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An Agricultural Law Research Article

The Family Farmer in Bankruptcy: Recent Developments in Chapter 12

by

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THE FAMILY FARMER IN BANKRUPTCY: RECENT DEVELOPMENTS IN CHAPTER 12

*Susan A. Schneider**

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I. INTRODUCTION

During the past year, the overall agricultural economy has been strong. Nevertheless, as is the case in any highly capitalized business sector, some farm operations and some farming communities have experienced severe financial stress. Moreover, the combination of heavy capitalization and the farmer's dependence upon forces beyond his or her control keeps farmers continually looking over their shoulders at bankruptcy options. Chapter 12 of the Bankruptcy Code continues to serve as the best bankruptcy option for family farmers and as the baseline for non-bankruptcy workouts for the financially distressed family farm. Chapter 12 is

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presently set to sunset on October 1, 1998.¹ As of this writing, there is legislation pending in Congress that would make Chapter 12 a permanent part of the Bankruptcy Code.² Action on this legislation will determine whether the law made with regard to Chapter 12 bankruptcy has lasting significance.

This Article reviews some of the most significant recent decisions in Chapter 12 bankruptcy cases and discusses several of the recurring themes in farm bankruptcy litigation.³ It is divided into the following chronological sections that mirror the Chapter 12 process: Part II discusses Eligibility for Chapter 12 Relief; Part III discusses Pre-confirmation Issues; Part IV discusses Plan Confirmation; Part V discusses Chapter 12 Trustee Compensation; and finally, Part VI discusses Discharge and Post-Discharge Issues.

II. ELIGIBILITY FOR CHAPTER 12 RELIEF

Only a "family farmer with regular annual income" is eligible for Chapter 12 relief.⁴ The term "family farmer" is defined in § 101(18) of the Bankruptcy Code, with specific requirements for individuals, and similar but distinct requirements for partnerships and corporations.⁵

For individuals, § 101(18)(A) provides that a "family farmer" is defined as follows:

[An] individual or individual and spouse engaged in a farming operation whose aggregate debts do not exceed \$1,500,000 and not less than 80 percent of whose aggregate noncontingent, liquidated debts (excluding a debt for the principal residence of such individual or such individual and spouse unless such debt arises out of a farming operation), on the date the case is filed, arise out of a farming operation owned or operated by such individual or such individual and spouse, and such individual or such individual and spouse receive from such farming operation more than 50 percent of such individual's or such individual and spouse's gross income for the taxable year preceding the taxable year in which the case concerning such individual or such individual and spouse was filed⁶

1. See Pub. L. No. 103-65, 1993 U.S.C.C.A.N. (107 Stat.) 311.

2. See S. 1024, 105th Cong. (1997).

3. The case review that produced the background for this Article was done in preparation for the American Agricultural Law Association annual conference in October 1997. The cases reviewed were those published between this conference date and the preceding conference, held in October 1996.

4. 11 U.S.C. § 109(f) (1994).

5. See 11 U.S.C. § 101(18) (1994).

6. 11 U.S.C. § 101(18)(A) (1994). For corporations and partnerships, § 101(18)(B) provides that a "family farmer" is defined as follows:

Because Chapter 12 offers significant powers to the debtor, powers that may not be available under other bankruptcy chapters,⁷ whether a debtor meets the specific eligibility requirements is a frequently litigated issue.

Recent litigation confirms this continuing struggle. Two cases are of particular interest and will be discussed. The first case concerns the farm income requirements for Chapter 12 eligibility, and the second case concerns the family involvement in a "family farm" setting.

A. Determining Farm Income

In the Georgia bankruptcy case *In re Lamb*,⁸ the debtor's eligibility for Chapter 12 relief was challenged by the trustee.⁹ At issue was whether more than fifty percent of the debtor's gross income in the previous tax year arose from farming.¹⁰ The debtor had income from his one-third share in a dairy operation partnership as well as cash rent income from leasing out a portion of his farmland.¹¹ In order to characterize these types of income and resolve this issue, the court analyzed both the meaning of the term "gross income" and the term "farming operation."¹²

[A] corporation or partnership in which more than 50 percent of the outstanding stock or equity is held by one family, or by one family and the relatives of the members of such family, and such family or such relatives conduct the farming operation, and (i) more than 80 percent of the value of its assets consists of assets related to the farming operation; (ii) its aggregate debts do not exceed \$1,500,000 and not less than 80 percent of its aggregate noncontingent, liquidated debts (excluding a debt for one dwelling which is owned by such corporation or partnership and which a shareholder or partner maintains as a principal residence, unless such debt arises out of a farming operation), on the date the case is filed, arise out of the farming operation owned or operated by such corporation or such partnership; and (iii) if such corporation issues stock, such stock is not publicly traded.

11 U.S.C. § 101(18)(B) (1994).

7. For example, under Chapter 12 there is no "absolute priority rule" as exists under Chapter 11. See 11 U.S.C. § 1129(b)(2)(B)(ii) (1994). The "absolute priority rule," which prohibits the retention of any equity interest by the debtor over the interest of objecting creditors, has made Chapter 11 plans for family farm operations extremely difficult to confirm. See *Norwest Bank of Worthington v. Ahlers*, 485 U.S. 197 (1988) (defining the absolute priority rule as applied to farming operations). Similarly, creditors involved in a Chapter 12 bankruptcy do not have the § 1111(b) election available to creditors of Chapter 11 debtors. See 11 U.S.C. § 1111(b) (1994).

8. *In re Lamb*, 209 B.R. 759 (Bankr. M.D. Ga. 1997).

9. See *id.* at 760.

10. See *id.*

11. See *id.*

12. See *id.* at 760-63.

With regard to “gross income,” the *Lamb* court held that it was appropriate to rely upon the Tax Code definition.¹³ The Tax Code defines “gross income” as “all income from whatever source derived” and provides a noncomprehensive listing of potential sources of gross income.¹⁴ Included in this Tax Code listing is “distributive share of partnership gross income.”¹⁵ The court noted that this amount would not appear on a partner’s individual tax return because each partner only reports his or her share of the partnership’s gain or loss.¹⁶ Rather, to compute a partner’s “gross income,” one must begin with the partnership’s gross income and then compute the individual partner’s percentage share of that income, based on the partner’s share of the partnership.¹⁷

Applying this methodology to the facts of the case in *Lamb*, the court found that the debtor had a one-third interest in the dairy partnership and that his distributive share of the partnership gross income was \$89,025.33.¹⁸ This amount was to be included in “gross income” from farming for purposes of determining Chapter 12 eligibility.¹⁹ The debtor’s gross income from other sources totaled \$90,436.00, however, so the partnership income did not satisfy the fifty percent requirement of § 101(18).²⁰ Therefore, the court analyzed the character of the debtor’s other income, which included \$37,000 in rents received from the debtor’s farm land.²¹ This led the court to an analysis of whether rental income constituted “farm income” for Chapter 12 purposes.²²

The *Lamb* court noted a split in authority on the issue of the characterization of farm rental income.²³ The Seventh Circuit decision in the case of *In re Armstrong*²⁴ represents the line of cases holding that in order for income to be categorized as farm income, the income must meet what is termed as the “risk test.”²⁵ Receipt of the income by the debtor depends upon the risk inherent in

13. See *id.* at 761.

14. *Id.* (citing 26 U.S.C. § 61(a)).

15. *Id.* (citing 26 U.S.C. § 61(a)(13)).

16. See *id.* (citing 26 U.S.C. § 702(a)).

17. See *id.* (citing 26 U.S.C. § 702(c)).

18. See *id.*

19. See *id.*

20. See *id.* at 762.

21. See *id.* at 761.

22. See *id.* at 760-62.

23. See *id.* at 762.

24. *In re Armstrong*, 812 F.2d 1024 (7th Cir.), cert. denied, 484 U.S. 925 (1987).

25. See *id.* at 1027-28. Although *Armstrong* involved the protection from involuntary bankruptcy afforded farmers, because both this protection and Chapter 12 eligibility rely in part on a determination of what constitutes farm income, Chapter 12 cases have generally either relied upon, dissented from, or distinguished *Armstrong* on a variety of eligibility issues.

traditional farming operations.²⁶ According to the majority in *Armstrong*, cash rental income does not meet this test.²⁷

The *Lamb* court noted a second line of cases led by the Eighth Circuit and first articulated in the case of *Otoe County National Bank v. Easton (In re Easton)*.²⁸ Under this approach, in order for rental income from farm land to be considered farm income, the debtor must have some degree of involvement in the farming operation taking place on that rented land.²⁹ Specifically, the Eighth Circuit stated that the debtor must show that he “had some significant degree of engagement in, played some significant operational role in, or had an ownership interest in the crop production” occurring on the rented land.³⁰

However, a third line of cases controlled the outcome for the court in *Lamb*. In the case of *Watford v. Federal Land Bank (In re Watford)*,³¹ the Eleventh Circuit Court of Appeals adopted the “totality of the circumstances test.”³² Citing the intention of Congress in enacting Chapter 12, the *Watford* court stated that the proper question for the court must be “whether under the totality of the circumstances the Watfords had not abandoned all farming operations, but rather were planning to continue farming operations”³³

Applying the totality of the circumstances test to the facts in *Lamb*, the court found that the debtor’s income from the rental of the farm land arose out of a “farming operation.”³⁴ The court stated:

Debtor was, himself, engaged in farming operations through his partnership interest It is not unusual for a farmer to rent some of his farm land to other farmers as part of his business plan. In addition, the Court deems the usage by the lessee of such farm land significant in its analysis. If the lessee uses the rented land for farming operations, some of the risks of farming are indirectly imparted to the lessor, thereby supporting a conclusion that the rental income from such property should itself be considered income from a “farming operation.” In the present

26. See *id.* at 1028.

27. See *id.* at 1027. The dissent rejected this mechanical approach and proposed a “totality of the circumstances test.” See *id.* at 1030. Under the dissent’s view, the debtor’s overall situation should be examined and an equitable result reached. See *id.* This dissenting opinion is frequently cited by courts that adopt the “totality of the circumstances” approach to the characterization of farm income.

28. *Otoe County Nat’l Bank v. Easton (In re Easton)*, 883 F.2d 630 (8th Cir. 1989).

29. See *id.* at 636.

30. *Id.*

31. *Watford v. Federal Land Bank (In re Watford)*, 898 F.2d 1525 (11th Cir. 1990) (adopting the totality of the circumstances test as articulated by the dissent in *In re Armstrong*, 812 F.2d 1024 (7th Cir. 1987)).

32. See *id.* at 1529.

33. *Id.*

34. See *In re Lamb*, 209 B.R. 759, 762 (Bankr. M.D. Ga. 1997).

case, no evidence has been offered indicating that the land was used by lessee for any purpose other than farming operations. Thus, under the circumstances of this case, the Court finds that the rental income of \$37,000 was income which arose out of a farming operation in accordance with 11 U.S.C. § 101(18) & (21).³⁵

Because the rental income was included as "farm income," the debtor was held to be eligible for Chapter 12 bankruptcy.³⁶

B. Family Involvement in a Family Farm

Another recent bankruptcy case, *In re Howard*,³⁷ also addressed the eligibility requirements for Chapter 12 bankruptcy.³⁸ This Tennessee case arose in the context of several creditors' objections to plan confirmation.³⁹ One creditor, however, also objected to the debtors' eligibility.⁴⁰ This creditor alleged that the husband and wife debtors were not family farmers because "in order for their plan to succeed they must rely on the labor and assets of third parties (the debtors' sons)."⁴¹ The creditor based its objection on the definition of "family farmer," which refers to an "individual or individual and spouse engaged in a farming operation"⁴² The creditor argued that under this definition the emancipated children could not be considered debtors along with their parents.⁴³

Under the facts of the *Howard* case, the debtors' two adult sons lived and worked on their parents' farm.⁴⁴ One of the sons owned nineteen of the dairy cattle on which the debtors depended for milk production; and, the debtors proposed growing five out of their planned twenty acres of tobacco on real property leased to one of the sons.⁴⁵ Both the debtors and their sons testified that all of their efforts and assets went into the debtors' farm operation in order to meet farm expenses and that this would continue throughout the Chapter 12 plan.⁴⁶ The evidence also showed that the sons worked on the farm full-time without a salary in return for

35. *Id.*

36. *See id.* at 763.

37. *In re Howard*, 212 B.R. 864 (Bankr. E.D. Tenn. 1997).

38. *See id.* at 873.

39. *See id.* at 869.

40. *See id.* at 872. The *Howard* court was somewhat gracious in addressing this issue in that, as is pointed out in the published opinion, the objecting creditor had already made and lost its eligibility arguments in a previous motion to dismiss. *See id.*

41. *Id.*

42. *Id.* (citing 11 U.S.C. § 101(18) (1994)).

43. *See id.*

44. *See id.* at 867.

45. *See id.* at 872.

46. *See id.*

room and board and occasional spending money.⁴⁷ Both testified that they were willing to do this in order to keep the farm and in the expectation that the farm would some day belong to them.⁴⁸

The court rejected the creditor's argument.⁴⁹ In so doing, the court first noted that the sons had not filed for Chapter 12 relief, so their eligibility was not at issue.⁵⁰ Only Mr. and Mrs. Howard, "an individual and spouse," were the debtors.⁵¹ The court further found that it was not necessary for the sons to be debtors in order for their assets and labor to be utilized by the debtors under the plan.⁵² The court stated that "§ 101(18) does not require the debtors to only use assets belonging to them; instead the debtors only have to be engaged in a farming operation" and meet the other requirements for family farmer status.⁵³ Citing a number of other cases that dealt with an extended family farming operation, the court held that "undoubtedly" the debtors were "engaged in a farming operation."⁵⁴ Rejecting the creditor's objection, the court stated that the debtors were the "classic family farmers for which Chapter 12 relief was designed."⁵⁵

47. *See id.*

48. *See id.* at 872-73.

49. *See id.* at 873-74.

50. *See id.* at 873.

51. *Id.*

52. *See id.*

53. *Id.*

54. *Id.* In reaching this conclusion, the court cited the following cases:

In re Voelker, 123 B.R. 749 (Bankr. E.D. Mich. 1990) (Chapter 12 debtor operated farm, even though he had only minor ownership interest, where debtor and owner, his son, jointly managed all phases of farm operation and debtor actually performed his fair share of physical labor in implementing those management decisions); *In re Land*, 82 B.R. 572 (Bankr. D. Colo.), *aff'd*, 96 B.R. 310 (D. Colo. 1988) (debtor's filing of Chapter 12 to forestall foreclosure in order to reorganize farm so it could be passed on to his son did not constitute bad-faith motive so as to preclude confirmation of Chapter 12 plan); *Otoe County Nat'l Bank v. Easton (In re Easton)*, 79 B.R. 836 (Bankr. N.D. Iowa 1987), *aff'd*, 104 B.R. 111 (Bankr. N.D. Iowa 1988), *vacated*, 883 F.2d 630 (8th Cir.1989), *on remand*, 118 B.R. 676 (Bankr. N.D. Iowa 1990) (elderly Chapter 12 debtors engaged in the process of transferring their farm from one generation to the next are "family farmers" even though they have substantially retired from active farming where they continue to reside upon the farm itself, conduct limited farming operations, and cash rent part of their farm real estate to a family member).

Id.

55. *Id.* at 874.

III. PRE-CONFIRMATION LITIGATION IN CHAPTER 12

Soon after a Chapter 12 bankruptcy case is filed, litigation is often brought to sort out the debtors and creditors rights. This litigation generally precedes the filing of the debtors' proposed plan, and in fact, what can be accomplished in the plan may well be determined by the outcome of this litigation. Several recently published decisions fall into this "pre-confirmation" category of litigation. This Part will first briefly discuss two cases that deal with debtors' attempts to affect or eliminate claims against them. It will then turn to the important issue of setoff and discuss the most recent cases on this issue.

A. The Chapter 12 Debtor's Powers

In *In re Double J Cattle Co.*,⁵⁶ a recent Wyoming bankruptcy case, a Chapter 12 debtor sought to use trustee avoidance powers to enhance the property of the Chapter 12 estate.⁵⁷ The debtor sought to avoid an unperfected security interest in cattle under § 544 of the Bankruptcy Code⁵⁸ and to avoid a prebankruptcy transfer as a preference under § 547 of the Bankruptcy Code.⁵⁹

The court first addressed the issue of the unperfected security interest.⁶⁰ The court noted that the trustee's "strong arm" powers under § 544 include the power to avoid any transfer of property of the debtor that would be voidable by a judgment lien creditor as of the date of the filing of the bankruptcy.⁶¹ Next, the court referenced § 1203, which provides that most of the powers of the trustee, including the "strong arm" power, are available to a Chapter 12 debtor.⁶² Reviewing the evidence presented, the court held that the lien at issue was unperfected under Wyoming state law.⁶³ The creditor argued that the debtor's personal knowledge of the lien precluded lien avoidance under § 544, but the court rejected this argument.⁶⁴ The court held that § 544 provided that the knowledge of either the trustee or the debtor in possession is immaterial.⁶⁵ For these reasons, the court allowed the avoidance of the unperfected lien.⁶⁶

56. *Double J Cattle Co. v. Geis (In re Double J Cattle Co.)*, 203 B.R. 484 (Bankr. D. Wyo. 1995).

57. *See id.* at 487.

58. *See id.* at 486-87 (referencing 11 U.S.C. § 544 (1994)).

59. *See id.* at 487-88 (referencing 11 U.S.C. § 547 (1994)).

60. *See id.* at 487.

61. *See id.* (citing 11 U.S.C. § 544(a)(1) (1994)).

62. *See id.* (citing 11 U.S.C. § 1203 (1994)).

63. *See id.*

64. *See id.*

65. *See id.* (citing *In re Paramount Int'l Inc.*, 154 B.R. 712, 714 (Bankr. N.D. Ill. 1993)).

66. *See id.*

On the preference issue in *Double J*, the debtor sought to avoid the transfer of title to cattle to the creditor.⁶⁷ The court explained the preference authority as follows:

The trustee may avoid any transfer of a debtor's interest in property to a creditor on account of an antecedent debt, if the debtor was insolvent at the time of the transfer, if the transfer took place within 90 days of the filing of the petition, and if the transfer enabled the creditor to receive more than it would receive in a Chapter 7 case.⁶⁸

The transfer of the cattle at issue in *Double J* occurred as a result of a court action brought against the debtor on an installment note that was in default.⁶⁹ In that court action, the creditor agreed to continue its hearing against the debtor and accept title to the cattle without possession.⁷⁰ The creditor argued that its concessions at the hearing constituted "new value" given for the transfer, triggering the new value exception under § 547(c)(1).⁷¹ Section 547(c)(1) provides that a transfer cannot be avoided if the debtor and creditor intended it to be "a contemporaneous exchange for new value given to the debtor" and if it was, in fact, a "substantially contemporaneous exchange."⁷² In order to qualify for this exception, the court held that "new value" had to be the equivalent of an enhancement of the estate.⁷³ Under the facts of the case, the court held that the creditor's agreement to continue the hearing and to accept title to the cattle without possession was not "new value."⁷⁴ Because this transfer was within ninety days of filing and was made on account of an antecedent debt, the court held that the transfer could be avoided as a preference.⁷⁵ Addressing final issues, the court in *Double J* held that when a lien or transfer is avoided, the benefit of the avoidance is preserved for the estate, preventing junior creditors from improving their positions.⁷⁶

In a different context, another Chapter 12 debtor enhanced the value of the estate in the case of *In re Carsten*.⁷⁷ The debtor in this case objected to the proof

67. See *id.* at 487-88 (citing 11 U.S.C. § 547 (1994)).

68. *Id.*

69. See *id.* at 487.

70. See *id.*

71. See *id.* at 488.

72. *Id.* (quoting 11 U.S.C. § 547(c)(1) (1994)).

73. See *id.* (citing 11 U.S.C. § 547(a)(2) (1994)).

74. See *id.*

75. See *id.*

76. See *id.* The court also determined the priorities of the creditors with respect to each other, applying Wyoming's Uniform Commercial Code provisions. See *id.* at 488-90.

77. *In re Carsten*, 211 B.R. 719 (Bankr. D. Mont. 1997).

of claim filed by the Environmental Protection Agency (EPA).⁷⁸ This allowed the debtor, in the favorable forum of bankruptcy, to challenge the penalty that he had been assessed for the illegal dredging and filling of a wetland.⁷⁹ In a lengthy opinion that is highly critical of the EPA, the court ruled on the application of the Clean Water Act wetlands provisions to the debtor's Chapter 12 bankruptcy.⁸⁰ The court found that at the time that the alleged violations occurred, the debtor did not own the property and was not in control of the work done thereon.⁸¹ Therefore, the court held that the debtor could not be liable for actions taken in violation of the Clean Water Act.⁸² The court also found that under the Clean Water Act farm pond exemptions,⁸³ the dredging, accomplished by the former owner in conjunction with his farming operation, did not require a permit.⁸⁴ Thus, the work avoided the recapture provisions.⁸⁵ The court further found that the work actually enhanced the flow so that a permit would not be required.⁸⁶ As a result, the court sustained the debtor's objection to the EPA proof of claim and disallowed the EPA claim against the debtor.⁸⁷

B. *Setoff in Bankruptcy*

In some cases, creditors are able to use the pre-confirmation period in Chapter 12 bankruptcy to their benefit. An important example of this is the exercise of setoff. The doctrine of setoff has its origin as an equitable right of a creditor to deduct a claim that it has against the debtor from an amount that the creditor owes to the debtor.⁸⁸ As the Supreme Court described it, "The right of setoff (also called 'offset') allows entities that owe each other money to apply their mutual debts against each other, thereby avoiding . . . the absurdity of making A pay B when B owes A."⁸⁹

The Bankruptcy Code does not create an independent right of setoff. Section 553 of the Code, however, recognizes setoff rights arising under state or

78. *See id.* at 720.

79. *See id.* at 721.

80. *See id.* at 737.

81. *See id.* at 721-22.

82. *See id.* at 737.

83. *See id.* at 734-36 (referencing 33 U.S.C. § 1344(f)(1)(C)).

84. *See id.* at 734, 737.

85. *See id.* at 734 (referencing 33 U.S.C. § 1344(f)(2)).

86. *See id.* at 737 (referencing 33 C.F.R. § 323.4(c)).

87. *See id.*

88. *See generally* 5 LAWRENCE P. KING, COLLIER ON BANKRUPTCY ¶ 553.03 (15th ed. rev. 1997) (explaining setoff under § 553). Setoff is distinguished from recoupment in that with setoff, the opposing claims need not arise out of the same transaction. *See id.*

89. *Citizens Bank of Maryland v. Strumpf*, 516 U.S. 16, 18 (1995) (quoting *Studley v. Boylston Nat'l Bank*, 229 U.S. 523, 528 (1913)).

federal law.⁹⁰ Thus, within the limits imposed by § 553 and other applicable Code sections, including the automatic stay provisions of § 362,⁹¹ setoff rights created under state or federal law may be exercised within a bankruptcy.⁹² In effect, where a right to setoff exists independently of the Code, § 553 allows setoff, but imposes restrictions on the right's exercise in bankruptcy.

Section 553 places restrictions on bankruptcy setoffs, which are commonly translated into three requirements that must be met before a setoff is permissible.⁹³ First, the creditor must owe a debt to the debtor that arose prior to the bankruptcy's commencement.⁹⁴ Second, the creditor must have a claim against the debtor that arose prior to the bankruptcy.⁹⁵ Third, the debt and the claim must be mutual obligations.⁹⁶

Although § 553 requires that the debt and the claim be mutual, the debt and claim do not have to arise out of the same transaction. "The basic test is mutuality, not similarity of obligation—something must be 'owed' by both sides."⁹⁷ Mutuality requires that "the debts must be in the same right and between the same parties, standing in the same capacity."⁹⁸ Thus, mutuality does not exist when "the debts to be set off arose between parties acting in different capacities."⁹⁹

Even if the creditor can satisfy each requirement of § 553, a setoff may not be allowed by the bankruptcy court. As one bankruptcy court described it, "The right of setoff is permissive, not mandatory. Allowance of a setoff is within the discretion of the court—which must exercise that discretion consistent with general principles of equity."¹⁰⁰

90. See 11 U.S.C. § 553 (1994).

91. See 11 U.S.C. § 362 (1994).

92. See 11 U.S.C. §§ 362, 553 (1994).

93. See *Small Bus. Admin. v. Gore (In re Gore)*, 124 B.R. 75, 77 (Bankr. E.D. Ark. 1990).

94. See *id.*

95. See *id.*

96. See *id.* Under the common law interpretation of setoff, the general requirements are similar to those imposed by § 553. The common law prerequisites are that the demands of the parties "be mutual, subsisting between the same parties, and due in the same capacity or right." *Boatman's Nat'l Bank v. Sears, Roebuck & Co.*, 106 F.3d 227, 230 (8th Cir. 1997) (quoting *Mercantile Trust Co. v. Mosby*, 623 S.W.2d 22 (Mo. Ct. App. 1981)).

97. 4 LAWRENCE P. KING, *COLLIER ON BANKRUPTCY* ¶ 553.04[1] (1989).

98. *Id.* ¶ 553.04[2].

99. *Id.*; see, e.g., *Jones v. Commodity Credit Corp. (In re Jones)*, 107 B.R. 888, 898-99 (Bankr. N.D. Miss. 1989) (holding that the CCC was not entitled to set off debt owed by farm corporation with payments owed to sole proprietorship, even though same individual was involved in both entities).

100. *In re Nielson*, 90 B.R. 172, 174 (Bankr. W.D.N.C. 1988). See generally 5 KING, *supra* note 88, ¶ 553.02 (explaining policy reasons for § 553's treatment of setoff).

There are two recent farm reorganization cases that addressed the issue of setoff. The first case, *Turner v. Small Business Administration (In re Turner)*,¹⁰¹ deals with the mutuality issue as applied to different agencies of the government and with the recovery of a setoff as a preferential payment. The second case, *Buckner v. United States (In re Buckner)*,¹⁰² considers the setoff rights of the government with respect to long term farm program contracts.

The case of *Turner v. Small Business Administration (In re Turner)* has now produced three separate appellate decisions involving setoff. The Tenth Circuit first ruled that different agencies of the federal government failed to meet the mutuality requirement of § 553.¹⁰³ The court subsequently voted to rehear the case en banc and vacated the panel judgment.¹⁰⁴ On rehearing, the panel decision was withdrawn and a new decision entered.¹⁰⁵ A third appellate decision was issued on the underlying issue of whether the setoff could be recovered under § 553(b)(2).¹⁰⁶ A brief review of the decisions in the first *Turner* and the second *Turner* is necessary for understanding the most recent *Turner* decision.

The debtors in *Turner* owed a substantial debt to the Small Business Administration (SBA).¹⁰⁷ Prior to bankruptcy, this debt was delinquent, had been accelerated, and was used to setoff against certain farm program payments due to the debtors.¹⁰⁸ The debtors did not challenge the legality of this setoff outside of bankruptcy and admitted that the SBA followed its regulations.¹⁰⁹ Subsequent to the setoff, however, the debtors filed for relief in bankruptcy under Chapter 12.¹¹⁰ Because the setoff had occurred within ninety days of the filing, the debtors brought an adversary proceeding seeking turnover of the setoff funds as a voidable preference under § 547.¹¹¹ The government argued that under § 553 of the Bankruptcy Code, setoff was allowed and avoidance was improper.¹¹² The

101. *Turner v. Small Bus. Admin. (In re Turner)*, 59 F.3d 1041 (10th Cir. 1995).

102. *Buckner v. United States (In re Buckner)*, 211 B.R. 46 (Bankr. D. Kan. 1997), *rev'd*, *Buckner v. United States (In re Buckner)*, Nos. 90-42105, 93-40549, Adv. No. 93-7189, 1998 WL 97233 (B.A.P. 10th Cir. Mar. 5, 1998).

103. *See Turner v. Small Bus. Admin. (In re Turner)*, 59 F.3d 1041, 1043 (10th Cir. 1995).

104. *See Turner v. Small Bus. Admin. (In re Turner)*, 84 F.3d 1294, 1294-95 (10th Cir. 1996).

105. *See Turner v. Small Bus. Admin. (In re Turner)*, 84 F.3d 1294, 1299 (10th Cir. 1996).

106. *See Turner v. Small Bus. Admin. (In re Turner)*, 96 F.3d 465, 467 (10th Cir. 1996).

107. *See Turner v. Small Bus. Admin. (In re Turner)*, 59 F.3d 1041, 1043 (10th Cir. 1995).

108. *See id.*

109. *See id.*

110. *See id.*

111. *See* 11 U.S.C. § 547 (1994). This claim could also be based on 11 U.S.C. § 553(b), and this alternative section was eventually determined to be the appropriate statutory provision for the court to apply. *See Turner v. Small Bus. Admin. (In re Turner)*, 84 F.3d at 1296, 1299; *Turner v. Small Bus. Admin. (In re Turner)*, 96 F.3d at 467.

112. *See Turner v. Small Bus. Admin. (In re Turner)*, 59 F.3d 1041, 1044-46 (10th Cir. 1995).

bankruptcy court held that the transfers were voidable preferences, the district court affirmed, and the government appealed to the Tenth Circuit.¹¹³

In its initial decision, the Tenth Circuit affirmed the lower court, basing its ruling specifically on the requirement for setoff under § 553 that the obligations between the debtor and the creditor be “mutual.”¹¹⁴ The court stated that “the obligations between debtor and creditor are mutual when both obligations are held by the same parties, in the same right or capacity.”¹¹⁵ The court stated that setoff should be given a narrow application in a reorganization and that this is best accomplished by strictly construing the mutuality requirement.¹¹⁶

Applying this requirement to the issue of two agencies of the federal government, the Tenth Circuit initially held that mutuality was lacking between the SBA and Agricultural Stabilization and Conservation Service (ASCS).¹¹⁷ The court based its decision on an analogy to “well-established” law that corporate subsidiaries do not meet the mutuality requirements of § 553, despite financial ties.¹¹⁸ The court further noted that “government agencies frequently squabble in court,” and have “distinct budgets and interests,” and that bankruptcy law does not treat debts to the government as a single claim, and in fact, some agencies’ claims may be given priority over others.¹¹⁹ For these reasons, the court disallowed the setoff as a voidable preference.¹²⁰

Shortly after the Tenth Circuit issued its initial *Turner* decision, the court granted the government’s request for a rehearing en banc to review the narrow issue of the mutuality of agencies of the federal government.¹²¹ Reaching the opposite conclusion of the panel in the first *Turner*, the court definitively held that “the United States is a unitary creditor in bankruptcy.”¹²²

As support for its decision, the court first established that outside of bankruptcy, agencies of the federal government are treated as a unitary creditor, at least with respect to setoff.¹²³ In *Cherry Cotton Mills v. United States*, the Supreme Court allowed the interagency setoff of Agricultural Adjustment Act payments

113. The facts of the case are recited in each of the first two *Turner* decisions. See *Turner v. Small Bus. Admin. (In re Turner)*, 59 F.3d at 1043; *Turner v. Small Bus. Admin. (In re Turner)*, 84 F.3d at 1295-96.

114. See 11 U.S.C. § 553(a) (1994).

115. *Turner v. Small Bus. Admin. (In re Turner)*, 59 F.3d 1041, 1044 (10th Cir. 1995) (citing *Davidovich v. Welton (In re Davidovich)*, 901 F.2d 1533, 1537 (10th Cir. 1990)).

116. See *Turner v. Small Bus. Admin. (In re Turner)*, 59 F.3d at 1043.

117. See *id.* at 1046.

118. See *id.* at 1045.

119. *Id.* at 1045-46.

120. See *id.* at 1046.

121. See *Turner v. Small Bus. Admin. (In re Turner)*, 84 F.3d 1294, 1295 (10th Cir. 1996).

122. *Id.* at 1299.

123. See *id.* at 1296.

against a debt owed to the Reconstruction Finance Corporation.¹²⁴ Although setoff was not the primary issue before the Court, language in the opinion clearly indicates the Court's treatment of the different agencies as one for setoff purposes.¹²⁵ Subsequent Supreme Court decisions have also allowed interagency setoff, and a federal statute and federal regulations expressly authorize this practice.¹²⁶ Thus, in its second *Turner* decision, the court concluded that under non-bankruptcy law, the United States is a unitary creditor for purposes of setoff.¹²⁷

The next question addressed by the court was whether the intervention of bankruptcy law and procedure altered the unitary status of the agencies.¹²⁸ The court held that it did not.¹²⁹ The court noted that the language of the Bankruptcy Code made it clear that setoff had no special meaning in the bankruptcy context and that setoff rights are determined primarily according to non-bankruptcy law.¹³⁰ The court quoted from the Supreme Court decision in *Citizens Bank v. Strumpf*, "Although no federal right of setoff is created by the Bankruptcy Code, 11 U.S.C. § 553(a) provides that, with certain exceptions, whatever right of setoff otherwise exists is preserved in bankruptcy."¹³¹

The court cited *Luther v. United States* as further support for the treatment of separate agencies as one entity in allowing setoff.¹³² In *Luther*, a bankruptcy referee allowed an IRS refund to be offset against an amount the debtor owed to the Commodity Credit Corporation.¹³³ The court rejected the debtor's attempts to distinguish *Luther* as a liquidation bankruptcy, noting that § 553 applies to liquidations and reorganizations alike.¹³⁴ The court also cited a number of bankruptcy court opinions that have held that different agencies of the federal government act as a unitary creditor for purposes of setoff in bankruptcy.¹³⁵

124. *See id.* at 1296-97 (citing *Cherry Cotton Mills v. United States*, 327 U.S. 536 (1946)).

125. *See id.* (citing *Cherry Cotton Mills v. United States*, 327 U.S. 536 (1946)).

126. *See id.* at 1298 (citing *Negonsott v. Samuels*, 933 F.2d 818, 819 (10th Cir. 1991) (noting that "statutes should be construed so that their provisions are harmonious with each other"), *aff'd*, 507 U.S. 99 (1993)).

127. *See id.* at 1296.

128. *See id.* at 1297.

129. *See id.* at 1298.

130. *See id.* at 1297.

131. *Id.* at 1297 (quoting *Citizens Bank v. Strumpf*, 516 U.S. 516, 518 (1995) (footnote omitted)).

132. *See id.* at 1298 (citing *Luther v. United States*, 225 F.2d 495 (10th Cir. 1954)). The court also noted that the holding in *Luther* was recently relied upon by the Ninth Circuit in *Doe v. United States*, 58 F.3d 494, 498 (9th Cir. 1995). *See id.*

133. *See id.*

134. *See id.*

135. *See id.* (citing *In re Kalenze*, 175 B.R. 35, 37 (Bankr. D.N.D. 1994); *In re Mohar*, 140 B.R. 273, 277 (Bankr. D. Mont. 1992); *In re Stall*, 125 B.R. 754, 757-58 (Bankr. S.D. Ohio 1991); *In re Julien Co.*, 116 B.R. 623, 624-25 (Bankr. W.D. Tenn. 1990); *In re Evatt*, 112 B.R. 405, 412-13 (Bankr. W.D. Okla. 1989)).

For these reasons, the second *Turner* decision was a definitive reversal on the issue of mutuality. It held that separate agencies of the government must be treated as one for purposes of setoff under § 553.¹³⁶ The case was remanded for further consideration of the remaining issues by the panel.¹³⁷

On remand, the panel considered the debtor's central claim—that the creditor's setoff could be avoided as a preference.¹³⁸ As the court explained, the issue of what statutory provision should be applied in addressing this claim was an underlying dispute in the previous decisions.¹³⁹ The bankruptcy court, affirmed by the district court, initially held that the setoff was avoidable under 11 U.S.C. § 553(b) because it occurred within the ninety day period before the Turners filed their bankruptcy petition.¹⁴⁰ On appeal, the court in the Tenth Circuit court's initial decision, it held that § 553 did not apply.¹⁴¹ “Instead, the court reasoned that the transaction in question was avoidable under 11 U.S.C. § 547.”¹⁴² In its second *Turner* decision, the court, en banc, held that § 553 rather than § 547 should have been applied, and remanded the case for consideration of § 553.¹⁴³

Under § 553(b), a setoff can be avoided “if (1) the setoff occurred within ninety days of the filing of the bankruptcy petition and (2) the creditor ‘improved its position’ as a result of the setoff.”¹⁴⁴ “To determine whether a creditor has improved its position, it is necessary to determine the ‘insufficiency’ both when the setoff occurred and at the point in time ninety days before the bankruptcy petition was filed.”¹⁴⁵ Section 553(b)(2) defines “insufficiency” as “the amount by which the debtor's debt to the creditor exceeds the amount which the creditor owes the debtor.”¹⁴⁶ “If the setoff occurs within the ninety-day prepetition period and it results in a smaller insufficiency than existed before the ninety-day period, then the creditor has improved its position.”¹⁴⁷ “The debtor may then recover the setoff amount to the extent that it improved the creditor's position.”¹⁴⁸ The court

136. *See id.* at 1299.

137. *See id.*

138. *See Turner v. Small Bus. Admin. (In re Turner)*, 96 F.3d 465 (10th Cir. 1996).

139. *See id.* at 467.

140. *See id.*

141. *See id.*

142. *Id.* (referencing *Turner v. Small Bus. Admin. (In re Turner)*, 59 F.3d 1041, 1046 (10th Cir. 1995)).

143. *See id.* (referencing *Turner v. Small Bus. Admin. (In re Turner)*, 84 F.3d 1294, 1296, 1299 (10th Cir. 1996)).

144. *Id.* (citing *Braniff Airways, Inc. v. Exxon Co.*, 814 F.2d 1030, 1040 (5th Cir. 1987)).

145. *Id.* (citing *Braniff Airways, Inc. v. Exxon Co.*, 814 F.2d 1030, 1040 (5th Cir. 1987)).

146. *Id.* (citing 11 U.S.C. § 553(b)(2) (1994)).

147. *Id.* at 467-68.

148. *Id.* at 468.

explained that "the statute prevents the creditor from using a setoff to put itself in a better position than it was in prior to the ninety-day prepetition period."¹⁴⁹

Applying this analysis to the facts of the case, the court compared the amount of the government's insufficiency immediately after taking the setoff with the amount of the insufficiency ninety days prior to the filing of the bankruptcy petition.¹⁵⁰ The court found that the ASCS had a contractual duty to pay the Turners and that this duty existed prior to the ninety-day period before to filing.¹⁵¹ Because this duty existed, the eventual setoff of the payments did not serve to improve the government's position.¹⁵² The ASCS payments were applied to reduce the SBA debt at the same time and in the same amount as the obligation to the debtor was satisfied.¹⁵³ The government's position remained constant.¹⁵⁴ Because the government did not improve its position for purposes of § 553(b), the court held that the setoff could not be avoided.¹⁵⁵ The court further held that a creditor's security interest in the payments did not defeat the right of the government to setoff.¹⁵⁶

Two recent Kansas bankruptcy cases, *In re Buckner* and *In re Tuttle*, also addressed the issue of setoff in the context of agricultural bankruptcy.¹⁵⁷ As in the *Turner* case, the setoff of farm program payments against debt obligations to the government was at issue in each of these cases. Moreover, each case involved the setoff of payments under the Conservation Reserve Program (CRP) against debts

149. *Id.* The court also explained that "[t]he purpose of § 553(b) is to keep creditors from using setoffs within the applicable ninety-day period to defeat the rights of other creditors. . . . In this respect, it mirrors the voidable preference policies expressed in 11 U.S.C. § 547." *Id.* (citing *Lee v. Schweiker*, 739 F.2d 870, 877 (3d Cir. 1984)).

150. *See id.*

151. *See id.* This finding is perhaps the most critical aspect of the decision. Nevertheless, it is relegated to a footnote. *See id.* at 468 n.5. The court makes this conclusion with very little discussion, despite the fact that the issue of when the government's obligation under a farm program contract arises is one of the most contested areas of government farm program litigation.

152. *See id.*

153. *See id.*

154. *See id.*

155. *See id.*

156. *See id.* On the issue of the competing security interest, the court implies that its holding is based on the fact that the third party creditor did not comply with government farm program regulations found at 7 C.F.R. pt. 1404. *See id.*; Assignment of Payments, 7 C.F.R. pt. 1404 (1997). The regulations in this part set forth the conditions under which an assignment of "government payments can be made to a creditor." *Id.*; Assignment of Payments, 7 C.F.R. pt. 1404 (1997). Section 1404.4 requires the use of a specific assignment form. *See* 7 C.F.R. § 1404.4 (1997). The court's implication that the secured creditor's claim was prejudiced by its failure to comply with this regulation is misleading. Section 1404.6 explicitly provides that setoff will be taken by the government "prior to the making of any payments to the assignee." 7 C.F.R. § 1404.6 (1997). Compliance with the assignment regulations provides no protection whatsoever against government setoff. *See id.*

157. *Buckner v. United States (In re Buckner)*, 211 B.R. 46 (Bankr. D. Kan. 1997).

owed to the former Farmers Home Administration (FmHA). As similar facts were presented, the bankruptcy court addressed the setoff issue in a combined opinion applicable to both cases. This decision and its subsequent reversal are instructive both in terms of the analysis of setoff and in revealing the problems caused by the slow resolution of issues by the courts.¹⁵⁸

The setoff issue initially arose in the *Buckner* case in early 1991 as a motion for relief from stay brought by the government to obtain permission to setoff.¹⁵⁹ At that time, the bankruptcy court held that the government could only setoff those payments that were due as of the filing of the bankruptcy, and the government appealed to the federal district court.¹⁶⁰

In the *Tuttle* case, the debtors filed for bankruptcy in 1993 and brought an adversary proceeding seeking turnover of CRP funds previously setoff along with a request for an injunction prohibiting further setoff.¹⁶¹ With regard to postpetition payments, the government's right to setoff depended on the same issue on appeal to the district court in *Buckner*. Therefore, in January 1994, pending the results of the appeal, the court ruled that the Tuttle could use the CRP payments provided that they give FmHA a second mortgage as adequate protection. The bankruptcy court stayed the *Tuttle* proceedings on the setoff issue pending the result of the *Buckner* appeal.¹⁶²

While the district court appeal was pending, however, Mr. Buckner and the government entered into an agreement regarding a plan of reorganization and a confirmation hearing was scheduled.¹⁶³ Despite this agreement, the government requested a continuance of the confirmation hearing, arguing that the district court should be allowed to resolve the government's setoff rights prior to confirmation. The court rejected the request for a continuance, holding that the government could appeal the confirmation and seek consolidation of the case with the pending district court setoff appeal. The *Buckner*'s plan was confirmed and the government elected not to appeal the confirmation.¹⁶⁴

The district court was never notified of the confirmation of Mr. Buckner's plan. Unaware that the case was proceeding without it, the district court did not issue its decision on the government's right to setoff until almost three years after the confirmation order had become final, near the end of Mr. Buckner's plan period.¹⁶⁵ That decision reversed the bankruptcy court, held that the government

158. *In re Buckner*, 211 B.R. at 46 was reversed on March 8, 1998, by *Buckner v. United States (In re Buckner)*, Nos. 90-42105, 93-40549, Adv. No. 93-7189, 1998 WL 97233 (B.A.P. 10th Cir. 1998).

159. *See Buckner*, 211 B.R. at 50.

160. *See id.*

161. *See id.* at 51.

162. *See Buckner*, 1998 WL 97233, at *2.

163. *Buckner*, 211 B.R. at 50.

164. *See id.* at 50-51.

165. *See In re Buckner*, 165 B.R. 942 (D. Kan. 1994).

was entitled to setoff payments coming due postpetition, and remanded the case for consideration of the government's request for relief from the automatic stay.¹⁶⁶ The debtors appealed to the Tenth Circuit, but the appeal was dismissed as interlocutory because of the remand order.¹⁶⁷ Meanwhile, Mr. Buckner completed making his plan payments. The government brought an action seeking the final CRP payment, due to Mr. Buckner after his plan was completed.¹⁶⁸ The bankruptcy court ruled that the district court opinion was moot as a result of the unappealed confirmation order and because important facts were presented to the bankruptcy court that were not part of the early district court record on appeal.¹⁶⁹ On the issue of setoff, the court again held that only those payments due as of the bankruptcy filing could be setoff; the government had no right to setoff the final CRP payment due to Mr. Buckner.¹⁷⁰

In reaching this decision, the bankruptcy court considered the requirements for setoff under § 553.¹⁷¹ The court described the requirements for setoff as follows.¹⁷² First, "the creditor must have a claim against the debtor" ¹⁷³ Second, the creditor "must owe a debt to the debtor."¹⁷⁴ Third, both the debt and the claim must have existed prepetition.¹⁷⁵ Finally, both the debt and the claim must be valid and enforceable obligations "between the same parties acting in the same capacity."¹⁷⁶ Applying these requirements to the facts of the case, the court held that the government's claim against the debtor existed as a valid prepetition obligation and that the government agencies were acting as "the same parties in the same capacity," and thus were one creditor for purposes of setoff.¹⁷⁷ The remaining determinative issue was "what debts the government owed to the debtors and when it owed it to them."¹⁷⁸ In order to allow setoff, an obligation must have existed prepetition.¹⁷⁹

166. *See id.* at 947.

167. *See Buckner*, 211 B.R. at 49.

168. *See id.* at 51.

169. *See id.* at 55-56.

170. *See id.* at 55.

171. *See id.* at 52.

172. *See id.*

173. *Id.* (citing *Davidovich v. Welton (In re Davidovich)*, 901 F.2d 1533, 1537 (10th Cir. 1990) (explaining the factors to be considered under 11 U.S.C. § 553(a) (1988)).

174. *Id.* (citing *Davidovich v. Welton (In re Davidovich)*, 901 F.2d 1533, 1537 (10th Cir. 1990) (explaining the factors to be considered under 11 U.S.C. § 553(a) (1988)).

175. *See id.* (citing *Davidovich v. Welton (In re Davidovich)*, 901 F.2d 1533, 1537 (10th Cir. 1990) (explaining the factors to be considered under 11 U.S.C. § 553(a) (1988)).

176. *Id.* (citing *Davidovich v. Welton (In re Davidovich)*, 901 F.2d 1533, 1537 (10th Cir. 1990) (explaining the factors to be considered under 11 U.S.C. § 553(a) (1988)).

177. *Id.* (citing *Turner v. United States (In re G. S. Omni Corp.)*, 835 F.2d 1317 (10th Cir. 1987)).

178. *Id.*

179. *See id.*

In order to make this determination, the court meticulously examined the CRP, analyzing the rights and obligations of the parties throughout the term of the CRP contract.¹⁸⁰ Based on their analysis the court concluded that only the payments that were actually due to the debtors for the year before the bankruptcy filing could be considered prepetition obligations.¹⁸¹ The court held that the government could only setoff those prepetition obligations; the payments due to the debtor in the future could not be setoff.¹⁸²

The court based its determination largely on the structure of the CRP.¹⁸³ The court explained that although the Buckner and Tuttle contracts, typical CRP contracts, extended for a ten year period, each year constituted an annual rental period.¹⁸⁴ “For each rental period, the government was not bound to pay unless the debtors fulfilled their obligations under the contracts and Congress, in its discretion, appropriated funds to the CRP.”¹⁸⁵ If the debtors failed to perform their duties under the contract, the government had no obligation to continue making payments, had the right to terminate the contract, and could pursue a refund of all payments previously made.¹⁸⁶ Even if the debtors consistently fulfilled all of their obligations under the contract, the Commodity Credit Corporation (CCC), the corporate agency responsible for making CRP payments, only has funds on an annual basis under the Congressional appropriation process.¹⁸⁷ Applying this analysis to the debtors’ situations, the court noted:

At the time the debtors filed for bankruptcy, the CCC could have had CRP money only to pay the debtors for performing in prior fiscal years and that only to the extent Congress had appropriated the money. Payments for subsequent years were not absolutely owing, due, or payable. Under these circumstances, the Court believes setoff is not available to the government on payments it would not be obliged to give the debtors until after they filed for bankruptcy.¹⁸⁸

Thus, the bankruptcy court held that only payments actually due prepetition could be setoff — subsequently paid program payments were not subject to setoff.¹⁸⁹

Obviously concerned about the precedential value of such a decision, the government again appealed the decision, this time to the bankruptcy appellate

180. *See id.*
181. *See id.*
182. *See id.* at 52, 56.
183. *See id.* at 52.
184. *See id.*
185. *Id.*
186. *Id.*
187. *See id.*
188. *Id.*
189. *See id.* at 55.

panel. The panel reversed, holding that the law of the case doctrine applied and that the bankruptcy court was bound to the district court decision allowing setoff.¹⁹⁰

IV. CHAPTER 12 PLAN CONFIRMATION

Chapter 12 sets forth specific requirements for plan confirmation.¹⁹¹ With regard to secured claim holders, § 1225 provides three alternatives for the debtor.¹⁹² The debtor can obtain the acceptance of the secured claim holder.¹⁹³ If a particular secured claim holder does not accept the plan, the debtor can choose to surrender the collateral to the claim holder.¹⁹⁴ Alternatively, the debtor can pay the secured claim holder an amount not less than the amount of the secured claim while allowing the claim holder to retain the lien securing the claim.¹⁹⁵ This is the alternative that is most commonly used. Because in most cases, the plan will provide for payments to be made over time, this alternative gives rise to disputes concerning the present value of the stream of payments promised by the plan. Central to these disputes is the issue of what interest rate will provide the secured claim holder with the present value of his or her claim. Several recent Chapter 12 cases addressed this interest rate issue.

Another important plan confirmation requirement is that of feasibility. Section 1225 requires that the debtor show that he or she "will be able to make all payments under the plan and to comply with the plan."¹⁹⁶ Several recent agricultural bankruptcy decisions address this requirement and the analysis that the court must undertake in determining whether the test was satisfied.

A. Determining the Market Rate of Interest

Bankruptcy courts are generally consistent in holding that the market rate of interest is the appropriate rate of interest for providing a Chapter 12 creditor with the present value of its claim.¹⁹⁷ The courts, however, have divergent ways of determining the "market rate." The Tenth Circuit has held that market rate should be the "current market rate of interest used for similar loans in the region."¹⁹⁸ This

190. See *Buckner*, 1998 WL 97233, at *3.

191. See 11 U.S.C. § 1225 (1994).

192. See *id.* § 1225(a)(5) (1994).

193. See *id.* § 1225(a)(5)(A) (1994).

194. See *id.* § 1225(a)(5)(C) (1994).

195. See *id.* § 1225(a)(5)(B) (1994).

196. See *id.* § 1225(a)(6) (1994).

197. See *Hardzog v. Federal Land Bank (In re Hardzog)*, 901 F.2d 858, 859-60 (10th Cir. 1990).

198. *Id.* at 860. The court in *Hardzog* reserved the right to take a different approach in "special circumstances" such as "the market rate being higher than the contract rate." *Id.*

has been termed the “coerced loan” approach.¹⁹⁹ In contrast, the Eighth and Ninth Circuits have used a formula approach.²⁰⁰ Under the formula approach, “the court starts with a base rate, either the prime rate or the rate on treasury obligations, and adds a factor based on the risk of default and the nature of the security.”²⁰¹

Three recent bankruptcy decisions address the determination of the market rate of interest. In *Koopmans v. Farm Credit Services of Mid-America*, the Seventh Circuit was asked to review the lower courts use of the formula approach.²⁰² The court referred to this approach as the “prime-plus” test because the test used the prime rate of interest, then added 1.5%.²⁰³ In analyzing the appropriateness of this test, the court stated that “the creditor is entitled to a rate of interest equal to what it could have obtained had it foreclosed and reinvested the proceeds in loans of equivalent duration and risk.”²⁰⁴ Using this as a standard, the court affirmed the bankruptcy court’s reliance on the prime-plus test.²⁰⁵ The court noted, however, that the prime-plus test may not be the only way to arrive at market rate interest.²⁰⁶

The case of *In re Howard* was already addressed with regard to the challenges raised to the eligibility of the debtors.²⁰⁷ The main focus of the decision in *Howard*, however, was an analysis of the debtor’s proposed plan under the confirmation standards of Chapter 12. One objection to this plan concerned the nine percent interest rate applied to an oversecured claim.²⁰⁸ The objecting claim holder argued that it was entitled to receive the contract rate of interest, 14.05%, as opposed to the market rate of interest.²⁰⁹ This creditor alleged that the interest rate of a fully secured creditor could not be “crammed down” to the market rate “because to do so would improperly deprive it of the full benefit of its contractual agreement.”²¹⁰

199. See RANDY ROGERS & LAWRENCE P. KING, COLLIER FARM BANKRUPTCY GUIDE ¶ 4.08[2][c][iii] (1997).

200. See *United States v. Doud*, 869 F.2d 1144, 1145 (8th Cir. 1989); *Farm Credit Bank v. Fowler (In re Fowler)*, 903 F.2d 694, 698 (9th Cir. 1990).

201. *Fowler*, 903 F.2d at 697.

202. See *Koopmans v. Farm Credit Servs. of Mid-America*, 102 F.3d 874 (7th Cir. 1996).

203. See *id.* at 875.

204. *Id.*

205. See *id.*

206. See *id.* Although other tests may be appropriate, the court indicated that the current “market rate” had to be applied consistently. See *id.* The court stated that “[j]ust as the debtor cannot insist on the lower of the contract or current market rates, neither may the creditor obtain the higher of the contract or current market. The market rate must be used consistently.” *Id.*

207. See *In re Howard*, 212 B.R. 864 (Bankr. E.D. Tenn. 1997). See *supra* notes 37-55 and accompanying text.

208. See *id.* at 869.

209. See *id.*

210. *Id.* at 870.

In addressing this objection, the court examined §§ 1225 and 506.²¹¹ Section 1225(a)(5)(B) sets forth the “cramdown” requirements, based on the value of the secured claim, which is determined under § 506(b).²¹² “With respect to oversecured claims, § 506(b) provides that the amount of a secured claim includes ‘interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement under which such claim arose.’”²¹³

The court noted that the majority of other courts have interpreted § 506(b) as allowing an oversecured creditor to receive the contract rate of interest.²¹⁴ This interpretation, however, only applies to the period of time between the bankruptcy filing and the effective date of the plan.²¹⁵ Section 506 provides for the protection of the creditors prior to plan confirmation and provides for the valuation of the secured claim. Section 1225 imports this valuation and provides the requirements for the plan provisions. With regard to interest, § 1225(a)(5)(B) sets the standard that the creditor must receive the present value of its secured claim. This requirement has been interpreted consistently to mean the market rate of interest.²¹⁶

Applying this to the objecting creditor’s arguments, the court held that despite its oversecured status, the creditor was entitled to a market rate of interest on its claim, not the higher contract rate of interest.²¹⁷ Because the creditor conceded that nine percent is the current market rate, the creditor’s objection was overruled.²¹⁸

211. *See id.* at 870-71.

212. *See id.* at 871 (citing 11 U.S.C. §§ 506(b), 1225(a)(5)(B)).

213. *Id.* at 871 (quoting 11 U.S.C. § 506(b)).

214. *See id.* (citing *In re Foertsch*, 167 B.R. 555, 561 (Bankr. D.N.D. 1994) and the authorities cited therein).

215. *See id.* The court further cites the following cases:

Rake v. Wade, 508 U.S. 464, 468, (1993) (“Section 506(b) applies only from the date of filing through the confirmation date.”); *In re DeMaggio*, 175 B.R. 144, 147 (Bankr. D.N.H. 1994) (“It needs to be emphasized that the § 506(b) issue deals only with the question of accrual of postpetition interest from the date of the chapter 13 filing to the effective date of a confirmed plan.”); *In re Wilmsmeyer*, 171 B.R. 61, 63 (Bankr. E.D. Mo. 1994) (contract rate accrues to the effective date, at which time the interest is added to the prepetition claim and the creditor thereafter receives the present value of that amount); *In re Foertsch*, 167 B.R. at 561 (Bankr. D.N.D. 1994) (“In determining the ‘amount’ of postpetition interest under § 506(b) only, this court follows the view of the majority courts which hold that such interest should be computed at the ‘contract rate’ under which the claim arose up to the point where the aggregate claim equals the value of the security. [Citations omitted.] Thereafter, the market rate of interest is generally the benchmark by which postpetition interest becomes payable under a plan of reorganization.”).

Id.

216. *See Howard*, 212 B.R. at 871-72.

217. *See id.* at 872.

218. *See id.*

The North Dakota bankruptcy court also addressed the appropriate rate of interest under a Chapter 12 plan in *In re Honeyman*.²¹⁹ In this case, the debtors proposed to pay their mortgage holder a rate of 10.5% on its secured claim.²²⁰ The creditor objected, arguing for a higher rate.²²¹ The court reviewed the controlling Eighth Circuit opinion in *United States v. Doud*.²²² Although other courts have interpreted this decision as endorsing a formula approach for determining the appropriate interest rate, the court in *Honeyman* selected language supportive of a coerced loan approach.²²³ Based on this language, the court stated that the interest rate provided to a secured creditor must be “the current market rate for similar loans made in the region at the time of confirmation.”²²⁴

The court then turned to evidence presented regarding the market rate of interest available for similar loans and came up with a rate of 12.28%.²²⁵ Because the debtors’ plan did not provide this interest rate, and for other reasons related to confirmation, the court denied confirmation of the debtors’ plan and dismissed the case.²²⁶

B. Feasibility

Both the *Howard* and *Honeyman* cases also addressed another fundamental requirement for Chapter 12 plan confirmation—feasibility.²²⁷ The feasibility requirement is set forth in § 1225(a)(6) and directs the court to consider whether the debtor “will be able to make all payments under the plan and to comply with the plan.”²²⁸ Both the *Howard* and *Honeyman* decisions provide a thoughtful and insightful analysis of this requirement.

219. See *In re Honeyman*, 201 B.R. 533 (Bankr. D.N.D. 1996).

220. See *id.* at 535.

221. See *id.*

222. See *id.* at 535-36 (discussing *United States v. Doud*, 869 F.2d 1144, 1146 (8th Cir. 1989)).

223. See *id.* at 535 (citing *United States v. Doud*, 869 F.2d 1144, 1146 (8th Cir. 1989)). The *Honeyman* court relied upon the following language from the *Doud* case:

The appropriate discount rate must be determined on the basis of the rate of interest which is reasonable in light of the risk involved. Thus, in determining the discount rate, the court must consider the prevailing market rate for a loan of a term equal to the payout, with due consideration for the quality of the security and the risk of subsequent default.

Doud, 869 F.2d at 1146.

224. *Honeyman*, 201 B.R. at 536.

225. See *id.*

226. See *id.* at 539.

227. See *In re Howard*, 212 B.R. 864, 878-82 (Bankr. E.D. Tenn. 1997) (referring to feasibility as an “overriding issue” in the case); *In re Honeyman*, 201 B.R. 533, 539 (Bankr. D.N.D. 1996).

228. 11 U.S.C. § 1225(a)(6) (1994).

According to *Howard*, “[f]easibility is fundamentally a factual question since it necessarily depends upon a determination of the reasonable probability of payment.”²²⁹ It requires the court to “scrutinize a debtor’s proposed plan payments in light of projected income and expenses in order to determine whether it is likely the debtor will be able to make the payments required by the plan.”²³⁰ Building on the same theme, the court in *Honeyman* added that “[w]hile a plan need not promise a guarantee of success, there must be a probability of success. The court must be persuaded that it is probable that a plan will be able to cash flow based upon realistic and objective facts (as opposed to visionary or overly optimistic projections).”²³¹ *Howard* confirmed this approach, adding that though courts may “give debtors the benefit of the doubt” feasibility “must be based on objective facts rather than wishful thinking.”²³²

In both *Howard* and *Honeyman*, the court compared the debtors’ projected farm income with the projected farm and living expenses to see if the proposed plan payments would “cash flow.”²³³ Neither court, however, accepted the projections submitted by the debtors without question. In *Howard*, the court evaluated the debtors’ projected income compared to historical financial data and discovered that the debtors were projecting annual net income greater than their annual gross income had been in any of the last eight years.²³⁴ In *Honeyman*, the court questioned both the prices and bushels projected for the sale of the debtors’ crops and questioned the wisdom of the means by which the debtors planned to cut expenses, referring to some as “impractical or contrary to good practice.”²³⁵ Therefore, in both cases, when the court actually made its determination of whether the debtors’ plan was feasible, it relied in large part on evidence presented in addition to the cash flow statements and projections created by the debtors. In *Howard*, the court found the debtors’ plan to be feasible;²³⁶ in *Honeyman*, the court did not.²³⁷ Each determination turned on the facts of the case.

C. Other Confirmation Issues

A number of other significant issues were raised with regard to Chapter 12 confirmation in recent cases. The issue of the reorganization of a livestock

229. *In re Howard*, 212 B.R. 864, 878 (Bankr. E.D. Tenn. 1997) (citing *In re Foertsch*, 167 B.R. 555, 566 (Bankr. D.N.D. 1994)).

230. *Id.* at 879 (citations omitted).

231. *Honeyman*, 201 B.R. at 537 (citations omitted).

232. *Howard*, 212 B.R. at 879.

233. *See id.* at 879-80; *Honeyman*, 201 B.R. at 537.

234. *See Howard*, 212 B.R. at 880.

235. *Honeyman*, 201 B.R. at 537.

236. *See Howard*, 212 B.R. at 881.

237. *See Honeyman*, 201 B.R. at 539.

operation arose in the *Howard* case.²³⁸ As this case discusses, the lien retention requirement under § 1225(a)(5)(B)(i) presents a “difficult problem” for debtors restructuring a livestock loan.²³⁹ “If taken literally, [this] lien retention language . . . would preclude a debtor from selling livestock, using the proceeds in his farming operations, and providing the creditor with substitute collateral.”²⁴⁰ However, the court in *Howard* observed that courts have interpreted the lien retention requirement as applying to the herd as a whole as opposed to particular animals that comprise the herd, thereby making reorganization possible.²⁴¹ In addition to retaining a lien in the herd, certain safeguards must be included in the plan in order to adequately protect a secured creditor’s interests. Such provisions were absent from the debtors’ plan in *Howard*, so the court held that the livestock creditor’s interest was not adequately protected.²⁴² The court listed three guidelines to be followed in revising the plan to meet this requirement.²⁴³ First, the minimum level and value at which the herd will be maintained should be in the plan.²⁴⁴ Second, the plan should require that the creditor receive frequent and detailed inventory and valuation reports and be allowed to inspect the herd.²⁴⁵ Third, the plan should specify the terms under which the cattle can be sold.²⁴⁶

Another issue addressed by the court in *Howard* was the negative amortization of a secured debt.²⁴⁷ The court held that although there was not a *per se* rule against this, it was generally not permissible.²⁴⁸ The court applied a list of ten relevant factors to consider in evaluating a negative amortization plan, each addressing an aspect of the protections afforded to the creditor in exchange for the risk of loss inherent with negative amortization.²⁴⁹ Applying these factors to the plan proposed in *Howard*, the court found the proposed payment schedule unacceptable.²⁵⁰

238. See *Howard*, 212 B.R. at 875.

239. See *id.*

240. *Id.* (referencing 11 U.S.C. § 1225(a)(5)(B)(i)).

241. See *id.* (citing *Abbott Bank-Thedford v. Hanna (In re Hanna)*, 912 F.2d 945, 949 (8th Cir. 1990)).

242. See *id.* at 876.

243. See *id.*

244. See *id.*

245. See *id.*

246. See *id.*

247. See *id.*

248. See *id.* at 877.

249. See *id.* at 878. (adopting the list of factors set forth in the Chapter 11 bankruptcy case of *Great Western Bank v. Sierra Woods Group*, 953 F.2d 1174, 1177 (9th Cir. 1992)).

250. See *id.* The court specified the changes that the debtors needed to make to the plan to address this as well as the objections that were sustained and provided the debtors with fourteen days within which to file an amended plan. See *id.* at 882-83.

Addressing the issue of valuation of a creditor's secured claim, the Texas bankruptcy court in *In re Pitcock*²⁵¹ considered the reach of a security interest in crops.²⁵² In this case, a creditor asked the court to find that its crop security interest covered rental payments received when the debtor pastured cattle on the crop "on the gain" rather than harvesting it.²⁵³ The debtor received the payments, deposited them in his bank account and subsequently used the funds to pay bills and living expenses prior to filing for relief under Chapter 12. At the time that the payments were received, the debtor was not in default with the secured creditor.²⁵⁴ The court declined to rule on the issue of whether the security interest attached to the rent, holding that even if it did, the funds were not in the possession of the debtor at the time of filing, so under § 506,²⁵⁵ the secured portion of the bank's claim would be zero.²⁵⁶

Also addressing the secured claim valuation issue, the court in *Honeyman* considered Agri-bank stock belonging to the debtor.²⁵⁷ This stock is a nonvoting, nontransferrable stock that was required to be purchased as a condition of the loan.²⁵⁸ According to the loan terms, the last loan payment was to be reduced by the amount of the stock held.²⁵⁹ The court held that the value of this stock must be reflected in the value of Agri-bank's secured claim.²⁶⁰

V. THE COMPENSATION OF THE CHAPTER 12 TRUSTEE

Another important issue that arises when the debtor seeks confirmation of his or her Chapter 12 plan is the compensation of the trustee. The source and the amount of compensation to be paid to a standing Chapter 12 trustee is set forth in 28 U.S.C. § 586(e).²⁶¹ This section entitles the Chapter 12 trustee to receive a percentage of the payments that the debtor makes under his or her plan, up to a maximum amount capped by the highest annual rate for a level V Executive Schedule employee.²⁶² The percentage fee to be assessed against the debtor is as follows:

251. *In re Pitcock*, 208 B.R. 862 (Bankr. N.D. Tex. 1997).

252. *See id.* at 862-63.

253. *See id.* at 864.

254. *See id.*

255. *See* 11 U.S.C. § 506 (1994).

256. *See Pitcock*, 208 B.R. at 866.

257. *See In re Honeyman*, 201 B.R. 533, 536 (Bankr. D.N.D. 1996).

258. *See id.*

259. *See id.*

260. *See id.* (citing *In re Davenport*, 158 B.R. 830 (Bankr. E.D. Cal. 1992)).

261. *See* 28 U.S.C. § 586(e)(1)(A)-(B) (1994). For a discussion of trustee compensation, see Janet A. Flaccus, *Bankruptcy Trustees' Compensation: An Issue of Court Control*, 9 BANKR. DEV. J. 39 (1992).

262. *See* 28 U.S.C. § 586(e)(1)(A) (1994).

(I) not to exceed ten percent of the payments made under the plan of such debtor, with respect to payments in an aggregate amount not to exceed \$450,000; and

(II) three percent of payments made under the plan of such debtor, with respect to payments made after the aggregate amount of payments made under the plan exceeds \$450,000; based on such maximum annual compensation and the actual, necessary expenses incurred by such individual as standing trustee.²⁶³

This statute authorizes the trustee to “collect such percentage fee from all payments received by such individual under plans in the cases under chapter 12 or 13 of title 11 for which such individual serves as standing trustee.”²⁶⁴

Over the years, a number of debtors have challenged the amount of compensation due the trustee.²⁶⁵ Though direct challenges to the trustee compensation system have been uniformly unsuccessful, two interpretive issues have brought mixed results. The first issue is whether the debtor can elect to make direct payments to his or her creditors and avoid the assessment of the trustee fee on these payments. This is referred to as the direct payment issue. The second issue is whether the trustee can charge a percentage commission on his or her own fees, in addition to the commission assessed against the payments to creditors. This issue is referred to as the “fee on a fee” issue. Both of these trustee compensation issues were addressed in recent bankruptcy decisions.

A. Direct Payments by the Debtor

As noted above, § 586(e)(2) authorizes the trustee to collect his or her “percentage fee from all payments received by [the trustee].”²⁶⁶ Some debtors have argued that if they make a payment directly to the creditor, and the trustee does not “receive” the payment, the trustee’s percentage fee should not be assessed on the payment. This issue, referred to as the direct payment issue, has produced numerous reported decisions and conflicting authority. One line of cases, led by the Ninth Circuit opinion in *In re Fulkrod*,²⁶⁷ has held that debtors do not have the authority to make direct payments—all payments must be made by the trustee.²⁶⁸

263. 28 U.S.C. § 586(e)(1)(B) (1994).

264. 28 U.S.C. § 586(e)(2) (1994).

265. See generally Susan A. Schneider, *Recent Developments in Agricultural Bankruptcy: Judicial Conflict and Legislative Indifference*, 25 U. MEM. L. REV. 1233, 1237-38 (1995) (discussing some of the cases challenging trustee compensation).

266. 28 U.S.C. § 586(e)(2) (1994) (emphasis added).

267. *In re Fulkrod*, 973 F.2d 801 (9th Cir. 1992).

268. See *id.* at 803. The conflicting lines of authority on this issue are discussed in Schneider, *supra* note 256, at 1239-49.

The Sixth Circuit in *In re Beard*²⁶⁹ and the Eighth Circuit in *In re Wagner*²⁷⁰ issued opinions in direct conflict with the *Fulkrod* interpretation. Both of these courts have issued decisions that hold that direct payments can be made by the debtor and that the trustee is not entitled to a fee on these direct payments.²⁷¹ These cases have also held, however, that the court has the authority to limit which payments can be made directly.²⁷²

The New York bankruptcy court in *In re McCann*²⁷³ recently addressed the direct payment issue.²⁷⁴ The debtors proposed direct payments to avoid the trustee's surcharge, relying on the statutory language that bases the fee assessment on payments "received by" the trustee. The court acknowledged the split of authority on the direct fee issue.²⁷⁵ Reviewing the express language of the provisions under Chapter 12, the court rejected the *Fulkrod* line of cases that held that Chapter 12 prohibits debtors from making direct payments.²⁷⁶ Agreeing with the decisions in *Beard* and *Wagner*, the *McCann* court held that Chapter 12 clearly authorizes a debtor to pay creditors directly.²⁷⁷ The court expressed concern, however, with trustee compensation and with judicial opinions that tend to minimize the duties of the Chapter 12 trustee.²⁷⁸ Nevertheless, the court held that direct payments, made without the trustee assessment, are permissible in some circumstances.²⁷⁹ In determining what payments might be made directly, the court rejected a multi-factor test in favor of a case by case analysis according to the discretion allowed the court under § 105.²⁸⁰ In the present case, the court was unable to find "sufficient cause to deviate from the general rule that the trustee should disburse on the impaired claims."²⁸¹ The only direct payment that the court allowed was on the car loan.²⁸²

269. *In re Beard*, 45 F.3d 113 (6th Cir. 1995).

270. *In re Wagner*, 36 F.3d 723 (8th Cir. 1994).

271. *See id.* at 727; *In re Beard*, 45 F.3d at 119.

272. *See In re Wagner*, 36 F.3d at 727; *In re Beard*, 45 F.3d at 119.

273. *McCann v. Keller (In re McCann)*, 202 B.R. 824 (Bankr. N.D.N.Y. 1996).

274. *See id.* at 826.

275. *See id.* at 827. For a discussion of the case law on this issue prior to *McCann*, see *Schneider*, *supra* note 265, at 1239-45.

276. *See McCann*, 202 B.R. at 827.

277. *See id.* (rejecting *In re Fulkrod*, 973 F.2d 801 (9th Cir. 1992)).

278. *See id.* at 828 (criticizing *In re Beard*, 45 F.3d 113 (6th Cir. 1995) for its "myopic view of reducing the professional life of a standing trustee to scrivener status")

279. *See id.* at 829.

280. *See id.* at 829-30.

281. *Id.* at 830.

282. *See id.*

B. Fee on a Fee

A second trustee compensation issue has resulted in a split in authority among the circuit courts. The “fee on a fee” issue concerns whether the trustee’s fee should attach only to the payments that are made to creditors of the debtor or whether it should also be assessed on the fee to the trustee.²⁸³ The Tenth Circuit was the first circuit court to address this issue. In *Foulston v. BDT Farms*,²⁸⁴ the court held that § 586(e)(1)(A), the statute governing trustee fees, was ambiguous, and therefore it was appropriate for the court to defer to the interpretation by the administering agency.²⁸⁵ The agency to which the court deferred was the very self-interested Executive Office of the United States Trustee (UST). Bankruptcy and district court cases that have considered this argument have reached conflicting results.²⁸⁶

The Eighth Circuit addressed compensation due Chapter 12 trustees under § 586(e)(1)(A) in the case of *Pelofsky v. Wallace*.²⁸⁷ In *Pelofsky*, as in *BDT Farms*, the UST took the position that trustees were entitled not only to ten percent of the payments made to creditors, but also to ten percent of their own fee; that is ten percent of all payments made to them, including the percentage payment made for the trustee’s fee.²⁸⁸ However, the Eighth Circuit rejected the UST argument and the *BDT Farms* holding.²⁸⁹ Though the court in *Pelofsky* agreed that the statute was ambiguous, it found the UST position “unreasonable” and thus not entitled to deference.²⁹⁰ The Eighth Circuit affirmed the lower court holdings that restricted the trustee to a fee capped at ten percent of the plan payments. The court relied on its decision in a previous Chapter 12 case, in which it held that “[t]rustee’s fees are not ‘debts provided for by the plan,’ but are fees levied for services provided in administering the plan.”²⁹¹ This finding supported the argument that the trustee’s fees were not payments “under the plan” for purposes of computing the ten percent fee under § 586.²⁹² For these reasons, the court held that the trustee’s fee should be assessed solely against payments made under the plan and not assessed against his or her own fees.²⁹³

283. See *Schneider*, *supra* note 265, at 1245-1249.

284. *Foulston v. BDT Farms, Inc.*, 21 F.3d 1019 (10th Cir. 1994).

285. See *id.* at 1023 (citing *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 844 (1984)).

286. See, e.g., *In re Edge*, 122 B.R. 219, 221 (D. Vt. 1990); *In re Weaver*, 118 B.R. 730 (Bankr. D. Neb. 1990).

287. *Pelofsky v. Wallace*, 102 F.3d 350 (8th Cir. 1996).

288. See *id.* at 351.

289. See *id.* at 355-56.

290. See *id.* at 355.

291. *Id.* at 356 (quoting *In re Wagner*, 36 F.3d 723, 726 (8th Cir. 1994)).

292. See *id.* at 352.

293. See *id.* at 356.

VI. DISCHARGE AND POST-DISCHARGE ISSUES

Section 1228 sets forth the discharge procedure for Chapter 12 bankruptcy.²⁹⁴ In the typical Chapter 12 case, at the end of the Chapter 12 plan term, a discharge hearing will be held. If the debtor has completed all of the payments under the terms of the plan, he or she will request and will generally receive an order from the court granting a discharge of debts. If, however, the court finds that the debtor has not made "all payments under the plan," the debtor's discharge can be withheld pending compliance.²⁹⁵ Moreover, material default under a confirmed plan is grounds for dismissal of the bankruptcy.²⁹⁶ The disposable income requirement under § 1225 of Chapter 12 is the issue that has most frequently arisen as an objection to discharge.²⁹⁷ This issue was addressed by the Eighth Circuit in the recent bankruptcy case of *Hammrich v. Lovald (In re Hammrich)*.²⁹⁸

Frequently, disagreements between the debtor and creditor arise at the discharge hearing, in which each has a different opinion as to the meaning and effect of the confirmed plan. This gives rise to the second important discharge issue—the effect of the plan. Two recent Eighth Circuit decisions discuss the effect of Chapter 12 plan confirmation. First, in the case of *Harmon v. United States*,²⁹⁹ the court addressed the issue of "lien-stripping," that is, whether a confirmed Chapter 12 plan "strips down" a creditor's lien to the value of the secured claim.³⁰⁰ Second, in the case of *First National Bank v. Allen*,³⁰¹ the court ruled on a motion to modify the Chapter 12 plan to provide additional money to an unsecured creditor.³⁰² The *Allen* decision discusses the effect of a creditor's waiver of rights as part of the confirmation process.³⁰³

A. Disposable Income

Chapter 12 plan confirmation requirements include what is termed the "disposable income requirement." This requirement is as follows:

294. See 11 U.S.C. § 1228.

295. *Id.*

296. See 11 U.S.C. § 1208(c)(6).

297. See 11 U.S.C. § 1225(b)(1)(B).

298. *Hammrich v. Lovald (In re Hammrich)*, 98 F.3d 388 (8th Cir. 1996).

299. *Harmon v. United States*, 101 F.3d 574 (8th Cir. 1996).

300. See *id.* at 581-82.

301. *First Nat'l Bank v. Allen*, 118 F.3d 1289 (8th Cir. 1997).

302. See *id.*

303. See *id.* at 1290-95.

If the trustee or the holder of an unsecured claim objects to the confirmation of the plan, then the court may not approve the plan unless . . . the plan provides that all of the debtor's projected disposable income to be received in the three year period . . . will be applied to make payments under the plan.³⁰⁴

Despite the phrase "projected disposable income" and Chapter 13 case law that interprets identical language literally, Chapter 12 decisions concur that this requirement necessitates a review of the debtor's "actual" disposable income.³⁰⁵ This interpretation compels the court to examine the debtor's compliance with the disposable income requirement as part of the debtor's discharge hearing. Only if all payments of disposable income have been made can the debtor receive a discharge.

The determination of what constitutes disposable income was at issue in *Hammrich v. Lovald*.³⁰⁶ At the conclusion of the plan period in this Chapter 12 case, the debtors filed their final report and requested discharge.³⁰⁷ The trustee and an under-secured creditor objected to discharge and asked the court to determine the amount of the debtors' disposable income during the plan term.³⁰⁸ The bankruptcy court found that as of the final report, the debtors' inventories totaled \$281,601.³⁰⁹ From this amount, the court subtracted their obligations, which the court found totaled \$16,980.³¹⁰ The court then further subtracted \$168,735.14, an amount computed to be that required to continue the farming operation.³¹¹ The remaining amount, \$95,885.86, was held to be disposable income to be paid to the unsecured creditors.³¹²

On appeal, the Eighth Circuit court described the determination of disposable income as "a fact-intensive inquiry into whether [the] debtor has income which is in excess of that *reasonably* required for maintenance and continuation of [its] farming operation from one year to the next."³¹³ As the court held in a previous Chapter 12 case, disposable income is "[t]he amount by which the debtors' income exceeds their obligations at the end of their plan, after accounting

304. 11 U.S.C. § 1225(b).

305. *See, e.g.*, *Rowley v. Yarnall*, 22 F.3d 190 (8th Cir. 1994). *See generally* *Schneider*, *supra* note 265, at 1249-60 (discussing the projected versus actual disposable income dispute).

306. *Hammrich v. Lovald (In re Hammrich)*, 98 F.3d 388 (8th Cir. 1996).

307. *See id.* at 389.

308. *See id.*

309. *See id.* at 390.

310. *See id.*

311. *See id.*

312. *See id.*

313. *Id.* (quoting *Broken Bow Ranch, Inc. v. Farmers Home Admin.*, 33 F.3d 1005, 1009 (8th Cir. 1994)).

for carryover funds sufficient to continue their farming operation.”³¹⁴ On this basis, the court affirmed the bankruptcy court findings as follows: (1) the market value of 326 calves on hand as of the conclusion of the plan was considered part of the disposable income calculation as a marketable commodity, even though they had not yet reached sale weight;³¹⁵ (2) government farm program payments attributable to the farming operation during the plan term, but received after the conclusion of the plan, were included in the disposable income calculation;³¹⁶ (3) repayment of a loan and a real estate tax payment made during the plan term should not be included in the expense calculation, as only those obligations that exist at the end of the plan term are to be included;³¹⁷ and (4) sufficient funds were included in the calculation for the debtors to continue their farming operation.³¹⁸ Thus, the bankruptcy court order was affirmed, and the debtors were ordered to pay \$95,885.86 in order to obtain their discharge.³¹⁹

B. *Effect of Plan*

In the case of *Harmon v. United States*,³²⁰ the Eighth Circuit was asked to rule on the issue of “lien-stripping” in a Chapter 12 bankruptcy.³²¹ The issue arose when a discharged debtor brought an action seeking to quiet title to proceeds from the sale of farm property. The debtors in this case had completed all of their plan payments, paid out an additional \$75,000 of disposable income in order to resolve an objection to discharge, and had received a discharge.³²² Upon the subsequent death of the debtor-husband, the wife sold the farm property and paid off the amount remaining due on the secured obligation.³²³ The secured creditor, Farm Service Agency (FSA), however, claimed that it was entitled to the profits of the sale and sought to apply them to the unpaid balance of the loan.³²⁴ FSA argued that a Chapter 12 debtor cannot strip down a secured creditor’s lien and that the FSA mortgage remained on the property securing the full amount of the original loan.³²⁵ The district court held that FSA’s lien on the property was extinguished by the

314. *Id.*

315. *See id.*

316. *See id.*

317. *See id.* at 391.

318. *See id.*

319. *See id.*

320. *Harmon v. United States*, 101 F.3d 574 (8th Cir. 1996).

321. *See id.* at 577.

322. *See id.* at 578.

323. *See id.*

324. *See id.*

325. *See id.*

payment of the full amount of the secured claim and the required disposable income payments on the unsecured claim.³²⁶ The FSA appealed to the Eighth Circuit.

Although many farmers and attorneys previously assumed that lien-stripping was available in Chapter 12, after the Supreme Court decision in another case, *Dewsnup v. Timm*,³²⁷ the ability of debtors to do so was somewhat in question.³²⁸ *Dewsnup* held that lien-stripping was not available to Chapter 7 debtors.³²⁹ The court in *Harmon* was the first appellate court to address this issue in a Chapter 12 bankruptcy.

The *Harmon* court found that *Dewsnup* did not hold that § 506(d) prohibits lien-stripping in Chapter 7; it held only that § 506(d) does not by itself provide the authority for a debtor to strip down liens.³³⁰ In Chapter 12, the court found that there were other provisions that provided debtors with the authority to strip down a creditor's lien to the value of the collateral.³³¹ Specifically, the court noted that § 1222(b)(2) permits a debtor's plan to "modify the rights of holders of secured claims."³³² Similarly, § 1227(c) vests property in the debtor "free and clear of any claim or interest of any creditor provided for by the plan."³³³ Based primarily on these provisions, and on the intent behind Chapter 12 bankruptcy, the court held that lien-stripping is a tool available to farmers under Chapter 12.³³⁴ The court affirmed the district court order granting judgment for the debtor and holding that the FSA lien was extinguished.³³⁵

Just as FSA in *Harmon* sought to improve its position based on changed circumstances and money available that was not anticipated at confirmation, in another recent Eighth Circuit case, *First National Bank v. Allen*,³³⁶ the creditor attempted to get more than what was provided for in the Chapter 12 plan.³³⁷ Under the facts in *Allen*, one of the creditors negotiated with the debtor to receive a higher value on its secured claim in exchange for not being included in the class of unsecured claim holders.³³⁸ During the plan term, the debtor inherited a large amount of farm land and, consequently, a substantial amount of disposable income

326. See *Harmon v. United States (In re Harmon)*, 184 B.R. 352, 354-55 (Bankr. D.S.D. 1995).

327. *Dewsnup v. Timm*, 502 U.S. 410 (1992).

328. See *id.* at 410-11.

329. See *id.* at 417.

330. See *Harmon*, 101 F.3d at 581.

331. See *id.* at 584.

332. *Id.* (citing 11 U.S.C. § 1222(b)(2)).

333. *Id.* (citing 11 U.S.C. § 1227(c)).

334. See *id.*

335. See *id.* at 587.

336. *First Nat'l Bank v. Allen*, 118 F.3d 1289 (8th Cir. 1997).

337. See *id.* at 1290-92.

338. See *id.* at 1292.

was available for distribution to unsecured creditors.³³⁹ The creditor sought payment from this disposable income, but the bankruptcy and district courts held that the creditor had waived its right to an unsecured claim through the negotiations prior to confirmation.³⁴⁰ The Eighth Circuit affirmed, holding that the creditors “effectively gave away their speculative, unlikely chance for collecting on their large, unsecured claim in exchange for” more favorable treatment of their secured claim.³⁴¹

VII. CONCLUSION

Although not as many Chapter 12 bankruptcy decisions have been published as in previous times of widespread financial distress in the agricultural community, the decisions that have been published continue to address challenging issues. These decisions form the basis for the success or failure of future Chapter 12 bankruptcies.

339. *See id.*

340. *See id.* at 1293.

341. *Id.* at 1295.