variation between debtor and lender appraisals and the difficulty of determining a "fair" market value of the debtor's assets.[359]

Perhaps the greatest achievement of Chapter 12 is that it has forced debtors and creditors to negotiate before a bankruptcy petition is actually filed.[360] Neil Harl, economics professor at Iowa State University, has conducted a detailed study of the effects of Chapter 12 and concludes that five farmers avoid bank-

356. *See* Welsh, *supra* note 344, at J-5.
357. *Id.*
358. *See* 11 U.S.C. § 1229 (Supp. 1986) (allows modification of plan after confirmation).
359. *Id.*
360. *See* Tevis, *Chapter 12 Offers New Option to Family Farmers*, 85 SUCCESSFUL FARMING, Feb. 1987, at 18-S, 18-R (more workouts will result from Chapter 12); *see also* Blodgett, *supra* note 345, at 36 (many farmers now avoid bankruptcy entirely because of Chapter 12 threat).

ruptcy for every one that actually files because of the increased pressure to negotiate.[361] Perhaps this forced negotiation between borrower and lender, outside of the bankruptcy court, is the best legacy of what has indeed been a troubled "chapter" in the history of American agriculture.

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361. *See* Bahls, *supra* note 102, at 27 (balance of power in farm foreclosure actions has shifted to debtor); *see also* Tevis, *supra* note 360, at 18-S. The Farmers Home Administration (FmHA) did not previously allow debt "write downs" and Chapter 12 was virtually the only way to deal with them. *Id.* The recently passed Farm Credit Bill now allows debt "write downs" by the FmHA if it is no more costly than foreclosure. 1988 U.S. CODE CONG. & ADMIN. NEWS 1686-1718.