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Chapter 12 After Almost One Year in Bankruptcy Courts

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CHAPTER 12 AFTER ALMOST ONE YEAR IN THE BANKRUPTCY COURTS

*The Honorable Robert D. Martin**

On October 27, 1986, after much thoughtful consideration in Congress, careful drafting by staff, and political ballyhoo from farm states supporters, chapter 12 of the U.S. Bankruptcy Code was enacted.[1] The expectations of its proponents, although widely varied, were focused on creating a system of relatively simple, relatively inexpensive stop gap relief[2] for beleaguered small farmers during a time of rapid declines in farm income and property values. This article considers the way in which Congress' plans for chapter 12 have played out in the bankruptcy courts. The problems that have been observed, the issues that seem to have become important, and the mechanics developed for the handling of chapter 12 cases will be analyzed.

During its first eleven months, several striking characteristics of chapter 12 cases have become obvious. The number of cases filed, the shortness of time within which matters must be completed, and the complexity of the issues which have been raised are the most obvious. These characteristics are interrelated and appear either singly or together to affect nearly all chapter 12 cases.

The sheer number of cases filed has been staggering.[3] In Nebraska alone there are more than 600 pending chapter 12 cases. In the Western District of Wisconsin, there have been more than 140 cases filed, of which approximately thirty percent have been confirmed.[4] The actual confirmation rate of those cases getting to the stage of confirmation has been quite high; approximately ninety percent in most courts. Although there has been some decline

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1. Bankruptcy Judges, United States Trustees, and Family Farmers Bankruptcy Act of 1986, Pub. L. No. 99-554, 100 Stat. 3088, 3128 (1986).

2. Due to its experimental nature, chapter 12 contains a sunset date of October 1, 1993. Pub. L. 99-554, § 302(f), 100 Stat. 3124 (1986).

3. For instance, for the north central region of the country, including Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, North Dakota, Ohio, South Dakota and Wisconsin the total filings were 2,728 as of July 31, 1987. *See* Pelzer, *Chapter 12: A One-Year Assessment of the New Farm Bankruptcy Law*, AGRI FINANCE, Nov. 1987, at 54 citing statistics compiled by Iowa State University [hereinafter Pelzer].

4. From November 26, 1986, to November 18, 1987, approximately 148 cases have been filed in the Western District of Wisconsin. Forty-five cases have been confirmed, 30 have been dismissed, 16 have been converted to another chapter (nearly all to chapter 7—only three converted to chapter 13) and the remainder have yet to reach the stage where confirmation may be considered.

in the number of farm chapter 11 cases filed and a smaller decline in farm chapter 7 cases since chapter 12 became available, the total of those declines is not commensurate with the large number of chapter 12 cases filed.[5]

The second striking feature of chapter 12 is the shortness of the time allowed for crucial steps which must be taken at the outset of the case. The compression of time produces elevated stress upon the parties to meet deadlines imposed both by the statute and by the practical needs of the farmer clients. Within ninety days after a case is commenced, a plan must be filed.[6] Forty-five days after the plan is filed a hearing to determine whether the plan can be confirmed must be held and completed.[7] Time pressures imposed by law are coupled with those which arise from the realities of farming. Neither planting nor harvesting can be delayed. Livestock and leaseholds must also be dealt with in a timely fashion.

Time is never neutral in a bankruptcy proceeding. Delay always favors one party or the other. In chapter 12, the short periods of time were instituted with the intention that secured creditors would be benefited.[8] It was perceived that adherence to the time prescription would prevent the debtor from continual delays deferring the secured creditors' rights to seize collateral.[9] This benefit has generally been provided, but it has been observed in the courts that the time requirements can work to the debtor's advantage as well. If the debtor files a plan of reorganization with the petition commenc-

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5. It may be that the evaluation undertaken in preparation for chapter 12 filing has made clear to some farmers the greater benefits to them of chapter 7 or chapter 11. *See* Bromley, *The Effects of Chapter 12 Legislation on Informal Resolution of Farm Debt Problems*, 37 DRAKE L. REV. 197 (1988).

6. The Code provides: "The debtor shall file a plan not later than 90 days after the order for relief under this chapter, except that the court may extend such period if an extension is substantially justified." 11 U.S.C. § 1221 (Supp. IV 1986). *See also In re* Raylyn AG, Inc., 72 Bankr. 523 (Bankr. S.D. Iowa 1987) (failure to file plan on ninetieth day not jurisdictional so plan filed on ninety-second day may be confirmed). *But see In re* Offield, 77 Bankr. 222 (Bankr. W.D. Mo. 1987) (case dismissed where no plan filed within 110 days). *See also In re* Lubbers, 73 Bankr. 440 (Bankr. D. Kan. 1987) (case dismissed where debtors did not show "substantial justification" for extension of time where they waited 100 days to file any plan and ignored previous deadlines).

7. 11 U.S.C. § 1224 provides:

> After expedited notice, the court shall hold a hearing on confirmation of the plan. A party in interest, the trustee, or the United States trustee may object to the confirmation of the plan. Except for cause, the hearing shall be concluded not later than 45 days after the filing of the plan.

See In re Ivy, 76 Bankr. 147 (Bankr. W.D. Mo. 1987) (if hearing held after 45 days court does not lose its jurisdiction and turn "into a pumpkin at the stroke of midnight on the forty-fifth day after the plan is filed").

8. Earlier versions of chapter 12 allowed the debtors 240 days to file a plan. This time period was shortened due to the concern that during this time collateral would deteriorate without the promise of a confirmable plan. 132 CONG. REC. S15,076 (daily ed. Oct. 3, 1986) (statement of Sen. Grassley).

9. *Id.*

ing the case, the creditor has only forty-five days to respond.[10] For many lenders, and particularly for governmental or quasi-governmental lenders, that response time is far from adequate.[11] Under compressed time limits, creditors' attorneys often lack the time to review the plan's assumptions and projections, audit the farmer's tax return or records (if any) and figure the actual costs and markets which will influence the plan. They also lack sufficient time to analyze potential objections to confirmation and to marshall the evidence necessary to support those objections at a hearing. The result can be the confirmation of a plan which would be subject to reasonable objections if the creditors had an adequate opportunity to prepare.

A third feature of chapter 12 practice which has demanded attention is the court congestion which it has created. Chapter 12 cases have presented their new and unfamiliar issues at the same time bankruptcy courts are experiencing record caseloads brought about by increases in all bankruptcy filings.[12] Because there is so little time available between the filing of the case and the hearing on confirmation of the plan, the opportunity to hold pretrial and preliminary hearings to limit issues and encourage compromises is sharply curtailed. It has been extremely difficult for courts to help narrow the focus of disputes to the issues which are actually contested. As the courts can assist little in focusing on the issues, there is less opportunity for the parties to negotiate settlements or to work out consensual plans for reorganization. This is particularly unfortunate in light of the strong emphasis the 1978 Bankruptcy Code placed upon creating flexibility so that, at least in chapter 11 cases, negotiated plans of reorganization would be the norm.[13]

In the final analysis, most of the congestion in the courts arises from the difficulty of the issues presented. Immediately after chapter 12 became available, this difficulty was exacerbated by both the courts and counsel being unfamiliar with the legal issues and the appropriate procedures in chapter 12.[14] Most lawyers who first filed chapter 12 cases had little or no experi-

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10. *See* 11 U.S.C. § 1224.

11. *See In re* O'Farrell, 74 Bankr. 421 (Bankr. N.D. Fla. 1987) (where continuance past 45 days requested when debtor and creditor had requested only one day for presentation of evidence as to valuation and that time proved inadequate); *In re* Edwardson, 74 Bankr. 831 (Bankr. D.N.D. 1987) (one day was sufficient time for analyzing six page modified chapter 12 plan where creditor's counsel had considerable experience with bankruptcy matters and nature of changes in plan were mostly of form, not of substance).

12. Since November 1986, most courts have experienced an increase greater than 10% over the prior year. The prior year was the largest year for filings in the history of the bankruptcy law. For the fiscal year, October 1, 1985, to September 30, 1986, the Statistical Analysis and Reports Division of the Administrative Office of the United States Courts recorded 507,554 total bankruptcy filings. For the following fiscal year, ending September 30, 1987, 568,450 total filings were recorded.

13. 124 CONG. REC. H11,100-02 (1978).

14. *See In re* Bentson, 74 Bankr. 56 (Bankr. D. Minn. 1987) (despite inadequacies in initial chapter 12 plan, the debtors were allowed to file another chapter 12 plan where case law and practice in the district were not fully known to counsel and some of the problems with the

ence under chapter 13, which provides the most useful procedural as well as substantive parallels to chapter 12.[15] To some extent over the last eleven months the greater experience with chapter 12 has reduced the severity of this problem, but as new tactics are attempted by debtors and new responses explored by creditors, the problem refuses to go away.

There are several substantive issues which the courts have found to be difficult. The initial problem has been whether the debtor is even eligible for chapter 12. Many elements of eligibility have received attention. The most objective condition for chapter 12 relief is the debt ceiling of $1,500,000.[16] Efforts to discount Farm Credit Service stock for the purposes of determining the debt ceiling have been rejected.[17] Less objective elements of eligibility that have been widely litigated include several variations on whether the debtor is engaged in or receiving income from "farming operations" as re-

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first plan were attributable to counsel's lack of familiarity).

15. Chapter 12 was closely modeled after chapter 13. "At the same time, however, the new chapter [12] alters those provisions which are inappropriate for family farmers—the requirement that the plan be filed within 15 days of the petitions; the requirement that plan payments start within 30 days of the plan confirmation; and the low debt limits found in chapter 13." H.R. CONF. REP. No. 958, 99th Cong., 2d Sess., *reprinted in* 1986 U.S. CODE CONG. & ADMIN. NEWS 5227, 5249.

16. 11 U.S.C. § 109(f) provides: "Only a family farmer with regular annual income may be a debtor under chapter 12 of this title." 11 U.S.C. § 101(17) provides:

> "family farmer" means—
>
> (A) individual or individual and spouse engaged in a farming operation whose aggregate debts do not exceed $1,500,000 and not less than 80 percent of whose aggregate noncontingent, liquidated debts (excluding a debt for the principal residence of such individual or such individual and spouse unless such debt arises out of a farming operation), on the date the case is filed, arise out of a farming operation owned or operated by such individual or such individual and spouse, and such individual or such individual and spouse receive from such farming operation more than 50 percent of such individual's or such individual and spouse's gross income for the taxable year 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 corporation or such partnership; and
>
> (iii) if such corporation issues stock, such stock is not publicly traded.

17. *See In re* Stedman, 72 Bankr. 49 (Bankr. D.N.D. 1987) (court refused to deduct value of debtors' stock in FLB in determining whether debtors owed more than $1.5 million).

quired under sections 101(17) and (20).[18]

The best general approach to the question of the debtor's involvement in farming, and the one which seems to be emerging explicitly or implicitly from decisions of the courts, is to determine whether the enterprise in question is subject to the risks which have historically been cited in connection with bankruptcy laws to set farming apart from other businesses. If the enterprise generally appears to be what has traditionally been known as farming and is subject to risks from weather, disease, and uncontrollable markets, then in all probability it will be deemed to be a farming operation.[19] It should be noted, however, that the effect of the risk on the enterprise must be similar to that commonly associated with farmers. Where a custom harvester testified that his profits rose when the weather was bad at harvest time and that generally he was affected by weather in a way opposite to the farmers, it was determined that he was not engaged in farming operations as defined in section 101(2).[20]

A second recurring problem for the courts has come from the extreme

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

> While the [corporate] debtor's expectation for payment is subject to the same inherent risks faced by the tenant, this alone cannot transform a passive activity, which consists of receiving rents into a 'farming operation' conducted by the debtor's shareholders. Granting chapter 12 protection to this debtor would open the door for nonfarmer lessors whose principle interests in agriculture are land speculation and sheltering of nonfarm income, a group Congress certainly did not intend to benefit by enacting chapter 12.

Id. at 474; *see also In re* Mary Freese Farms, Inc., 73 Bankr. 508 (Bankr. N.D. Iowa 1987). The court in that case stated:

> A landlord under a cash lease similar to the leases of MFF [Mary Freese Farms] is not the entity the Family Farmer Bankruptcy Act was designed to protect. If Chapter 12 is construed to provide relief to a cash rent landlord such as MFF, there seems to be nothing to prevent any corporation or partnership that owns farmland for investment purposes and rents it out to be farmed from qualifying as a "family farmer" for purposes of Chapter 12 relief, as long as 80 percent of the corporate debt is farm related and its total debt is less than $1,500,000.00. This result would be achieved in spite of Senator Grassley's caveat to the Senate before the vote on the Conference Committee Report: "Though the purpose [of the subtitle] is to give family farmers a fighting chance to reorganize their debts, the provisions ensure that only family farmers—not tax shelters or large corporate entities—will benefit." 132 Cong. Rec. S15,075 (daily ed. Oct. 3, 1986).

Id. at 510-11. *But see In re* Rott, 73 Bankr. 366 (Bankr. D.N.D. 1987) (rental income received from son, where debtor was also working with son on management decisions, was income from farming operation).

19. *See In re* Wolline, 74 Bankr. 208 (Bankr. E.D. Wis. 1987) (combination horse farm and dairy operation is farming operation); *In re* Maike, 16 Bankr. Ct. Dec. (CRR) 349 (D. Kan. 1987) (nontraditional enterprise of game farm and kennel operation (puppy farm) constituted a farming operation). *Cf. In re* McKillips, 72 Bankr. 565 (Bankr. N.D. Ill. 1987) (training and showing horses owned by third parties is essentially a service operation as debtor's profits are not subject to risks, such as weather and fluctuating farm economy).

20. *In re* Harrington, No. MM12-87-02143 (W.D. Wis. 1987).

importance placed on the valuation of collateral in chapter 12 cases. Valuation is necessary for several purposes. At the outset, there is a consideration of whether adequate protection of interests of nondebtors must be provided. In fact, the issues of adequate protection have been far less a problem than the drafters of the Code probably anticipated.[21] This is largely due to the very short time period in which the collateral is presumably at risk.[22] It is also due in large part to the redefinition of adequate protection in section 1205.[23] Predictably, in courts where the time limits are strictly enforced, the

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21. One response to anticipated problems with adequate protection was to deny creditors lost opportunity costs. As the legislative history explains:

> Lost opportunity costs payments present serious barriers to farm reorganizations, because farmland values have dropped so dramatically in many sections of the country—making for many undercollateralized secured lenders. Family farmers are usually unable to pay lost opportunity costs. Thus, family farm reorganizations are often throttled in their infancy upon motion to lift the automatic stay.
>
> Accordingly, section 1205 of the conference report provides a separate test for adequate protection in Chapter 12 cases. It eliminates the need of the family farmer to pay lost opportunity costs, and adds another means for providing adequate protection for farmland—paying reasonable market rent. Section 1205 eliminates the 'indubitable equivalent' language of 11 U.S.C. 361(3) and makes it clear that what needs to be protected is the value of property, not the value of the creditor's 'interest' in property.
>
> It is expected that this provision will reduce unnecessary litigation during the term of the automatic stay, and will allow the family farmer to devote proper attention to plan preparation.

H.R. CONF. REP. No. 958, 99th Cong. 2d Sess., *reprinted in* 1986 U.S. CODE CONG. & ADMIN. NEWS 5227, 5250-51.

22. This is in contrast to chapter 11 where time-lag between filing the petition and actual plan implementation can span several years in complex or neglected cases.

23. 11 U.S.C. § 1205 provides:

> (a) Section 361 does not apply in a case under this chapter.
>
> (b) In a case under this chapter, when adequate protection is required under section 362, 363, or 364 of this title of an interest of an equity in property, such adequate protection may be provided by—
>
> (1) requiring the trustee to make a cash payment or periodic cash payments to such entity, to the extent that the stay under section 362 of this title, use, sale, or lease under section 363 of this title, or any grant of a lien under section 364 of this title results in a decrease in the value of property securing a claim or of an entity's ownership interest in property;
>
> (2) providing to such entity an additional or replacement lien to the extent that such stay, use, sale, lease, or grant results in a decrease in the value of property securing a claim or of an entity's ownership interest in property;
>
> (3) paying to such entity for the use of farmland the reasonable rent customary in the community where the property is located, based upon the rental value, net income, and earning capacity of the property; or
>
> (4) granting such other relief, other than entitling such entity to compensation allowable under section 503(b)(1) of this title an administrative expense, as will adequately protect the value of property securing a claim or of such entity's ownership interest in property.

Thus, in a chapter 12 the creditor is not allowed lost opportunity costs nor benefit of the bar-

issues of adequate protection are rarely raised. If creditors anticipate that a plan will be confirmed or the case dismissed within 135 days after it is filed, it is not economical to engage in substantial litigation to determine whether there is adequate protection during that short period.[24]

The predominant reason for valuing collateral at an early stage in a chapter 12 case is to determine the plan's treatment of allowed secured claims.[25] An allowed secured claim must be paid its present value as of the effective date of the plan.[26] Thus, it is extremely important for both the debtor and the creditor to have the value fixed prior to considering confirmation of a plan. The need to know the value is heightened by the interaction of two other sections which prescribe terms necessary for confirmation of a plan.

The first, section 1225(a)(6),[27] requires that the debtor be able to make

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gain payments.

24. Note, however, that some creditors routinely seek relief from the stay to trigger section 109(g) in the event the case is thereafter dismissed. That section provides:

> (g) Notwithstanding any other provision of this section, no individual or family farmer may be a debtor under this title who has been a debtor in a case pending under this title at any time in the preceding 180 days if—
>
> (1) the case was dismissed by the court for willful failure of the debtor to abide by orders of the court, or to appear before the court in proper prosecution of the case; or
>
> (2) the debtor requested and obtained the voluntary dismissal of the case following the filing of a request for relief from the automatic stay provided by section 362 of this title.

11 U.S.C. § 109(g).

25. Upon confirmation pursuant to 11 U.S.C. § 1225:

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

11 U.S.C. § 1225(a).

26. *See* § 1225(a)(5)(B)(ii). The payments under the plan must be discounted by the appropriate rate in order for the creditor to receive the present value of its claim as of the effective date of the plan. Section 1225 does not contain any specific discount rate nor does it provide any guidance as to what discount rate is appropriate. Therefore, courts have been left with the task of determining the appropriate discount rate to apply. The courts have not approached this issue in a uniform fashion. Some courts have concluded that the current market rate is the correct rate to apply. *See In re* Citrowske, 72 Bankr. 613 (Bankr. D. Minn. 1987). Other courts have applied the creditor's cost of funds as the appropriate discount rate. *See In re* Hardzog, 74 Bankr. 701 (Bankr. W.D. Okla. 1987).

27. 11 U.S.C. § 1225(a)(6) provides: "Except as provided in subsection (b), the court shall

all payments called for under the plan, including the full payment of the present value of allowed secured claims.[28] The second, section 1225(b), requires that the debtor must make its best effort by contributing "all . . . disposable income" to payments under the plan.[29] Until the amount of the allowed secured claims and the amount of the payments necessary to pay those claims at their present value is known, it is impossible to determine whether the debtor can make all the payments called for and, if it can, whether it is making its best effort to do so. If a debtor's plan is based on a low valuation of the collateral and provides for the disposition of all disposable income, and then a disputed claim is determined to be greater than anticipated, there will be no additional funds from which such a payment can be made. The plan will then not be confirmable unless the debtor can convince the court that there are additional new sources of income.

Because of the dilemma created by the interaction of the three sections noted above, courts have had to labor to achieve early valuations where possible. Some courts have adopted procedures requiring the holding of a valuation hearing[30] within forty-five days after the filing of the case.[31] Others have adopted pretrial procedures directed at seeking agreements between the parties either as to the value of collateral or as to an impartial means of determining that value. Some courts have obviated this concern to some extent by ordering that an appraiser be appointed pursuant to Federal Rule of Evidence 706[32] to report to the court. In at least one court, the independent

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confirm a plan if . . . the debtor will be able to make all payments under the plan and to comply with the plan."

28. In other words, making the payments to the secured creditor must be "feasible."

29. 11 U.S.C. § 1225(b). The legislative history explains:

> Section 1225 defines "disposable income" as income which is not reasonably necessary to be expended for the maintenance or support of the debtor or a dependent of the debtor or for the payment of expenditures necessary for the continuation, preservation, and operation of the debtor's business.
>
> The Conferees recognize that family farmers who are eligible for Chapter 12 may be involved in *minor* businesses not directly related to the farming operation. The conferees intend that the term "debtor's business" in section 1225 include such businesses.

H.R. CONF. REP. NO. 958, 99th Cong., 2d Sess., *reprinted in* 1986 U.S. CODE CONG. & ADMIN. NEWS 5227, 5251.

30. 11 U.S.C. § 506(a), (b) and (d) provide for valuation of collateral to determine allowed secured claims.

31. *See, e.g.*, rules promulgated by Utschig, Bankr. J., for the Western District of Wisconsin.

32. Federal Rule of Evidence 706 provides:

> (a) Appointment. The court may on its own motion or on the motion of any party enter an order to show cause why expert witnesses should not be appointed, and may request the parties to submit nominations. The court may appoint any expert witnesses agreed upon by the parties, and may appoint expert witnesses of its own selection . . . . A witness so appointed shall advise the parties of his findings, if any; his deposition may be taken by any party; and he may be called to testify by the court or

appraiser's fee is then assessed against the party whose own appraiser falls farthest from the independent appraiser's values.[33] There is some concern that the use of independent appraisers in this fashion, where it is predetermined that their testimony will be given either absolute credence or unusual weight in the court, is a violation of the prohibition in the Bankruptcy Rules against the use of special masters.[34]

The problem of valuation is exacerbated by the difficulty of presenting appraisal evidence. Appraisers tend to invite extensive examination and even longer cross-examination due to the admittedly speculative nature of their testimony—what a hypothetical willing buyer will pay to an equally hypothetical willing seller. Furthermore, appraisers are expensive. The problem is at its worst when appraisals are presented to courts in chapter 12 cases.[35] The debtor has a very substantial interest in having the valuation of collateral as low as possible, while the creditor has an equally substantial interest in having the valuation as high as possible.[36] Bankruptcy judges are frequently provided with appraisals which are at such wide variance and entitled to so little credibility that they have scant choice but to "kick field goals," ensuring that their decision on value falls somewhere between the appraisals.

A third problem under chapter 12 is the general inadequacy of the debtor's records and accounting. Shoebox filing is typical. Farmers often believe that their checkbooks and tax returns are sufficient records upon which to base both a reconstructed history of their operations and projections for the future. A parallel problem arises from the pervasive, almost universal, use of cash accounting in agricultural enterprises. Because there is no ac-

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any party. He shall be subject to cross-examination by each party, including a party calling him as a witness.

(b) Compensation. Expert witnesses so appointed are entitled to reasonable compensation in whatever sum the court may allow . . . . In other civil actions and proceedings the compensation shall be paid by the parties in such proportion and at such time as the court directs, and thereafter charged in like manner as other costs.

. . .

(d) Parties' Experts of Own Selection. Nothing in this rule limits the parties in calling expert witnesses of their own selection.

33. Apparently, Kansas Bankruptcy Judge John Pearson adheres to this approach. Pelzer, *supra* note 3, at 69.

34. *See* FED. R. BANKR. 9031.

35. This problem was characterized by one judge as "the shoot-out of the dueling appraisers." Pelzer, *supra* note 3, at 69.

36. Because only the allowed secured claim must receive payment of its full present value under a chapter 12 plan, 11 U.S.C. § 1225(a)(5), while the unsecured claim need only receive a distribution of property under the plan which is "not less than the amount that would be paid . . . under chapter 7," 11 U.S.C. § 1225(a)(4), an amount which in most cases would be nil; and because the secured creditor's lien is reduced to the amount of its allowed secured claim upon conformation of a chapter 12 plan, 11 U.S.C. § 506(d) and 11 U.S.C. § 1227, the debtor benefits from a low valuation of collateral while the creditor, who gives up any right to share in future appreciation, benefits from a high valuation of collateral.

counting for accrual of liabilities and assets, it is almost impossible to determine future viability or projected expenses of operation. Although some rough conversion to an accrual accounting is usually made for the purposes of analysis, a genuine and careful conversion to a useful system of accounting is expensive and time consuming. To require a full and adequate accounting would, in most cases, undermine the intention of the supporters of chapter 12 that it be simple and inexpensive.

A final problem which has occupied the courts during this first year of chapter 12 operation has been the central issue in most contested confirmations: whether the debtor will be able to make the plan payments.[37] Feasibility, like all other issues under chapter 12 confirmation, must be proved by the debtor.[38] That initial burden of proof may be met by the presentation of evidence that the farm will in the future generate net funds sufficient to make the proposed plan payments. If such a *prima facie* case is made, the burden shifts to the creditor.[39] The proofs involved are extremely difficult because they primarily involve projections based on such elusive variables as future production of the farming enterprise, future availability and character of government programs, and future market conditions.[40] In almost all cases, the debtors have to overcome a negative history and demonstrate the changes which they anticipate will ensure a productive farm in the future.

Farm economists note that as a general historical average, farming enterprises which are well run can produce a yield of approximately five to nine percent of total asset value per year. This historical average, although by no means stable, is protected to a large extent because the values of assets, whether real estate, livestock, equipment, or growing crops, are closely related to the market value of farm products. As a result of this historical relationship, it would seem a very difficult burden on the debtor to prove that it can, under a chapter 12 plan, finance the entire capital asset value of the farm at a market interest rate[41] and pay a trustee's fee of approximately

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37. Section 1225(a)(6) requires that the debtor be able to make all payments under the plan. This requirement is generally referred to as the "feasibility" of the plan.

38. *See* 11 U.S.C. § 1225.

39. *Id.*

40. *See In re* Edwardson, 74 Bankr. 831 (Bankr. D.N.D. 1987) (plan confirmed despite alleged infeasibility where court found projected 37-bushel yield realistic, debtors fully insured their crop against hail losses, and creditor's lower projections were based on severe hail losses in recent years); *see also In re* Mikkelsen Farms, 74 Bankr. 280 (Bankr. D. Or. 1987) (debtor's annual income was "sufficiently stable and regular" where land not rented by debtor would be farmed by debtor, specific leases were entered into for crop year, and there was no showing that land was not tillable or incapable of being leased during duration of plan); *In re* Hoskins, 74 Bankr. 51 (Bankr. C.D. Ill. 1987) (debtor's income, including income from farming and nonfarming sources, was sufficiently stable and regular income to enable debtor to make payments under the plan); *In re* Douglass, 16 Bankr. Ct. Dec. (CRR) 456 (Bankr. W.D. Mo. 1987) (plan not feasible since there was no provision for repair of levees which were necessary to protect debtor's 660 acres from flooding).

41. *See In re* Citrowske, 72 Bankr. 613 (Bankr. D. Minn. 1987). *Cf. In re* Hardzog, 74

ten percent on all payments.[42] Obviously if the market rate of interest is nine percent or higher, that interest plus a ten percent surcharge cannot be paid from income of nine percent or less. As this has played out in the courts, however, several patterns have emerged. In some courts, there has been a strong presumption of feasibility even to the point of placing the burden immediately upon the creditor to disprove the feasibility of a proposed reorganization. In other cases, the opponents of the reorganization have typically failed to present appropriate evidence to overcome or rebut the *prima facie* case presented by the debtor. Debtors normally are able to generate some set of figures which would "cash flow" the farm. Whether this is done by terminating the stray voltage which has cut production in the past, by rapidly turning a weak herd to a strong herd, or by having the highest yields in the history of the farm, depends upon the necessities which the debtor faces. What is important, however, is to recognize that it is virtually impossible for creditors to rebut the *prima facie* case for feasibility merely by negative evidence elicited on cross-examination of the debtor. In most cases a creditor opposing confirmation must obtain expert testimony, directed not at national averages or rules of thumb in the operation of farms, but at the actual circumstances of the farming enterprise which is being evaluated.[43]

Frequently creditors do not oppose confirmation. This is not because they believe that the reorganization is feasible but because they have exacted certain concessions which will protect them whether the reorganization is successful or not. Many of these arrangements are included within the general category known as "drop dead" agreements.[44] Debtors who enter into "drop dead" agreements bargain away either the right to a continued stay against the creditor's collection efforts or even the right to continue operation of their farms. If there is any default in payment, either directly to the creditor or through the chapter 12 trustee, the creditor is granted strong remedies. Desperate farmers often appear to believe the future consequences are worth risking in order to obtain the consent of creditors to confirmation of the plan. There is, however, some concern that courts will be reluctant to approve these agreements.

Even in the absence of a "drop dead" agreement, a creditor may view

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Bankr. 701 (Bankr. W.D. Okla. 1987) (creditor's cost of funds is appropriate discount rate).

42. *See In re* Meyer, 73 Bankr. 457 (Bankr. E.D. Mo. 1987) (debtors had to reasonably anticipate trustee's fee of 10% on all payments). *But see In re* Hasensick, 16 Bankr. Ct. Dec. (CRR) 28 (Bankr. N.D. Iowa 1987) (5% is appropriate rate for trustee fees on payments up to $450,000).

43. Agricultural lenders are often familiar with the actual history of the farming operations, having dealt with the farmer for an extended period of time.

44. Basically a "drop dead" agreement placed the "burden of feasibility" squarely on the farmer. The wording may vary a bit, but generally, if the farmer defaults at any point within the repayment period, the chapter 12 protection, including the stay under 11 U.S.C. § 362, will be forfeited.

the confirmation of a plan as being no worse than a liquidation under chapter 7 or a foreclosure outside of bankruptcy. Thus, although opponents of a plan may be armed with an outstanding weapon in contesting feasibility, it is less frequently exercised than many of the analysts of chapter 12 anticipated at the time of enactment.

As we approach the one-year anniversary of the enactment of chapter 12, it appears that Congress has succeeded in providing a relatively simple and rapid procedure for agricultural bankruptcies. Certainly chapter 12 is a solution which has been turned to by a large number of farmers. It is beyond question that, in addition to the many farm enterprises which have actually filed under chapter 12, there are a large, if incalculable, number which have been reorganized outside of bankruptcy along lines determined by the provisions of chapter 12. Whether the reorganizations effected within this year are a successful solution to the problems which Congress sought to address cannot yet be told.

In the short run, it seems likely that the bankruptcy courts will face a whole series of new problems as chapter 12 matures. The availability and effect of postconfirmation modifications are sure to be explored as farmers operating under confirmed plans find their projections too optimistic. Certainly the effect of dismissal or conversion to chapter 7 will be explored in the years ahead.

Until chapter 12 plans are completed and discharges are obtained in the cases, it will be impossible to determine whether chapter 12 has provided anything more than a postponement of the "moment of truth" for farmers who have filed. Until the agricultural economy has stabilized and rural society including "main street" businesses, has resumed its traditional function, it is impossible to assess the full impact of chapter 12 on farm lenders. In the meantime, there is a system in place which seems to have achieved sufficient accommodation within court procedures to at least give the intentions of Congress a chance to be tested.