CURRENT DEVELOPMENTS IN AGRICULTURAL BANKRUPTCIES AND INSOLVENCIES

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I. INTRODUCTION

The farm crisis of the mid 1980s led to a large number of agricultural bankruptcy and reorganization cases. Those cases raised many issues that were contentious and not easy to resolve because of the severity of the financial problems encountered by so many farmers. For a period, agricultural bankruptcy cases led the development of bankruptcy law. Agricultural cases concerning government setoff, use of the proceeds of collateral, and chapter 11 plan confirmation had ramifications

that extended well beyond agricultural cases.[1] The problems posed by agricultural cases led to amendments in the Bankruptcy Code, including the creation of a new reorganization chapter available only to family farmers.[2]

The farm crisis has long since passed and the difficult issues raised during the crisis have generally been resolved. The dubious honor of being the industry that drives the development of bankruptcy law was passed on to the real estate industry, which in turn seems to have passed it on to healthcare and telecommunications. There are, however, still a fair number of agricultural bankruptcies, and they still raise some interesting issues, but the issues are narrower and more easily resolved.[3]

This article contains summaries of agricultural bankruptcy and insolvency cases from the last few years.[4] The cases are arranged by subject matter and most case discussions are broken down into specific subsections highlighting the significance of the cases discussed.

II. GENERAL AGRICULTURAL BANKRUPTCY ISSUES

A. *Property of the Estate*

Under section 541 of the Bankruptcy Code, the estate created by the debtor upon filing a bankruptcy petition includes, subject to certain exceptions, all legal and equitable interests of the debtor.[5] In agricultural bankruptcy cases, this includes the tangible property such as: farmland, farm equipment, growing crops, and farm supplies. It also includes the intangible property such as: crop receivables, income tax refunds, government farm program benefits, insurance polices, and causes of action.

1. *Property Levied Upon Pre-Petition Remains Property of the Estate*.

Prior to bankruptcy, the debtor in *In re Becker*[6] purchased registered horses but failed to pay for them.[7] The sellers obtained judgment against the debtor and the

1. *See, e.g*., Norwest Bank v. Ahlers, 485 U.S. 197 (1988) (considered the most celebrated agricultural case).
2. *See* 11 U.S.C. §§ 507(a)(5)(A), 546(d), 557 (1994)(the 1984 amendments to the Bankruptcy Code added several provisions dealing with the insolvency of grain storage facilities); Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, 100 Stat. 3088 (codified as amended at 11 U.S.C. § 1200 et seq.) (reorganization of Chapter 12, available only to family farmers).
3. *See* discussion *supra* Part II-V.
4. *See* discussion *supra* Part II-V.
5. *See* 11 U.S.C. §541(a)(1) (1994).
6. *In re* Becker, 217 B.R. 231 (Bankr. M.D. Tenn. 1998).
7. *See id.* at 233.

horses were seized by the sheriff prior to bankruptcy.[8] The court held that despite the seizure, the horses remained the property of the estate.[9]

2. *Assets Subject to Perishable Agricultural Commodities Act (PACA) are Not Property of the Estate.*[10]

If a debtor is a fiduciary under PACA, only those assets not part of the PACA trust are considered property of the debtor's bankruptcy estate.[11]

3. *Surety Bonds are Not Property of the Estate*

Prior to filing bankruptcy, the debtor in *In re Hallmark Builders, Inc.* [12] posted a surety bond to meet state licensing requirements.[13] The bond was not property of the bankruptcy estate and the Florida Department of Agriculture was permitted to take action against the bond.[14]

B. *Automatic Stay*

Under section 362 of the Bankruptcy Code, an injunction arises automatically upon the filing of any bankruptcy case that prevents creditors from enforcing debts against the debtor or its property or continuing litigation against the debtor.[15] This injunction is called the automatic stay. The purpose of the automatic stay is to freeze on the date of the bankruptcy filing the substantive rights of all parties to a bankruptcy case.

The failure to turn over property of the estate is not always a violation of the automatic stay.[16] A creditor in *In re Kolberg*[17] failed to turn over soybeans subject to its security interest immediately upon the filing of the petition.[18] The debtor alleged that the secured creditor willfully violated the automatic stay and sought damages against the creditor.[19] The court held that mere knowledge of the case did not ipso facto render a creditor's retention of collateral a willful violation of the stay

8. *See id.*
9. *See id.* at 235.
10. *See* Tom Lange Co. v. Kornblum & Co. (*In re* Kornblum & Co.), 81 F.3d 280, 286 (2d Cir. 1996).
11. *See id.*
12. *In re* Hallmark Builders, Inc., 205 B.R. 974 (Bankr. M.D. Fla. 1996).
13. *See id.* at 976.
14. *See id.* at 976-77.
15. *See* 11 U.S.C. § 362(a) (1994).
16. *See id.* at 934.
17. Kolberg v. Agricredit Acceptance Corp. (*In re* Kolberg), 199 B.R. 929 (Bankr. W.D. Mich. 1996).
18. *See id.* at 931.
19. *See id.*

especially, as in this case, where there was reason for the creditor to be concerned about the safety of its collateral.[20] In another case, the levy on property owned by the chapter 12 debtor's wholly owned corporation did not violate the automatic stay, even though the debtor was co-obligor on the debt.[21]

C. *Executory Contracts*

Under section 365 of the Bankruptcy Code, most unperformed contracts to which the debtor is a party at the time of the bankruptcy filing must be accepted or rejected during the bankruptcy case.[22] The term "executory contract" is not defined in the Bankruptcy Code, however, so there are often disagreements about what makes a contract "executory." For example, in the cases below, a contract for sale of horses and a shared appreciation mortgage were held not to be executory contracts.[23]

1. *Contract for Sale of Horses is Not an Executory Contract*

In *In re Becker*,[24] the debtor purchased horses from a seller and agreed to make installment payments.[25] The seller retained the registration papers for the horses and agreed to turn them over to the debtor when the installment payments were completed.[26] The debtor failed to make any installment payments and filed a bankruptcy petition under chapter 12.[27] The court held that the contract was not executory, despite the remaining obligation of the seller to deliver the registration papers.[28]

2. *Shared Appreciation Mortgage Agreement is Not an Executory Contract*

In *In re Tunnissen*,[29] the debtors signed a shared appreciation agreement with the Farm Service Agency.[30] At the time that the contract was entered into, the Farm Service Agency provided the debtors with a write-down of the debt.[31] There were no

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20. *See id.* at 934.
21. *See In re* Johnson, 209 B.R. 499, 500-01 (Bankr. D. Neb. 1997).
22. *See* 11 U.S.C. § 365(a) (1994).
23. *See In re* Becker, 217 B.R. 231, 234 (Bankr. M.D. Tenn. 1998); Sentinel Fed. Credit Union v. United States (*In re* Tunnissen), 216 B.R. 834, 844 (Bankr. D.S.D. 1996); discussion *infra* Parts II.C.1-2.
24. *See In re* Becker, 217 B.R. at 234.
25. *See id.* at 233.
26. *See id.*
27. *See id.*
28. *See id.* at 234.
29. Sentinel Fed. Credit Union v. United States (*In re* Tunnissen), 216 B.R. 834 (Bankr. D.S.D. 1996).
30. *See id.* at 835-36.
31. *See id.* at 837.

ongoing duties for the Farm Service Agency to perform under the contract, so it was not executory.[32]

D. *Claims*

The Bankruptcy Code defines a "claim" as a right to payment or a right to an equitable remedy for breach of performance if such breach gives rise to a right of payment.[33] The Bankruptcy Code directs how certain claims are treated in a bankruptcy case. In many bankruptcy cases, creditors spend a lot of energy trying to "climb up" the priority ladder so that they may realize a higher rate of recovery of their claim.

1. *Farm Supplier Is Entitled to Administrative Priority Even Though Debtor was Liquidating Business*

In *In re Molnar Bros.*,[34] a supplier sold seed and fertilizer on credit to a debtor that was liquidating its farming business pursuant to a chapter 12 plan.[35] The chapter 12 trustee contested the creditor's assertion of an administrative priority expense claim on the grounds that because the debtor was liquidating, the extension of credit did not provide any benefit to the estate.[36] The court disagreed and held that the debtor received value.[37]

2. *Interest Allowed on Secured Claim Despite Contrary State Statute*

In *In re Schriock Construction*,[38] an over-secured creditor was held to be entitled to interest as part of its secured claim despite a North Dakota statute that rendered attorney's fees clauses void as a matter of public policy.[39]

E. *Setoff Rights*

Section 553 of the Bankruptcy Code provides that the right of a creditor to offset two mutual debts is unaffected by a bankruptcy filing, with a few exceptions.[40] In agricultural bankruptcy cases, setoff issues often arise concerning debts owed to federal governmental agencies.

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32. *See id.*
33. *See* 11 U.S.C. § 101(5) (1994).
34. *In re* Molnar Bros., 200 B.R. 555 (Bankr. D.N.J. 1996).
35. *See id.* at 557.
36. *See id.* at 559.
37. *See id.* at 560.
38. First Western Bank & Trust v. Drewes (*In re* Schriock Constr., Inc.), 104 F.3d 200 (8th Cir. 1997).
39. *See id.* at 203.
40. *See* 11 U.S.C. § 553(a) (1994).

1. *Units of the United States Government are a Single Entity for Purposes of Exercising Setoff Rights*

The debtors in *In re Turner*[41] were in default on loans to the Small Business Administration (SBA).[42] The debtors later entered into price support contracts with the Agricultural Stabilization and Conservation Service (ASCS).[43] After the debtors received some payments under the ASCS contract, they were notified that the SBA would request administrative setoff of further payments under the ASCS contract against the delinquent SBA loan.[44] Administrative setoff was approved at an SBA hearing and a portion of the debtors' ASCS payments were paid by ASCS to the SBA.[45] Within ninety days after the setoff occurred, the debtors filed for relief under chapter 12.[46]

The debtors sought to avoid the full amount of the payments received by ASCS as a preference under Bankruptcy Code section 547.[47] SBA argued that it did not receive a preference because it did not obtain a greater recovery than it would have obtained in a chapter 7 case if the payment had not been made.[48] SBA argued that if the payment had not been made, it would have retained a right of setoff under Bankruptcy Code section 553.[49] Accordingly, it would have been able to exercise the right of setoff in chapter 7 and receive the same payment that it had received prior to the chapter 12 case.[50]

The debtors asserted that SBA was not entitled to setoff rights under Bankruptcy Code section 553 because there was no mutual obligation owed between the debtors and SBA.[51] The debtors contended that SBA and ASCS, even though they were both agencies of the United States government, should be treated as different entities for purposes of setoff.[52] The bankruptcy court agreed and granted summary judgment to the debtors.[53] The decision was affirmed by the district court.[54]

A panel of the Tenth Circuit Court of Appeals affirmed the decision granting summary judgment.[55] The panel agreed that the SBA and ASCS ought to be

41. Turner v. SBA (*In re* Turner), 84 F.3d 1294 (10th Cir. 1996).
42. Turner v. SBA (*In re* Turner), 59 F.3d 1041, 1043 (10th Cir. 1995) *vacated en banc*, 84 F.3d 1294 (10th Cir. 1996).
43. *See id.*
44. *See id.*
45. *See id.*
46. *See id.*
47. *See id.*
48. *See id.* at 1044.
49. *See id.*
50. *See id.*
51. *See id.*
52. *See id.*
53. *See id.* at 1043.
54. *See id.*
55. *See id.*

considered separate entities for purposes of the exercise of setoff rights.[56] That decision was published as *Turner v. Small Business Administration* (*In re Turner*), 59 F.3d 1041 (10th Cir. 1995), but was vacated when an en banc rehearing was granted.[57] The en banc decision came to the opposite conclusion.[58] The en banc decision agreed with the majority of other courts considering the issue and held that agencies of the United States government are to be considered a single creditor for purposes of Bankruptcy Code section 553.[59] The case was remanded back to the original panel for a determination of the other issues raised by the appeal.[60] The subsequent panel decision is discussed below under the heading "Avoidance Actions."[61]

2. *Post-Petition Conservation Reserve Program Payments Can be Offset Against Pre-Petition Indebtedness*

In *In re Buckner*, [62] a farmer entered into a Conservation Reserve Program (CRP) contract with the United States prior to filing for bankruptcy.[63] At the time of the filing, no payments had been made to the farmer under the contract and no payments were then due and owing.[64] In the bankruptcy case, the United States sought to offset its obligation to make future payments to the farmer under the CRP contract against prepetition indebtedness owed to the Farmers Home Administration.[65] The court allowed such setoff and held that the government's obligation under a CRP contract arises when the contract is entered into, even if no payments are then owing.[66]

F. *Avoidance Actions*

Certain transfers made by the debtor may be undone or "avoided" during a bankruptcy case if the transfers interfere with the equitable distribution of the debtor's estate to its creditors.[67]

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56. *See id.* at 1045.
57. *See* Turner v. SBA (*In re* Turner), 84 F.3d 1294, 1294-95 (10th Cir. 1996).
58. *See id.* at 1295.
59. *See id.*
60. *See id*.
61. *See* discussion *supra* Part II.F.
62. FmHA v. Buckner (*In re* Buckner), 218 B.R. 137 (B.A.P. 10th Cir. 1998).
63. *See id.* at 139-40.
64. *See id.* at 139.
65. *See id* at 140.
66. *See id* at 148.
67. *See* 11 U.S.C. § 547(b)(1) (1994).

1. *Setoff is Not a Preferential Transfer if it Does Not Improve the Creditor's Position.*

In *In re Turner*, [68] the court held that the SBA did not receive a preference when it offset the debtors' payments due under price support contracts against SBA loan obligations because it did not improve its position by exercising setoff rights.[69] The facts of the case are set forth above under the heading of "Setoff Rights."[70] On remand, the debtors argued that the SBA still received a preference because it received an "improvement in position" during the ninety-day preference period by virtue of its exercising the setoff right.[71] The Tenth Circuit did the necessary financial analysis and determined that the insufficiency that existed on the ninetieth day prior to the filing of the chapter 12 case was no greater than the insufficiency that existed after exercise of the setoff.[72]

2. *Failure to Get Consent from the Federal Crop Insurance Corporation is Not a Sufficient Basis for Avoidance of a Security Interest*

The debtors and the FSA in *In re Rees*[73] stipulated that the FSA held a security interest in the debtors' crop insurance proceeds that was perfected under state law.[74] At issue in the case was whether federal regulations prohibited the attachment of a state-law security interest.[75] The applicable regulations prohibited assignment of a farmer's right to receive federal crop insurance payments unless consented to by the Federal Crop Insurance Corporation.[76] The court held that the regulations prohibited an assignment of the right to payment but not the right to receive the proceeds of an insurance policy.[77] Accordingly, the debtors could not avoid the security interest held by the FSA.[78]

G. *Plan Confirmation*

In chapters 9, 11, 12 and 13 cases, the bankruptcy court must approve a plan outlining how the debtor will deal with the claims filed against it.[79] During the period covered by this article, the issues raised in agricultural bankruptcy cases

68. Turner v. SBA (*I n re* Turner), 59 F.3d 1041 (10th Cir. 1995) *vacated en banc*, 84 F.3d 1294 (10th Cir. 1996).
69. *See id.* at 1043.
70. *See* discussion *supra* Part II.E.
71. *See In re* Turner, 59 F.3d at 1043.
72. *See id.* at 1046.
73. *In re* Rees, 216 B.R. 551 (Bankr. N.D. Tex. 1998).
74. *See id.* at 552.
75. *See id.*
76. *See id.* at 553.
77. *See id.* at 555.
78. *See id.* at 556.
79. *See* 11 U.S.C. §§ 943, 1129 (1994); 11 U.S.C. §§ 1225, 1325 (1994 & Supp. 1998).

involved interest rates in a chapter 13, a chapter 12, and a chapter 11 plan that proposed to transfer real property to the creditor.[80]

1. *What Constitutes a Market Rate*

The order confirming the chapter 13 plan in *In re Roso*[81] provided for the Farmers Home Administration (FmHA) to receive interest on its secured claim at a rate of six and a half percent.[82] This rate was halfway between FmHA's five percent rate available under a special program to new farmers and the eight percent regular rate.[83] It also stood in contrast to the eight to eleven percent rates then offered by commercial lenders.[84] The Eighth Circuit reversed the order confirming the plan on the grounds that the bankruptcy court improperly considered the subsidized rate in determining the applicable market rate.[85] The case was remanded to the bankruptcy court to determine the market rate of interest without consideration of the subsidized rate offered by FmHA.[86]

2. *"Coerced Loan" Approach to Determining Interest Rates is Proper*

In *Koopmans v. Farm Credit Services*,[87] a chapter 12 debtor sought confirmation over the objection of a well-secured creditor.[88] The debtor alleged that the prepetition interest rate should constitute a cap on the interest that the creditor would receive under the plan.[89] The court disagreed and held that the "coerced loan" approach is the proper method for determining the market rate of interest for a secured claim.[90] The bankruptcy court allowed a floating rate equal to the prime rate plus one and a half percent.[91]

The decision was affirmed by the Seventh Circuit Court, which held that "the creditor is entitled to the rate of interest it could have obtained had it foreclosed and reinvested the proceeds in loans of equivalent duration and risk. Nothing else gives the creditor the indubitable equivalent of its non-bankruptcy entitlement."[92]

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80. *See* discussion *supra* Part II.G.1-3.
81. United States v. Roso (*In re* Roso), 76 F.3d 179 (8th Cir. 1996).
82. *See id.* at 181.
83. *See id.* at 180.
84. *See id.* at 181.
85. *See id.*
86. *See id.*
87. Koopmans v. Farm Credit Servs., 102 F.3d 874 (7th Cir. 1996) *aff'd*, 196 B.R. 425 (Bankr. N.D. Ind. 1996).
88. *See id.* at 875-76.
89. *See id.*
90. *See id.*
91. *See id.*
92. *Id.*

3. *Partial "Eat Dirt" Plan Cannot be Confirmed*

In the chapter 11 case of *In re Arnold & Baker Farms*,[93] FmHA held a lien on 1,320 acres of farmland to secure a debt of approximately $3,800,000.[94] The property owner filed bankruptcy and filed a plan proposing to transfer 510 acres of the property to FmHA in full satisfaction of its claim against the debtor.[95] Under the plan, FmHA would be required to release its lien on the remaining acreage.[96] This type of plan is often called an "eat dirt" or "dirt for debt" plan.[97]

The plan was approved by the bankruptcy court, although the court required that FmHA receive property worth an additional ten percent to compensate it for the costs of disposing of the land.[98] The bankruptcy appellate panel reversed the bankruptcy court and this reversal was upheld by the Ninth Circuit.[99] Both courts emphasized that the return of only a portion of a creditor's collateral is not the indubitable equivalent of the creditor's claim.[100]

H. *Discharge*

For most debtors, the aim of filing bankruptcy is to gain relief from liability for prepetition debt. This relief is called a discharge.[101] Some debts, however, are not dischargeable, such as those resulting from willful and malicious injury and debts incurred through fraud.[102]

1. *Debtor Who Sold Collateral and Did Not Remit Proceeds Does Not Receive Discharge for Debt*

In *In re Cantrell*,[103] a cattleman sold cattle subject to a security interest and failed to remit the proceeds to the lender.[104] The underlying agreement required that cattle proceeds be payable by joint check and turned over to the lender, consistent with industry standards.[105] The court found that there was no ill will toward the

93. Arnold & Baker Farms v. United States (*In re* Arnold & Baker Farms), 85 F.3d 1415 (9th Cir. 1996) *aff'd*, 177 B.R. 648 (B.A.P. 9th Cir. 1994).
94. *See id.* at 1417.
95. *See id.*
96. *See id.*
97. *See id.*
98. *See id.* at 1419.
99. *See id.* at 1419, 1423-24.
100. *See id.* at 1423.
101. *See* 11 U.S.C. § 727 (1994).
102. *See id.* § 523(a)(2).
103. Bank of Western Oklahoma v. Cantrell (*In re* Cantrell), 208 B.R. 498 (B.A.P. 10th Cir. 1997).
104. *See id*. at 500.
105. *See id*.

lender; the rancher merely failed to turn over the proceeds.[106] Under Tenth Circuit precedent, however, that was sufficient to justify a finding that debt resulted from willful and malicious injury and was thus non-dischargeable.[107]

2. *Violation of PACA Trust May Result in Non-Dischargeability*

In a dischargeability action brought by a beneficiary of a PACA trust, the bankruptcy court granted summary judgment to the debtor on the grounds that the PACA trust provisions were not the type of trust necessary to except a debt from the discharge provisions of Bankruptcy Code section 523(a)(4).[108] The district court reversed and held that the failure to comply with PACA trust provisions could amount to "defalcation while acting in a fiduciary capacity" within the meaning of section 523(a)(4).[109] The case was remanded to bankruptcy court for a factual determination of whether defalcation occurred.[110]

In *In re Zois*,[111] the court held that when determining whether the failure to pay PACA trust fund claims leads to a non-dischargeable debt, courts are not bound by the finding in pre-bankruptcy actions by the trust beneficiary.[112] This case also holds that violation of the PACA trust fund provisions can give rise to a non-dischargeable debt.[113] An order declaring a debt non-dischargeable entered in a pre-bankruptcy lawsuit filed by the trust beneficiary is not binding on the bankruptcy court.[114] The bankruptcy court will need to determine whether the failure to pay the trust fund claims amounted to defalcation while acting in a fiduciary capacity.[115]

I. *Exemptions*

In exchange for a discharge, debtors give up all their non-exempt property.[116] Exempt property may include a home, car, life insurance policy, and capped dollar amounts of business and farm equipment.[117] A debtor may choose the exemptions set

106. *See id.* at 502.
107. *See id.*
108. *See* N.P. Deoudes, Inc. v. Snyder (*In re Snyder*), 184 B.R. 473, 475 (Bankr. D. Md. 1995) *rev'd*, 171 B.R. 532 (Bankr. D. Md. 1994).
109. *Id.*
110. *See id.*
111. Strube Celery & Vegetable Co. v. Zois (*In re* Zois), 201 B.R. 501 (Bankr. N.D. Ill. 1996).
112. *See id.* at 506.
113. *See id.* at 510-11.
114. *See id.*
115. *See id.* at 506.
116. *See* 11 U.S.C. § 522 (1994).
117. *See id.* at § 522(d).

forth in section 522(d) of the Bankruptcy Code or they may choose the exemptions available under other federal law and the state law of the debtor's domicile.[118]

1. *Lien Avoidance Cap on Tools of Trade*

In *In re Ehlen*,[119] the court held that the Bankruptcy Code limitation of $5,000 on exemptions only applies where state law is subject to both restrictions listed in clauses (A) and (B).[120] Wisconsin law permitted debtors to exempt $7,500 each in "business and farm property."[121] The debtors sought to avoid a lien of the FSA under Bankruptcy Code section 522(f) to the extent of $15,000 because it impaired this exemption.[122] FSA contended that section 522(f)(3), which was added by the 1994 amendments to the Bankruptcy Code, limits such exemptions to $5,000 per person.[123] The court disagreed and held that section 522(f)(3) is applicable only if both the requirements listed in clause (A) and (B) are fulfilled.[124] The $5,000 limitation in section 522(f)(3) was not applicable because Wisconsin law did not prohibit debtors from electing federal exemptions.[125]

2. *Enforcing Security Interest Does Not Create Possessory Lien*

In *In re White*,[126] the court held that a lien is not "possessory" for purposes of section 522(f) when the lienholder obtained possession through enforcement of a security interest.[127] The lender in this case had a security interest in the debtor's farm equipment.[128] Prior to bankruptcy, the lender obtained possession of the equipment as part of a foreclosure action.[129] The debtor sought to avoid the lender's lien under section 522(f).[130] The lender claimed that section 522(f) did not apply because the lender's security interest was "possessory."[131] The court held that a lien intended by the parties to be non-possessory does not change its character because the lienholder obtains priority through enforcing its security interest.[132] The court held the debtor

118. *See id.* at § 522(b).
119. *In re* Ehlen, 202 B.R. 742 (Bankr. W.D. Wis. 1996).
120. *See id.* at 745.
121. *See id.* at 749.
122. *See id.* at 750-51.
123. *See id.* at 743.
124. *See id.* at 749.
125. *See id.* at 750.
126. *In re* White, 203 B.R. 613 (Bankr. N.D. Tex. 1996).
127. *See id.* at 617.
128. *See id.* at 615.
129. *See id.* at 614.
130. *See id.* at 615.
131. *See id.*
132. *See id.* at 617.

may assert rights under section 522(f).[133] Furthermore, breeding cattle cannot be considered "tools of the trade."[134]

J. *Bankruptcy Taxation*

In *In re Sun World Int'l*,[135] the debtor employed foreign agricultural workers to harvest seasonal crops.[136] The debtor's labor contractor paid over $30,000,000 between 1988 and 1991 to these workers.[137] The debtor believed that the workers fit within the scope of "Special Agricultural Workers" (a status of foreign workers created by the Immigration Control and Reform Act of 1986) and were thus immune from federal employment taxes.[138] The IRS disagreed and assessed the debtor for such taxes.[139] The bankruptcy court granted summary judgment to the United States and the debtor appealed.[140] The district court reversed the bankruptcy court and held that the wages paid to the employees were not subject to employment taxation.[141]

III. CHAPTER 12 CASES

A. *Eligibility for Filing Under Chapter 12*

To file bankruptcy under chapter 12 of the Bankruptcy Code, a debtor must be a family farmer with regular annual income and have debts under $1.5 million.[142] During the period covered by this article, five bankruptcy courts ruled on whether particular debtors met the requirements for filing under chapter 12.

1. *Debtors Who Take Off-Farm Employment and Hire a Full-Time Farm Manager are Still Considered to be Engaged in a Farming Operation*

In *In re Lockard*,[143] the debtors were engaged in farming and still owned the farm property at the time they filed their petition for bankruptcy.[144] Accordingly, there was enough of a connection to farming to render them eligible for chapter 12.[145]

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133. *See id.*
134. *See In re* Smith, 206 B.R. 186, 190 (Bankr. N.D. Iowa 1996).
135. *In re* Sun World Int'l, Inc., 217 B.R. 281 (Bankr. C.D. Cal. 1998).
136. *See id.* at 282-83.
137. *See id.* at 282.
138. *See id.* at 284.
139. *See id.* at 283.
140. *See id.*
141. *See id.* at 286.
142. *See* 11 U.S.C. §§ 101(18), 109(f) (1994).
143. *In re* Lockard, 234 B.R. 484 (Bankr. W.D. Mo. 1999).
144. *See id.* at 491.
145. *See id.* at 492.

2. *Debtors are Engaged in a Farming Operation Even Though They are Not Primary Operators*

In *In re Howard,*[146] a creditor asserted that a husband and wife were not "engaged in a farming operation" within the meaning of Bankruptcy Code section 101(18) because the farm was primarily operated by the debtors' sons, and the sons owned some of the farm assets.[147] The court held that the debtors were engaged in a farming operation because they devoted their full-time efforts to the farming operation.[148] The fact that the debtors' sons worked on the farm did not mean that the debtors were not also engaged in a farming operation.[149]

3. *IRS Definition Determines "Gross Income"*

The court in *In re Lamb*[150] held that to determine eligibility as a family farmer, "gross income" should be determined according to the Internal Revenue Code definition.[151] Also, where a debtor is a partner in a partnership, the debtor's gross income includes the debtor's distributive share of the gross income of the partnership.[152] Furthermore, farm rental income is to be considered income from a farming operation where a debtor is also engaged in a farming operation.[153] The party objecting to the debtor's eligibility for chapter 12 alleged that the net profit from the debtor's partnership interest is all that should be considered as part of the debtor's gross income.[154] The court disagreed and held that a pro rata share of the partnership's gross income should be attributed to the debtor.[155] The court also held that rental income from farmland will be considered income from a farming operation where the debtor was also engaged in a farming operation.[156]

4. *A Debtor Must be Currently Engaged in a Farming Operation*

The debtors in *In re Buckingham*[157] were not eligible for chapter 12 because they were not engaged in a farming operation.[158] The court held that an intent to

146. *In re* Howard, 212 B.R. 864 (Bankr. E.D. Tenn. 1997).
147. *See id.* at 873.
148. *See id.* at 874.
149. *See id.* at 873.
150. *In re* Lamb, 209 B.R. 759 (Bankr. M.D. Ga. 1997).
151. *See id.* at 760-61.
152. *See id.* at 761.
153. *See id.* at 762.
154. *See id.* at 760.
155. *See id.* at 761.
156. *See id.* at 762.
157. *In re* Buckingham, 197 B.R. 97 (Bankr. D. Mont. 1996).
158. *See id.* at 109.

lease out farmland to others for grazing purposes did not constitute being engaged in a farming operation.[159]

5. *A Debtor with an Outside Job May Nonetheless be Considered Engaged in a Farming Operation*

The debtors in *Cottonport Bank v. Dichiara*[160] who held full-time, non-farming jobs, were held to be "engaged in a farming operation" because they continued some farming on a reduced basis.[161] The court also held that proceeds from the sale of farm equipment would be considered farm income where the sales were isolated and the sale was of some but not all of the debtor's farm equipment.[162]

B. *Codebtor Stay*

Chapter 12 contains a supplement to the automatic stay provided by section 362 of the Bankruptcy Code, which protects individuals liable along with the chapter 12 debtor from the commencement or continuation of any civil action to collect all or any part of a consumer debt.[163] Not surprisingly, disputes about the codebtor stay often involve whether or not a particular debt is a "consumer debt."

"A debt for personal property tax is not a consumer debt."[164] The debt at issue in *In re Stovall*[165] was a debt for the personal property tax on goods that were held for personal, family, and household use (i.e., a consumer use).[166] The court held that the tax itself was not a consumer debt, in line with the series of cases holding that tax debts are not consumer debts.[167]

C. *Trustee's Fee*

As in chapter 13, a trustee is appointed in every chapter 12 case. Compensation for trustees appointed in districts with no standing trustee is based on services rendered, not to exceed five percent of all payments under the plan.[168] Standing trustees receive an annual compensation plus a percentage fee fixed by the U.S. Attorney General.[169] How to compute these percentages is not always clear, however.

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159. *See id.* at 107.
160. Cottonport Bank v. Dichiara, 193 B.R. 798 (Bankr. W.D. La. 1996).
161. *See id.* at 804.
162. *See id.* at 803-04.
163. *See* 11 U.S.C. § 1201(a) (1994).
164. *See In re* Stovall, 209 B.R. 849, 851 (Bankr. E.D. Va. 1997).
165. *Id.*
166. *See id.*
167. *See id.* at 853-54.
168. *See* 11 U.S.C. § 586(e) (1994).
169. *See id.*

1. *Computation of the Trustee's Fee Does Not Include the Trustee's Fee Itself*

The debtors' plan in *Pelofsky v. Wallace*[170] provided for the standing trustee to receive a percentage fee equal to ten percent of the amount that the debtor proposed to pay to creditors.[171] The office of the United States Trustee objected to the plan on the grounds that the payment to the standing trustee was inadequate.[172] Under policy set by the executive office of the United States Trustee, the United States Trustee asserted that it was entitled to a percentage fee on all funds paid by the debtor to the standing trustee, "including funds paid to the trustee as payment of the trustee's percentage fee."[173]

Under section 586(e)(1)(B) of the United States Code, a standing chapter 12 trustee is entitled to a percentage fee "not to exceed ten percent of the payments made under the plan" of a chapter 12 debtor.[174] The debtors argued this language provided that the fee should be ten percent of payments made under the plan by the debtors.[175] Section 586(e)(2) provides, however, that the standing trustee "shall collect such percentage fee from all payments received by such individual under plans in the cases . . . for which such individual serves as standing trustee."[176] The United States Trustee argued that this language provided that the fee of ten percent should be calculated against all payments received by the trustee, including payments received with respect to the trustee's fee.[177]

In a situation only a lawyer could love, both the debtors and the United States Trustee argued that section 586(e) was unambiguous—only they disagreed on its meaning.[178] Not surprisingly, the Eighth Circuit concluded that the language of section 586(e) was ambiguous.[179] The court recognized that under the Supreme Court decision of *Chevron U.S.A., Inc. v. NRDC*[180] a court is required to defer to an agency's interpretation of an ambiguous statute so long as that interpretation is reasonable.[181]

The Eighth Circuit concluded, however, that the interpretation of the United States Trustee was not reasonable because the standing trustee ended up with a percentage fee equal to eleven point eleven percent of the payments being made by

170. Pelofsky v. Wallace, 102 F.3d 350 (8th Cir. 1996).
171. *See id.* at 352.
172. *See id.*
173. *Id*.
174. 28 U.S.C. § 586(e)(1)(B)(ii)(I) (1994).
175. *See Pelofsky*, 102 F.3d at 352.
176. 28 U.S.C. § 586(e)(2) (1994).
177. *See Pelofsky*, 102 F.3d at 352.
178. *See id*.
179. *See id.* at 354.
180. Chevron U.S.A., Inc. v. NRDC, 467 U.S. 837 (1984).
181. *See Pelofsky*, 102 F.3d at 352 (discussing *Chevron U.S.A., Inc*., 467 U.S. at 845).

the debtors to creditors under the plan.[182] Accordingly, the court decided in favor of the debtor's interpretation.[183]

The *Pelofsky* decision is in conflict with the decision of the Tenth Circuit in *In re BDT Farms, Inc.*[184] The Tenth Circuit also concluded that section 586(e) was ambiguous, however, the court held that the interpretation of the statute by the United States Trustee was not unreasonable, so the court deferred to that interpretation.[185]

2. *Computation of the Trustee's Fee Does Not Include Payments Made Directly to Secured Creditors*

In *In re Jennings*,[186] the court held that a chapter 12 trustee is not entitled to fees from payments made directly to secured creditors.[187] Similarly, the court held in *Lydick v. Cross*[188] that a chapter 12 trustee is not entitled to a percentage fee with respect to payments on impaired claims made by the debtor directly to the secured creditor and not through the trustee.[189] In *In re Cross*,[190] it was held that the bankruptcy court lacks authority to grant additional compensation to a standing chapter 12 trustee in addition to that authorized by section 586 of the United States Code.[191]

D. *Treatment of Priority Tax Claims*

The court *In re Brown*[192] held that priority tax claims must be paid in full under chapter 12 plans.[193] However, a chapter 12 plan is not required to provide for the payment of postpetition interest on a priority tax claim.[194] Unlike chapter 11, chapter 12 does not provide tax claims with the present value of the amount of the claim.[195] Thus the court in *In re Mitchell*[196] concluded that a priority tax claim held

182. *See id.* at 355.
183. *See id.*
184. Foulston v. BDT Farms, Inc. (*In re* BDT Farms, Inc.), 21 F.3d 1019 (10th Cir. 1994).
185. *See id.* at 1023.
186. *In re* Jennings, 190 B.R. 863 (Bankr. W.D. Mo. 1995).
187. *See id.* at 865.
188. Lydick v. Cross, 197 B.R. 321 (Bankr. D. Neb. 1995).
189. *See id.* at 342.
190. *In re* Cross, 195 B.R. 440 (Bankr. D. Neb. 1996).
191. *See id.* at 441.
192. Brown v. IRS (*In re* Brown), 82 F.3d 801 (8th Cir. 1996).
193. *See id.* at 806.
194. *See* Bossert v. United States (*In re* Bossert), 201 B.R. 553, 563 (Bankr. E.D. Wash. 1996) *aff'd*, 230 B.R. 172 (1999).
195. *See* Mitchell v. United States (*In re* Mitchell), 210 B.R. 978, 983 (Bankr. N.D. Tex. 1997).
196. *See id.*

by the Internal Revenue Service is not entitled to interest accruing after plan confirmation.[197]

E. *Treatment of Secured Claims*

Section 1222 of the Bankruptcy Code sets forth several mandatory and optional features that a plan must or may include.[198] In order for a chapter 12 plan to be confirmed over the objection of a secured creditor, the debtor must meet the requirements set forth in section 1225 of the Bankruptcy Code.[199] The interpretation of section 1225 often leads to disputed issues. A number of recent cases have considered the standards to be applied in the treatment of secured claims.

1. *Amortization Periods Must be Reasonable*

In *In re Lockard*,[200] the court held that the proposed twenty-year amortization period was too long where the debtor was sixty-nine years old and was unlikely to continue farming for more than five years.[201] The court suggested that a twenty-year amortization period and a five-year balloon payment would be more appropriate.[202]

2. *Value of a Shared Appreciation Mortgage Claim can be Estimated*

According to the court in *In re Tunnissen*,[203] a secured claim based on a shared appreciation mortgage agreement between the debtors and the Farm Service Agency can be estimated by the court for purposes of plan confirmation.[204] The estimation is to be based on the value of the property as of the effective date of the plan.[205]

197. *See id.* at 984.
198. *See* 11 U.S.C. § 1222 (1994).
199. *See* 11 U.S.C. § 1225 (1994).
200. *In re* Lockard, 234 B.R. 484 (Bankr. W.D. Mo. 1999).
201. *See id.* at 495.
202. *See id.* at 496.
203. Sentinel Fed. Credit Union v. United States (*In re* Tunnissen), 216 B.R. 834 (Bankr. D.S.D. 1996).
204. *See id.* at 838.
205. *See id.*

The claim of a county for real estate taxes may be treated under the plan despite the fact that the applicable property was already sold to the county under state law.[206] The plan must, however, preserve the lien so that it does not expire.[207] The applicable interest rate for the claim is determined in the same manner as non-tax secured claims.[208]

3. *Farm Credit Stock Must be Taken into Account*

The value of stock in a farm credit lending institution must be considered in determining the amount of a secured claim.[209]

4. *Debtor May Make Direct Payments to Holders of Secured Claims*

Payments may be made directly to secured creditors, rather than through a chapter 12 trustee.[210] Debtors may make payments directly to the secured creditor even if the claims are impaired or modified.[211] The court in *In re McCann*[212] held that the language of the Code permits debtors to make payments directly to the holders of impaired secured claims, but the court will scrutinize direct payment plans on a case-by-case basis.[213] The court further held that it will approve such plans only in rare instances when trustee supervision of a debtor's operations is not required.[214]

F. *Interest Rates for Cramdown of Secured Claims*

The cramdown provisions of section 1225 require not only that the holder of a secured claim retains its lien, but that the holder also receives property with a present value not less than the allowed amount of the claim.[215] To satisfy this requirement for plans that propose to pay the secured claim in deferred cash installments, courts must apply a discount factor to determine the present value of the payments.[216] This is commonly done by ascribing the "market" rate of interest.[217] The courts in chapter 12 cases, as in chapters 11 and 13, have been inconsistent in their methods for calculating the "market" rate.

206. *See In re* Woerner, 214 B.R. 208, 211 (Bankr. D. Neb. 1997).
207. *See id.*
208. *See id.*
209. *See In re* Honeyman, 201 B.R. 533, 536 (Bankr. D.N.D. 1996).
210. *See In re* Jennings, 190 B.R. 863, 865-66 (Bankr. W.D. Mo. 1995).
211. *See* Lydick v. Cross, 197 B.R. 321, 324 (Bankr. D. Neb. 1995).
212. *In re* McCann, 202 B.R. 824 (Bankr. N.D.N.Y. 1996).
213. *See id.* at 830.
214. *See id.*
215. *See* 11 U.S.C. § 1225(a)(5)(B)(ii) (1994).
216. *See* United States v. Doud, 869 F.2d 1144, 1146 (8th Cir. 1989).
217. *See id.*

Following the Eighth Circuit decision in *United States v. Doud*,[218] the court in *In re Lockard*[219] held that a market rate of interest would be the applicable treasury rate plus an upward adjustment of two percent.[220] The court noted that the debt to the creditor was approximately $340,000 and the property value was approximately $440,000, so the equity cushion justified an upward adjustment of only two percent.[221] In *In re Honeyman*, the court adopted the cramdown interest rate proposed by the lender who established that the proposed rate was the rate that the debtor would qualify for under the lender's available financing programs.[222]

In *In re Goodyear*,[223] the court adopted the treasury rate as the rate to apply to a secured claim under a plan.[224] The court deciding this case had a unique perspective on determining interest rates.[225]

G. *Confirmation of Plan*

In chapter 12, creditors do not vote on the plan as in chapter 11.[226] The plan becomes effective only if the bankruptcy court approves it.[227] Five general requirements must always be met, a sixth applies to the treatment of secured claims, and a seventh arises only if the trustee or an unsecured creditor objects to the plan.[228]

1. *Negative Amortization is Possible*

The plan in *In re Nauman*[229] called for a partial deferral of interest on a secured claim for a twenty-one month period, resulting in negative amortization.[230] The court held that the plan could be confirmed since the loan to value ratio would never exceed seventy-five percent.[231]

2. *When is a Plan Filed in Good Faith?*

The debtors in *In re Barger*[232] sold property subject to a lien without notifying the lienholder or paying any of the proceeds to the lienholder.[233] They then

218. *See id.* at 1145-46.
219. *In re* Lockard, 234 B.R. 484 (Bankr. W.D. Mo. 1999).
220. *See In re* Lockard, 234 B.R. 484, 496 (Bankr. W.D. Mo. 1999).
221. *See id.* at 496.
222. *See In re* Honeyman, 201 B.R. 533, 536 (Bankr. D.N.D. 1996).
223. *In re* Goodyear, 218 B.R. 718 (Bankr. D. Vt. 1998).
224. *See id.* at 719.
225. *See id.* at 721.
226. *See* 11 U.S.C. § 1126, 1225 (1994).
227. *See id.* § 1225.
228. *See id.*
229. Miller v. Nauman (*In re* Nauman), 213 B.R. 355 (B.A.P. 9th Cir. 1997).
230. *See id.* at 363.
231. *See id.*
232. Barger v. Hayes County Non-Stock Co-op (*In re* Barger), 233 B.R. 80 (B.A.P. 8th Cir. 1999).

proposed a series of chapter 12 plans, all of which purported to treat the lienholder as an unsecured creditor.[234] Despite clear instructions from the bankruptcy court as to what would be required for a confirmable plan, the debtors filed plans that could not be confirmed.[235] The bankruptcy court held that the final plan was not filed in good faith and therefore dismissed the case.[236] The bankruptcy appellate panel upheld the finding of lack of good faith and dismissal of the case.[237]

However, good faith does not require that the debtors be engaged in farming for the duration of their chapter 12 plan.[238] A creditor in *In re Lockard*[239] asserted that the debtors' chapter 12 plan was not filed in good faith because the debtors had hired a full-time farm manager and took off-farm employment.[240] The court disagreed and held that the debtors still owned the farm and had enough of a relationship to the farming operation to support a finding that the plan was filed in good faith.[241]

On the other hand, the court found the plan in *In re Buckingham* was not proposed in good faith and therefore could not be confirmed because it provided for more favorable treatment of insider claims.[242] Relying on precedent established in these chapter 12 cases, the court in *In re Donahue*[243] then held that an "eat dirt" plan (i.e., a plan providing for the transfer of real property in satisfaction of debt) is permissible in a chapter 13 case.[244]

3. *Claim Secured by Livestock Must be Protected Throughout the Repayment Period*

The court in *In re Howard*[245] held that the lienholder must receive a replacement lien on newly acquired livestock and the plan must contain safeguards to ensure that the value of the herd does not diminish during the plan payment period.[246] Because of the inherent uncertainties involved in a livestock operation, negative amortization is not a permissible treatment of a secured claim.[247] The court

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233. *See id.* at 82.
234. *See id.*
235. *See id.*
236. *See id.* at 84.
237. *See id.* at 85.
238. *In re* Lockard, 234 B.R. 484, 491 (Bankr. W.D. Mo. 1999).
239. *See id.*
240. *See id.*
241. *See id.* at 492.
242. *See In re* Buckingham, 197 B.R. 97, 104-05 (Bankr. D. Mont. 1996).
243. *In re* Donahue, 231 B.R. 865 (Bankr. D. Vt. 1998).
244. *See id.* at 870.
245. *In re Howard,* 212 B.R. 864 (Bankr. E.D. Tenn. 1997).
246. *See id.* at 876.
247. *See id.* at 878.

also found that the plan was not feasible and that a twenty-year payout period was too long for farmers who were in their sixties.[248]

4. *Strip-Down of Liens Permitted in a Chapter 12 Case*

The debtors in *Harmon v. United States*[249] owned real property with a stipulated value of $165,000 at the time of plan confirmation.[250] The property was encumbered by a first lien for $113,800 and a second lien in favor of FmHA for $425,817.[251] The debtors' plan provided for the bifurcation of the FmHA claim into a secured portion of approximately $52,000, to be paid in installments over a thirty-year period, and an unsecured portion of $373,000, to be paid in part from the debtors' projected disposable income during the plan period.[252] At the end of the plan period the debtors received a discharge.[253]

A couple years after the debtors received a discharge, they sold the property for $730,000.[254] After payment of the first lien and the secured portion of the FmHA claim, a surplus of $587,798 remained.[255] FmHA argued that it was entitled to receive a portion of the surplus up to the amount of its original lien claim at the time of the filing.[256] The debtors argued that the unsecured portion of FmHA's claim had been discharged in the chapter 12 case and that the debtors were entitled to keep the excess.[257]

The court agreed with the debtors.[258] FmHA argued strenuously that the result of the decision would be to allow "lien stripping" in chapter 12 cases and that such lien stripping was prohibited by the Supreme Court decision in *Dewsnup v. Timm*.[259] The court noted that *Dewsnup* did not prohibit lien stripping in bankruptcy cases, but merely held that Bankruptcy Code section 506(d) did not provide authority in chapter 7 cases for lien stripping.[260] If another provision of the Code permitted lien stripping, a debtor could rely on that provision and nothing in section 506(d) or the *Dewsnup* opinion would preclude lien stripping.[261] According to the court in *Harmon*, Bankruptcy Code section 1225 permits the outcome advocated by the debtors.[262]

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248. *See id.* at 882.
249. Harmon v. United States, 101 F.3d 574 (8th Cir. 1996).
250. *See id.* at 577-78.
251. *See id.* at 577.
252. *See id.* at 578.
253. *See id.*
254. *See id.*
255. *See id.*
256. *See id.*
257. *See id.*
258. *See id.*
259. *See* Dewsnup v. Timm, 502 U.S. 410, 417 (1992).
260. *See* Harmon, 101 F.3d at 581.
261. *See* Dewsnup, 502 U.S. at 418-19.
262. *See* Harmon, 101 F.3d at 583.

However "lien stripping" is not permitted where a chapter 12 case is converted to a chapter 7 case. The debtor in *In re Hoffman Farms*[263] also bifurcated a claim held by FmHA into secured and unsecured portions.[264] Unlike the debtors in *Harmon*, however, this debtor defaulted on his plan payments prior to receiving a discharge and the case was converted to a chapter 7 case on the grounds that the debtor committed fraud.[265] The court held that the *Dewsnup* decision was controlling because the case was now under chapter 7.[266]

In a chapter 12 case, the strip-down that occurs at plan confirmation is tentative.[267] If the debtor completes plan payments and receives a discharge, the unsecured portion of the claim is discharged.[268] If the debtor fails to complete plan payments and obtain a discharge, and the case is dismissed, then the lien is reinstated just as if it had never been bifurcated.[269]

H. *Calculation of Net Disposable Income*

Bankruptcy Code section 1225(b)(1) requires that if the trustee or the holder of an unsecured claim objects to the plan, the court must find that the plan provides for all of the debtor's projected disposable income received during the plan period to be applied to plan payments.[270] The amount by which a debtor's income exceeds the debtor's obligations at the end of the plan period, after accounting for carryover funds sufficient to continue the farming operation, is to be considered disposable income.[271] In a chapter 13 case with implications for chapter 12 cases, the Sixth Circuit held in *In re Freeman*[272] that exempt funds are not per se excluded from the calculation of gross income.[273]

I. *Feasibility of Plan*

Bankruptcy Code section 1225(a)(6) requires that a chapter 12 debtor must be able to make all payments and otherwise comply with the terms of the plan for it to be confirmed.[274] This "feasibility test" is similar to the test applied in chapter 11 cases.[275]

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263. Hoffman Farms v. Pokela (*In re* Hoffman Farms), 195 B.R. 80 (Bankr. D.S.D. 1996).
264. *See id.* at 82.
265. *See id.*
266. *See id.* at 85.
267. *See* Harmon, 101 F.3d at 579.
268. *See id.*
269. *See id.*
270. *See* 11 U.S.C. § 1225(b)(1) (1994).
271. *See* Hammrich v. Lovald (*In re* Hammrich), 98 F.3d 388, 390 (8th Cir. 1996).
272. Freeman v. Schulman (*In re* Freeman), 86 F.3d 478 (6th Cir. 1996).
273. *See id.* at 481.
274. *See* 11 U.S.C. § 1225(a)(6) (1994).
275. *See In re* Lockard, 234 B.R. 484, 493 (Bankr. W.D. Mo. 1999).

In *In re Nauman*,[276] the court held that a plan was feasible, even though the plan called for an expansion of the debtors' livestock operation beyond the scope of their prepetition operations.[277]

The court in *In re Lockard*[278] evaluated a creditor's objections to the debtors' proposed plan and held that the plan was based on a reasonable assumption.[279] The court noted that if it took the inherent uncertainties of farming into account when evaluating a debtor's projections, no farmer's chapter 12 plan could ever be confirmed.[280]

However, a court should find that a plan is not feasible where it is based on unrealistic assumptions. The court in *In re Tate*[281] denied confirmation because the plan was based on groundless assumptions that cattle herd would increase, cattle prices would increase, custom farming income would increase, and expenses would decrease.[282]

Some debtors are too optimistic. For example, in *In re Gough*,[283] the plan was denied confirmation for not being feasible where the debtor's proposed citrus yields were too optimistic in light of yields in previous years.[284] In *In re Honeyman*,[285] a plan was also held in feasible because debtor understated his expenses and overstated his projected income.[286]

J. *Effect of Confirmation*

The provisions of a confirmed plan bind all the debtor's creditors.[287] Upon confirmation, all property of the estate not distributed to creditors under the plan vests in the debtor free and clear of creditor claims unless the plan provides otherwise.[288]

A plan negotiated between the debtor and two secured creditors in *First Nat'l Bank v. Allen*[289] provided for treatment of the creditors' secured claims, but did not grant the creditors an unsecured claim for their deficiency.[290] The debtor later received an inheritance and the secured creditors attempted to assert an unsecured

276. Miller v. Nauman (*In re* Nauman), 213 B.R. 355 (B.A.P. 9th Cir. 1997).
277. *See id.* at 385-61.
278. *In re* Lockard, 234 B.R. at 484.
279. *See id.* at 494.
280. *See id.* at 493.
281. *See In re* Tate, 217 B.R. 518, 520 (Bankr. E.D. Tex. 1997).
282. *See id.* at 521.
283. *In re* Gough, 190 B.R. 455 (Bankr. M.D. Fla. 1995).
284. *See id.* at 458-59.
285. *In re* Honeyman, 201 B.R. 533 (Bankr. D.N.D. 1996).
286. *See id.* at 539.
287. *See* 11 U.S.C. § 1227(a) (1994).
288. *See id.* § 1227(b).
289. First Nat'l Bank v. Allen, 118 F.3d 1289 (8th Cir. 1997).
290. *See id.* at 1290-91.

claim.[291] The court held that the creditors were bound by the terms of the plan and had waived any right to assert an unsecured claim.[292]

K. *Modification of a Plan*

The debtor's plan may be modified at any time after confirmation but before completion of payments under the plan.[293] A plan may be modified under Bankruptcy Code section 1229 even after expiration of the three-year plan period and the granting of a discharge to deal with a claim that was to be paid over an extended period.[294] A plan may not be modified, however, unless there has been a material change in circumstances.[295]

L. *Dismissal and Conversion*

Bankruptcy Code section 1230 provides that a debtor may have a chapter 12 case dismissed at any time unless the case has been previously converted from chapter 7 or chapter 11.[296] The debtor may also have a chapter 12 case converted to chapter 7 at any time.[297] The bankruptcy court must find cause to dismiss a case.[298]

1. *A Case May be Dismissed for Failure to Pay Priority Claims*

In *In re Brown*,[299] the court held that dismissal was appropriate where debtor could not demonstrate that it would be able to pay the full amount of priority tax claims under the plan.[300]

2. *A Case May be Dismissed After Repeated Denial of Plan Confirmation*

The court in *In re Barger*[301] dismissed the debtors' chapter 12 case after denying confirmation to several attempted chapter 12 plans.[302] The court repeatedly informed the debtors of the requirements that would need to be met before the court would confirm a plan.[303] The debtors proposed a plan that did not meet the

291. *See id.* at 1291.
292. *See id.* at 1295.
293. *See* 11 U.S.C. § 1229 (1994).
294. *See In re* Schnakenberg, 195 B.R. 435, 438 (Bankr. D. Neb. 1996).
295. *See id.* at 439.
296. *See* 11 U.S.C. § 1208(b) (1994 & Supp. 1998).
297. *See id.* § 1208(a).
298. *See id.* § 1208(c).
299. Brown v. IRS (*In re* Brown), 82 F.3d 801 (8th Cir. 1996).
300. *See id.* at 806.
301. Barger v. Hayes County Non-Stock Co-op (*In re* Barger), 233 B.R. 80 (B.A.P. 8th Cir. 1999).
302. *See id.* at 85.
303. *See id.* at 83.

requirements, so the case was dismissed.[304] On appeal, the bankruptcy appellate panel affirmed the dismissal.[305]

3. *Bad Faith Filing*

In *In re Massie*,[306] a creditor moved to convert a chapter 12 case to a chapter 7 case based on the debtor's alleged fraud.[307] The court held that the debtor filed her chapter 12 case in bad faith, but did not find fraud.[308] Bad faith filing is not equivalent to fraud and does not justify conversion; however, the debtor may be enjoined from further filing after dismissal.[309] The court dismissed the case, enjoined the debtor from filing another bankruptcy case for 180 days, and required the debtor to pay the creditor's attorney's fees as a sanction for the improper filing.[310]

If a chapter 12 case is dismissed, liens that were avoided during the case are reinstated, even if such liens were avoided as part of a confirmed plan.[311]

IV. PACA CASES

The Perishable Agricultural Commodities Act (PACA) creates a statutory trust on certain assets of a commission merchant, broker, or dealer in favor of unpaid sellers or suppliers of perishable agricultural commodities.[312] The trust is superior to rights of secured creditors.

A. PACA *Beneficiary May Assert Rights Against Assets Acquired Before the Beneficiary Extended Credit to the Debtor*

The only assets of value in the debtor's estate in *In re Kornblum & Co.*[313] were interests in a produce cooperative acquired by the debtor prior to the time that the unpaid trust beneficiaries extended credit to the debtor.[314] The lower court held that assets acquired by the debtor prior to the existence of the particular claims could not constitute proceeds of a trust in their favor.[315]

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304. *See id.*
305. *See id.* at 85.
306. *In re* Massie, 231 B.R. 249 (Bankr. E.D. Va. 1999).
307. *See id.* at 250.
308. *See id.*
309. *See id.* at 252-254.
310. *See id.* at 254.
311. *See* Derrick v. Richard L. Grafe Commodities, Inc. (*In re* Derrick), 190 B.R. 346, 350-51 (Bankr. W.D. Wis. 1995).
312. *See* 7 U.S.C. § 499e(c) (1994).
313. *See* Tom Lange Co. v. Kornblum & Co. (*In re* Kornblum & Co.), 81 F.3d 280, 284 (2d Cir. 1996) *vacated*, 177 B.R. 187 (Bankr. S.D.N.Y. 1995).
314. *See id.* at 282.
315. *See id.* at 283.

The Second Circuit disagreed and held that the PACA trust is a single non-segregated floating trust benefiting all sellers to the trust debtor.[316] Once created, the trust continues in existence until all trust beneficiaries have been paid in full.[317] The case was remanded to the lower court to determine whether the interest in the cooperative was purchased with trust assets.[318]

B. *Processing Perishable Produce May Destroy PACA Trust Fund Status*

Dried apricots and dried prunes do not qualify as "fresh fruits" within the meaning of PACA.[319] The drying process applied to the apricots and prunes is more than mere removal of surface moisture and thus amounted to processing that rendered them ineligible commodities for the PACA trust.[320]

C. *Violation of a PACA Trust can be Nondischargeable*

In a dischargeability action brought by a beneficiary of a PACA trust, the bankruptcy court in *In re Snyder*[321] granted summary judgment to the debtor on the grounds that the PACA trust provisions were not the type of trust necessary to except a debt from the discharge provisions of Bankruptcy Code section 523(a)(4).[322] The district court reversed and held that the failure to comply with PACA trust provisions could amount to "defalcation while acting in a fiduciary capacity" within the meaning of section 523(a)(4).[323] The case was remanded to bankruptcy court for a factual determination of whether defalcation occurred.[324]

D. *Courts are Not Bound by Finding in Pre-Bankruptcy Action by Trust Beneficiary in Determining Whether Failure to Pay PACA Trust Fund Claims Leads to Non-Dischargeable Debt*[325]

An order declaring a debt non-dischargeable entered in a pre-bankruptcy lawsuit filed by the trust beneficiary is not binding on the bankruptcy court, according to the court in *In re Zois*.[326] This case also holds that violation of the

316. *See id.* at 286.
317. *See id.*
318. *See id.* at 287.
319. *See In re* L. Natural Foods Corp., 199 B.R. 882, 883 (Bankr. W.D. Pa. 1996).
320. *See id.* at 888.
321. *See* N.P. Deoudes, Inc. v. Snyder (*In re* Snyder), 184 B.R. 473 (Bankr. D. Md. 1995) *rev'd*, 171 B.R. 532 (Bankr. D. Md. 1994).
322. *See id.* at 474.
323. *Id.*
324. *See id.* at 475.
325. *See* Strube Celery & Vegetable Co. v. Zois (*In re* Zois), 201 B.R. 501, 510 (Bankr. N.D. Ill. 1996).
326. *See id.* at 510-11.

PACA trust fund provisions can give rise to a non-dischargeable debt.[327] The bankruptcy court will need to determine whether the failure to pay the trust fund claims amounted to defalcation while acting in a fiduciary capacity.[328]

A restaurant is also not subject to PACA unless the buying arm of the restaurant is a separate legal entity and is reselling to another entity.[329] Note that this holding differs from the court's holding in *In re Magic Restaurants*.[330]

V. NON-BANKRUPTCY CASES OR ISSUES THAT MIGHT AFFECT AGRICULTURAL BANKRUPTCY

A. *Farm Credit Act Cases*

A decision of the Eighth Circuit Court of Appeals has held that the Farm Credit Act preempts state law regarding pre-payment premiums. In *Bank of America v. Shirley*,[331] an Iowa state law prohibited the enforcement of pre-payment premiums.[332] A provision in the Farm Credit Act provides that state laws shall not apply to any amount that a lender may charge for a loan to be included in a Farmer Mac pool.[333] Accordingly, the Iowa state law was preempted and the pre-payment premium contained in the Farmer Mac loan was enforceable.[334]

B. *Uniform Commercial Code Cases*

A number of Uniform Commercial Code cases were decided in bankruptcy courts the last few years and raise interesting issues of interpretation in bankruptcy.

1. *Federal Regulations Prohibiting Assignment of Federal Crop Insurance Payments*

In *In re Rees*,[335] the debtors and the FSA stipulated that the FSA held a security interest in the debtors' crop insurance proceeds that was perfected under state law.[336] At issue in the case was whether federal regulations prohibited the attachment of a state law security interest.[337] The applicable regulations prohibited

327. *See id.* at 506-07.
328. *See id.*
329. *See* Monteverde's, Inc. v. Italian Oven, Inc. (*In re* The Italian Oven, Inc.), 207 B.R. 839, 844 (Bankr. W.D. Pa. 1997).
330. *See id. But see* Bowie Produce Co. v. Magic American Café, Inc. (*In re* Magic Restaurants, Inc.), 197 B.R. 455, 457-58 (Bankr. D. Del. 1996).
331. Bank of America v. Shirley, 96 F.3d 1108 (8th Cir. 1996).
332. *See id.* at 1111-12.
333. *See id.* at 1114.
334. *See id.* at 1112.
335. *In re* Rees, 216 B.R. 551 (Bankr. N.D. Tex. 1998).
336. *See id.* at 552.
337. *See id.*

assignments of a farmer's right to receive federal crop insurance payments unless consented to by the Federal Crop Insurance Corporation.[338] Federal regulations prohibiting assignment of Federal Crop Insurance payments do not invalidate security interest in proceeds of a crop insurance contract.[339] The court held that the regulations prohibited an assignment of the right to payment but not the right to receive the proceeds of an insurance policy.[340] Accordingly, the debtors could not avoid the security interest held by the FSA.[341]

2. *A Security Interest in a Cooperative Member's Equity Retainage*

In *In re Bonnema*,[342] a member of a cooperative filed bankruptcy.[343] The member had granted a blanket article 9 security interest to a bank.[344] The member's bankruptcy trustee filed a complaint to determine the validity of the bank's security interest and claimed that the bank's failure to obtain the cooperative's consent to a security interest in the member's equity retainage rendered the security interest invalid under Kansas law.[345]

The court held that the equity retainage constituted a "general intangible" under article 9 but that article 9 was subject to a Kansas law granting a cooperative the right to place restrictions on the disposition of a member's capital interest in the cooperative.[346] A security interest in a cooperative member's equity retainage taken without the consent of the cooperative is invalid.[347] Because the bylaws of the cooperative in question required the consent of the cooperative to any assignment or transfer of an equity retainage, and the bank failed to obtain that consent, the purported security interest was invalid.[348]

3. *A Purchase Money Security Interest Perfected by Possession of Cattle Sold by Filing*

The chapter 11 trustee in *In re Kunkel*[349] sought a determination as to the priority of two competing security interests in cattle owned by the estate.[350] A bank

338. *See id.* at 554.
339. *See id.* at 555.
340. *See id.*
341. *See id.* at 556.
342. Morton v. Santa Anna Nat'l Bank (*In re* Bonnema), 219 B.R. 951 (Bankr. N.D. Tex. 1998).
343. *See id.* at 953.
344. *See id.*
345. *See id.*
346. *See id.* at 955-56.
347. *See id.*
348. *See id.* at 956.
349. Kunkel v. Sprague Nat'l Bank (*In re* Kunkel), 198 B.R. 734 (Bankr. D. Minn. 1996) *aff'd in part, rev'd in part*, by 128 F.3d 636 (8th Cir. 1997).

had a perfected security interest in the debtors' cattle due to the filing of a financing statement.[351] A feed lot subsequently sold cattle to the debtors, received the grant of a purchase money security interest to secure part of the purchase price, and retained possession of the cattle.[352]

The court held that a purchase money security interest in inventory perfected by possession of inventory never coming into the debtors' possession has priority over a security interest previously perfected by filing.[353] Because the debtor never obtained possession of the inventory, the purchase money secured party is not required to provide the notice to the senior secured party normally required to achieve a purchase money priority.[354]

4. *A Security Agreement That is Inadequate Because it Does Not Contain a Description of the Real Property*

In *In re Kevin Emrick Farms*,[355] a security agreement purporting to cover crops failed to contain a description of the real property on which the crops were grown, thus rendering the security agreement insufficient to create a security interest in growing crops.[356] The secured party sought to remedy this inadequacy by having the financing statement, which did not contain a description, read together with the security agreement as a composite document.[357] The court refused to do so and held the security interest invalid.[358]

C. *California Producer's Lien Cases*

The California producer's lien statute provides a lien to a farmer covering all farm products and processed or manufactured forms of farm products in the possession of a processor.[359]

In *In re Sargent Walnut Ranches*,[360] an agricultural processor obtained farm products from producers but failed to pay for those products.[361] A lien on the processor's farm products arose under the California producers' lien.[362] At the time

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350. *See id.* at 737.
351. *See id.*
352. *See id.* at 736.
353. *See id.* at 737.
354. *See id.* at 739.
355. Firstar Bank v. Stark Agric. Servs. (*In re* Kevin W. Emrick Farms, Inc.), 201 B.R. 790 (Bankr. C.D. Ill. 1996).
356. *See id.* at 799.
357. *See id.* at 800.
358. *See id.* at 801.
359. *See* CAL. FOOD & AGRIC. CODE § 55631 (West 1986).
360. U.S. Bank, N.A. v. Desert Farms of California, Inc. (*In re* Sargent Walnut Ranches, Inc.), 219 B.R. 880 (Bankr. E.D. Cal. 1998).
361. *See id.* at 881-82.
362. *See id.* at 882.

the processor filed for bankruptcy, all of the farm products had been sold and the processor owned an account receivable arising from the sale of the farm products.[363] A bank held a security interest in the processor's accounts receivable and claimed a security interest in the account arising from the sale of the farm products.[364]

A grower contended that its producers' lien on the farm products also extended to the accounts receivable created when the farm products were sold.[365] The court held that the producers' lien extended only to farm products and did not cover accounts.[366] The holding was based primarily on the language of the statute which grants a lien on farm products but not on their proceeds.[367]

The court contrasted the language of the statute with the livestock lien that was enacted by the legislature in the same year that the producers' lien was modified to create its current form.[368] The livestock lien, unlike the producers' lien, explicitly granted a lien on proceeds.[369] Accordingly, the bank was entitled to receive the proceeds of the account.[370]

VI. CONCLUSION

As the case discussion above indicates, agricultural cases still raise some interesting bankruptcy issues. One of the areas to watch out for in the future is the effect of the revised version of article 9 of the Uniform Commercial Code on agricultural bankruptcies. The revised version of article 9, which is scheduled to take effect on July 1, 2001, in any state that adopts it, contains many provisions affecting agricultural transactions. No doubt many of those new provisions will be tested in bankruptcy courts.

363. *See id.*
364. *See id.*
365. *See id.* at 884.
366. *See id.* at 886.
367. *See id.* at 883-84.
368. *See id.* at 884.
369. *See id.*
370. *See id.* at 886.