CHAPTER 12: ENTREPRENEUR PUNISHMENT AND FAMILY FAVORITES

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I. INTRODUCTION

Family farms have historically been the recipients of beneficial legislative actions, most prominently with the first Farm Bill enacted during the Great Depression.[1] In 1986, Congress created Chapter 12 of the Bankruptcy Code with

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1. David Phelps, *Struggling Farmers To Benefit from Proposed Bankruptcy Law*, STAR TRIB., Oct. 15, 1986, at 1A, *available at* 1986 WLNR 1137094; *see* Agricultural Adjustment Act of 1933, ch. 25, 48 Stat. 31.

farmers exclusively in mind.[2] Enacted amidst the unprecedented farm crisis of the 1980s and set to expire with a sunset date,[3] this Act was extended several times.[4] Finally, it became a permanent part of the Code in 2005.[5] From a micro perspective of the legislation, Congress' purpose in writing Chapter 12 was to create a chapter tailored to the specialized nature of operating a family farm.[6] From a macro view of the legislation, the purpose of Chapter 12 was to stall the decline of the farm economy, specifically family farms, long enough to allow its rejuvenation through other legislative actions.[7]

The farm crisis began in the Midwest and extended to other regions of the country by the mid-1980s.[8] The effects of the farm crisis were broad and representatives from the Midwestern farm states supported the bill.[9] For example, Senator Charles Grassley of Iowa spoke of the consequences of the high interest rates and low farmland values devastating his home state: "I hear it and I see it when I go back home every weekend. I know my colleagues have seen it too. We simply must stop the displacement. We must stop the bleeding on the farm."[10] He further noted that "farm problems are not just a problem for farmers and their lenders. There is an impact on other 'main street' and 'mom and pop' firms too, that cannot be overlooked."[11] Drawing from statements like this, it is apparent that a corollary goal of creating a special bankruptcy chapter for farmers was to support rural economies. Keeping family farmers on their land and farming would help avert these economies from total disaster.

In 1986 the initial bill creating Chapter 12 had considerable bipartisan political support.[12] This support is evidenced by its rapid movement through the

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2. Phelps, *supra* note 1; *see* Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, § 255, 100 Stat. 3088, 3105-14 (current version at 11 U.S.C. §§ 1201-1231 (2006)) [hereinafter 1986 Bankruptcy Act].

3. 1986 Bankruptcy Act § 302(f), 100 Stat. at 3124.

4. *See* Susan A. Schneider, *History of Chapter12 Bankruptcy: On Again, Off Again*, AGRIC. L. UPDATE, Aug. 2002, at 1-2, http://www.nationalaglawcenter.org/assets/aala/08-01.pdf.

5. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (codified in scattered sections of 11 U.S.C.) [hereinafter 2005 Bankruptcy Act].

6. *See* Phelps, *supra* note 1; *see generally* Ken D. Duft, *Chapter 12 Bankruptcy in Retrospect; Its Impact on Agribusiness Firms*, AGRIBUSINESS MGMT., at 1, *available at* http://www.agribusiness-mgmt.wsu.edu/ExtensionNewsletters/cash-asset/Chap12.pdf.

7. 131 CONG. REC. 16924 (1985).

8. Thomas J. Knudson, *Middle West's Farm Crisis Reaches the East*, N.Y. TIMES, Mar. 3, 1986, *available at* http://www.nytimes.com/1986/03/03/nyregion/middle-west-s-farm-crisis-reaches-the-east.html?&pagewanted=all.

9. *See* H.R. REP. NO. 99-958, at 51 (1986) (Conf. Rep.) (listing the representatives and senators who acted as managers for the bill); Phelps, *supra* note 1.

10. 132 CONG. REC. 28593 (1986).

11. 132 CONG. REC. 9896.

12. 131 CONG. REC. 16924 (1985).

often lengthy legislative process: initiated on August 1, 1986, the bill was law by the end of October.[13] The bill passed through the House and the Senate by voice vote, not roll call, making it difficult to discern its precise geographical and political support.[14] Its broad support can be attributed to the fact that it was designed to help family farmers who have a presence in almost every state.[15]

The 1986 version of Chapter 12 contained some important differences from its current form.[16] Originally, the bill disallowed farmers from filing for bankruptcy if their debt was above a ceiling of $1,500,000 or if less than 80% of their debt was farm-related.[17] When Congress made Chapter 12 permanent in 2005, both the debt ceiling and farm-related debt percentage were broadened in an effort to increase eligibility.[18]

In its current form, the Bankruptcy Code defines a "family farmer" as an "individual . . . whose aggregate debts do not exceed $3,544,525 and not less than 50 percent of whose aggregate noncontingent, liquidated debts . . . arise out of a farming operation owned or operated by such individual."[19]

The next much-litigated question is what exactly constitutes a "farming operation." Code section 11 U.S.C. § 101(21) offers a non-exhaustive list of possibilities: "The term 'farming operation' includes farming, tillage of the soil,

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13. 1986 Bankruptcy Act, Pub. L. No. 99-554, 100 Stat. 3088 (current version at 11 U.S.C. §§ 1201-1231 (2006)); 132 CONG. REC. 18669 (1986).

14. THOMAS, Library of Cong., Bill Summary and Status: H.R. 5316, http://thomas.loc.gov/cgi-bin/bdquery/z?d099:HR05316:@@@L&summ2=m& (last visited Oct. 31, 2010).

15. *See* 1986 Bankruptcy Act § 251, 100 Stat. at 3104 (describing a "family farmer" as: "(A) individual or individual and spouse engaged in a farming operation whose aggregate debts do not exceed $1,500,000 and not less than 80 percent of whose aggregate noncontingent, liquidated debts (excluding a debt for the principal residence of such individual or such individual and spouse unless such debt arises out of a farming operation), on the date the case is filed, arise out of a farming operation owned or operated by such individual or such individual and spouse, and such individual or such individual and spouse receive from such farming operation more than 50 percent of such individual's or such individual and spouse's gross income for the taxable year preceding the taxable year in which the case concerning such individual or such individual and spouse was filed").

16. *See* Susan A. Schneider, *Bankruptcy Reform and Family Farmers: Correcting the Disposable Income Problem*, 38 TEX. TECH L. REV. 309, 310-11 (2006) ("The new law eliminates the temporary authorization for Chapter 12, making it a permanent part of the Bankruptcy Code. Amendments expand Chapter 12 eligibility by broadening four different criteria. Congress eliminated the priority formerly given to certain capital gains taxes. The new law also prohibits the 'retroactive assessment of disposable income.'").

17. 1986 Bankruptcy Act § 251, 100 Stat. at 3104.

18. 2005 Bankruptcy Act, Pub. L. No. 109-8, §§ 1001-1007, 119 Stat. 23, 185-88 (current version at 11 U.S.C. § 101(18) (2006)); *see* Schneider, *supra* note 16, at 310.

19. 11 U.S.C. § 101(18)(A), *amended by* Revision of Certain Dollar Amounts in the Bankruptcy Code Prescribed Under Section 104(b) of the Code, 72 Fed. Reg. 7082 (Feb. 14, 2007) (increasing the aggregate debt limit from $3,237,000 to $3,544,525).

dairy farming, ranching, production or raising of crops, poultry, or livestock, and production of poultry or livestock products in an unmanufactured state."[20] Many courts have added various types of operations as qualifying because of the broad construction of § 101(21).[21] This open-ended wording of the statute has left bankruptcy judges with the case-by-case task of determining whose operations are included and whose are excluded. Therefore, this statutory construction has resulted in bankruptcy judges interpreting the phrase "farming operation" freely.

This Note focuses on the interpretations of "farming operation" contained in 11 U.S.C. § 101(18) and (21). Bankruptcy judges have interpreted the phrase broadly in concert with Congress' legislative intent to help family farms by enacting a favorable bankruptcy chapter. However, bankruptcy judges have also interpreted the phrase narrowly when it appears to them that a debtor is masquerading as a farmer and attempting to secure more favorable treatment under Chapter 12 while in bankruptcy.

First, this Note will examine the types of debt a family farmer typically incurs.[22] Based on the text of the statute, it can be assumed that Congress meant to cover basic farm debts.[23] Next, this Note will briefly compare and contrast Chapter 12 to Chapter 13,[24] a bankruptcy option largely for small businesses that farmers used prior to Chapter 12 which proved largely unworkable. Then, this Note will examine Chapter 12 bankruptcy cases that interpret the phrase "farming operation" broadly when family members owe one another money.[25] Throughout this Note, these will be referred to as the "family cases." In these cases, fissiparous families are transferring farm assets through debt instruments as a result of divorce and death.[26] This Note will examine the sole exception to this line of cases and the test that bankruptcy courts have developed.[27] It is this author's contention that the majority holding of these decisions may not have been intended by the legislators who passed Chapter 12.[28]

A second line of cases interpret "farming operation" narrowly when a farmer attempts to expand into other non-agricultural industries.[29] These cases will be referred to as "other business ventures." In this area, courts have em-

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20. 11 U.S.C. § 101(21).
21. *See, e.g.*, *In re* Douglass, 77 B.R. 714, 715 (Bankr. W.D. Mo. 1987).
22. *See* discussion *infra* Part II.
23. *See* 1986 Bankruptcy Act, Pub. L. No. 99-554, § 251, 100 Stat. 3088, 3104 (current version at 11 U.S.C. § 101(18) (2006)).
24. *See* discussion *infra* Part III.
25. *See* discussion *infra* Part IV.
26. *Id.*
27. *See* discussion *infra* Part IV(B).
28. *See* discussion *infra* Part IV(A)(4).
29. *See* discussion *infra* Part V(C)-(D).

ployed a stricter, more textually-based test than in the family cases, with notable exceptions.[30]

This Note will argue that the test for each line of cases is misguided. In the family cases, the court has given the statute a very broad interpretation in including non-farm-operation debts incurred from divorce and death into the farmer's total debt percentage.[31] This broad test should be replaced by a narrower test. There is a lone exception to the court's broad rulings, and it should be followed in all family cases. In cases involving debt incurred from other business ventures, the court's stringency in interpreting whether it qualifies as a "farm operation" debt makes little sense in light of two things. First, the congressional intent behind enacting Chapter 12 suggests a broad interpretation. Second, the corollary goals of Chapter 12 are arguably better met through a broader, more economic-friendly interpretation of the statute that allows farmers to diversify their business interests to support rural economies.

Finally, this Note will propose a model statute to eradicate the different treatment farmers receive for farm debt in the familial context versus the other-business-venture context.[32] Because the legislative intent in enacting Chapter 12 was to improve rural America, the inconsistent results of these two lines of cases seem counterintuitive.[33] A bankruptcy code that allows farmers to continue to have their debt classified as farming debt despite doing non-farming activities is essential for both family farmers and the rural economies they support.

II. BASIC FARM DEBT

It is widely known that the farming and agricultural industry is a heavily indebted industry.[34] Farmers accumulate a considerable amount of debt when purchasing seed, equipment, livestock, and land to expand their operations, in addition to short-term operating loans.[35] Debt is the most common way family farmers obtain financing.[36] Not surprisingly, mortgaging farm land remains the

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30. *Id.*

31. *See* discussion *infra* Part IV.

32. *See* discussion *infra* Part VII.

33. *See* 132 CONG. REC. 9896 (1986).

34. *E.g.*, J. MICHAEL HARRIS ET AL., USDA, THE DEBT FINANCE LANDSCAPE FOR U.S. FARMING AND FARM BUSINESSES 7 (2009), *available at* http://www.ers.usda.gov/Publications/AIS87/AIS87.pdf. U.S. farm sector debt was approximated at $240 billion in 2008 and was forecasted to decline to $234 billion in 2009. *Id.*

35. *See id.* at 37. In a 2007 Agricultural Resource Management survey, farmers were asked to report their primary purpose for debt financing, with responses including "real estate . . . purchasing feeder livestock, buying other livestock, funding current operating expenses, purchasing machinery and equipment, [and] consolidating debt." *Id.*

36. *See generally id.* (detailing the increasing debt levels in farms).

largest collateral type farmers can use to borrow sufficient funds.[37] Both familial debt and other business venture debts fall outside this general category of farm debt.

III. CHAPTER 12 V. CHAPTER 13

Despite the benefits of Chapter 12 bankruptcy available to family farmers, it is the second most underutilized chapter of the bankruptcy code.[38] Chapter 12 can be described succinctly in seven steps:

1. Farmer receives credit counseling from an approved credit counseling service
2. Farmer files a Chapter 12 petition with the bankruptcy court
3. 20-35 days after filing petition, the bankruptcy court will hold a meeting of creditors
4. Within 90 days of filing the initial petition, the farmer is required to submit a reorganization plan to the court
5. The court confirms the plan or rejects the plan
6. If confirmed, the farmer will stay in bankruptcy 3-5 years
7. The farmer will be discharged from bankruptcy and continue to make long term debt payments.[39]

Chapter 12 gives farmers and creditors incentives to renegotiate and resolve their disputes outside of bankruptcy.[40] Chapter 12 is written so that time benefits the farmer in three aspects, since "[t]ime is never neutral in a bankruptcy proceeding."[41] First, the efficiency of the bankruptcy process aids the farmer in

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37. *See id.* at 9-10 (explaining that real estate is "the single largest asset in farming" and that a portion of "farm sector debt is owed by farmers who use farm assets to secure debt for major household purchases or to fund other activities").

38. Rosemary E. Williams, *Representing the Debtor in a Chapter 12 Case*, *in* 2 BANKRUPTCY PRACTICE HANDBOOK § 11.1 (2d ed. 2009) (noting that Chapter 9 for municipalities is the most underutilized).

39. Robert Moore, *Chapter 12 Bankruptcy: Hope for Financially Stressed Family Farms* (2009), http://dairy.osu.edu/resource/2009%20BDN%20Chapter%2012%20Bankruptcy%20_2_.pdf (footnote omitted).

40. Mark Bromley, *The Effects of the Chapter 12 Legislation on Informal Resolution of Farm Debt Problems*, 37 DRAKE L. REV. 197, 209 (1987).

41. Robert D. Martin, *Chapter 12 After Almost One Year in the Bankruptcy Courts*, 37 DRAKE L. REV. 211, 212 (1987).

avoiding interest payments and penalties.[42] Second, the elongation of debt payments in the plan helps minimize periodic payments.[43] In the bankruptcy plan, debt negotiation has taken the form of interest rate reductions and shared appreciation agreements, which reduces the farmer's debt level to the value of the real estate.[44] Third, whatever debt ends up being classified as "long-term" may not have to be paid in full for several years.[45] As a debtor, the effects of currency inflation reduce the real value paid back to the creditor, but the nominal value of the debt remains the same or can be reduced to its current value.[46]

Chapter 13 is similar to Chapter 12 in that it reorganizes debt into a three to five year repayment plan.[47] Chapter 13 contains a lower debt ceiling and was primarily designed for wage-earners.[48] Because farmers do not earn wages and are usually leveraged, Chapter 13 was unworkable for family farmers in the Farm Crisis.

IV. FIRST GROUPING OF CASES

A. *The "But For" Test*[49]

The first grouping of cases involves debt arising from divorce settlements or death.[50] The bankruptcy courts have almost all subscribed to the same test in these cases when determining whether a debt "arise[s] out of a farming operation owned or operated by" the person filing for bankruptcy.[51] First, there must be a connection between the debt and the farming activity.[52] In determining

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42. *See id.*; *see also* Bromley, *supra* note 40, at 198 (discussing creditors' willingness to lower interest rates, allowing farmers to continue operations and continue making payments).

43. *See* Williams, *supra* note 38 ("The individual debtor in Chapter 12 is in bankruptcy for a period of five years, while the debtor in a case under Chapter 7 may receive a discharge and complete the case in a few months.").

44. Bromley, *supra* note 40, at 198.

45. *See id.* at 205-06 (discussing how a debtor can increase the amortization period to meet short term cash flow obligations).

46. Martin, *supra* note 41, at 217-18; *see also* Moore, *supra* note 39 (describing how Chapter 12 allows the debtor to "'cram down' the secured debt").

47. *Compare* 11 U.S.C. § 1322(d)(1)-(2) (2006), *with* 11 U.S.C. § 1222(c) (2006).

48. *See* § 1322(d)(1)-(2).

49. *In re* Reak, 92 B.R. 804, 805-06 (Bankr. E.D. Wis. 1988). The court identified the test developing throughout several similar cases and labeled it the "but for" test.

50. *In re* Marlatt, 116 B.R. 703, 705 (Bankr. D. Neb. 1990); *In re Reak*, 92 B.R. at 804; *In re* Roberts, 78 B.R. 536, 536 (Bankr. C.D. Ill. 1987); *In re* Rinker, 75 B.R. 65, 66 (Bankr. S.D. Iowa 1987).

51. 11 U.S.C. § 101(18)(A).

52. *In re Marlatt*, 116 B.R. at 705; *In re Reak*, 92 B.R. at 806; *In re Roberts*, 78 B.R. at 537; *In re Rinker*, 75 B.R. at 68.

the strength of the connection, the courts in these cases used the "but for" test. The "but for" test can be expressed as: but for the indebtedness created by the family farmer, there would be no farm. In all of these cases, the family member who is operating the farm is indebted to a relative, either because of a divorce or a death forcing relatives to rearrange the farm.[53] It is not surprising that the bankruptcy courts sided with the farmer in these cases given the ferocity of the farm crisis. However, it is surprising given the seemingly simple and direct language of the statute.

1. In re Rinker

In this case, there were three sisters and one son whose parents owned a farm in rural Boone County, Iowa.[54] As is usually the case, the will provided that if the son were farming the land, he would be given an option to purchase at fair market value.[55] When both parents died, the land was devised in equal shares to each sibling.[56] For the son to continue farming, he purchased his sisters' land with mortgages on each.[57] After negotiating the purchase of the land, he filed for bankruptcy under Chapter 12.[58] Included in the filings were the mortgages he owed his sisters as part of his total debt.[59]

The amount of debt the son owed his sisters was 39% of his total indebtedness, an amount significant enough to determine whether he would be eligible for Chapter 12.[60] The court succinctly phrased the issue as "whether a debt that arises out of a settlement of a will dispute is also a debt that arises out of a farming operation for purposes of 11 U.S.C. section 101(17)(A)."[61] The court relied on the "pragmatic viewpoint" set forth in *In re Armstrong*,[62] looking beyond simply the source of the debt in settlement of a lawsuit for its relation to the farming operation, and decided that the debt the son owed to his sisters was in-

53. *In re Marlatt*, 116 B.R. at 705; *In re Reak*, 92 B.R. at 804; *In re Roberts*, 78 B.R. at 536; *In re Rinker*, 75 B.R. at 66.

54. *In re* Rinker, 75 B.R. at 66.

55. *Id.*

56. *Id.*

57. *Id.* at 66-67.

58. *Id.* at 66.

59. *Id.* at 66-67.

60. *Id.*; *see* 1986 Bankruptcy Act, Pub. L. No. 99-554, § 251, 100 Stat. 3088, 3104 (current version at 11 U.S.C. § 101(18) (2006)) (requiring that not less than 80% aggregate debt "arise out of farming operation").

61. *In re Rinker*, 75 B.R. at 66 (citing the law as codified at 11 U.S.C. § 101(17) (1988) [now codified at 11 U.S.C. § 101(18) (2006)]).

62. *In re* Armstrong, 812 F.2d 1024, 1026 (7th Cir. 1987).

separable from the land.[63] Essentially, the court reduced the three sisters' inheritance by allowing the brother to stretch and extend his repayments on the buy-out mortgages, which significantly reduced the total they received due to inflation.

2. In re Roberts

Shortly after *In re Rinker* was decided, another bankruptcy court dealt with an issue arising from inheritance.[64] The case *In re Roberts* involved a daughter who inherited the farm she had been operating for her mother when her mother died.[65] The federal and state inheritance taxes and fees levied on the transfer of the farm from mother to daughter, totaling over $114,000, were so substantial that the daughter filed for Chapter 12.[66] The issue in this case was "whether estate taxes, payable as a result of the death of the Debtor's mother in 1980, are debts that arose out of a farming operation for purposes of 11 U.S.C. § 101(17)(A)."[67]

The court built upon the pragmatic analysis of *In re Armstrong* and *In re Rinker* and held that even though the debts were incurred by the estate taxes, they arose out of a farming operation.[68] The court noted that there was a "direct link between the estate taxes and the farming activity," and "[w]ithout the land, the Debtor would not have a farming operation."[69] Thus, the court adhered to the stance that "[*b*]*ut for* the payment of the estate taxes, there would be no farm."[70]

3. In re Reak

In re Reak introduces the second type of case presented in this section: bankruptcies surrounding divorces.[71] In this case, when the husband and wife were married, they purchased a farm from the wife's parents.[72] The farm was purchased on a land contract basis subject to a mortgage owned by the wife's parents, and both the husband and the wife became jointly liable for it.[73] When

63. *In re Rinker*, 75 B.R. at 68.
64. *In re* Roberts, 78 B.R. 536, 536 (Bankr. C.D. Ill. 1987).
65. *Id.*
66. *Id.*
67. *Id.* (citing the law as codified at 11 U.S.C. § 101(17) (1988) [now codified at 11 U.S.C. § 101(18) (2006)]).
68. *Id.* at 537-38.
69. *Id.* at 538.
70. *Id.* (emphasis added).
71. *In re* Reak, 92 B.R. 804, 804 (Bankr. E.D. Wis. 1988).
72. *Id.* at 805.
73. *Id.*

husband and wife later divorced, the husband agreed to be solely responsible for the mortgage as part of the divorce agreement and make payments on the farm to the estate of the wife's mother.[74] When the husband filed for bankruptcy, the wife risked having to assume the balance of the unsecured claim discharged against the husband's bankruptcy estate, which was effectively her inheritance—the value of her parent's farm.[75]

The court applied the "but for" test, concluding that but for the land being acquired earlier under mortgage, there would be no farm.[76] But for the mortgage, there would have been no provision in the divorce settlement making the husband solely responsible.[77] Passing the "but for" test, the court determined that the debt arose out of a farm operation.[78] The court wrote that deciding otherwise "would be unduly restrictive."[79] By interpreting § 101(18)(A) as Mrs. Reak requested, the court would have acted contrary to the philosophy that led to the enactment of Chapter 12, which focused on keeping the debtor, who in this case had been a farmer all of his life and who had farmed his wife's parent's land since 1963, on the land.[80] Clearly, the court did not feel restricted to a strict interpretation of debt arising out of a farming operation to qualify Mr. Reak as a family farmer under Chapter 12.[81]

4. In re Marlatt

Another family dispute occurred in *In re Marlatt* over the terms of a divorce agreement.[82] *In re Marlatt* involved a Chapter 12 bankruptcy filing subsequent to the signing of a divorce settlement between a farmer and his former wife.[83] The divorce settlement determined that the husband would pay his wife $10,000 a year over thirteen years, which was secured by a first lien on all "farm and non-farm" real estate.[84] The court alludes to the fact that this cash settlement was reached in lieu of dividing the assets of the farm through dissolution.[85] At an unspecified time after the divorce settlement was reached, the farmer filed for

74. *Id.* at 804-05
75. *Id.* at 806.
76. *Id.*
77. *Id.*
78. *Id.*
79. *Id.*
80. *Id.*
81. *Id.*
82. *In re* Marlatt, 116 B.R. 703, 705 (Bankr. D. Neb. 1990).
83. *Id.*
84. *Id.*
85. *See id.* at 706.

Chapter 12 bankruptcy, listing the $130,000 he owed his ex-wife along with his other debts incurred from operating the farm.[86] Because the $130,000 divorce settlement constituted over 20% of the farmer's total debt, Chapter 12 eligibility hinged on whether the debt was considered to be farm-related.[87]

Falling in line with the other cases in this section, the court found that the farmer's debt from the divorce settlement was sufficiently related to the operation of the farm for Chapter 12 purposes.[88] The court concluded that the underlying purpose of a divorce settlement of $130,000 cash was to allow the ex-husband to continue farming.[89] As such, the debt was "within the scope of and 'inescapably interwoven' with the farming operation" and counted towards the 80% threshold.[90]

The timing of *In re Marlatt* allowed the court to decide between the two tests developing in these types of cases: the *In re Rinker* "but for" test and the *In re Van Fossan* risk test.[91] By choosing the test from *In re Rinker* and applying the "but for" test, the court solidified a test in family cases which favors the debtor-farmer over the creditor-relative.[92]

Taking these cases out of the desperate era of the farm crisis, the results might appear strange. A brother reduces his sisters' inheritance in *In re Rinker*, an ex-husband reduces his ex-wife's inheritance in *In re Reak*, and two ex-husbands significantly delay their divorce settlements to their wives; all using the lenient provisions of Chapter 12 and the benefits of very high inflation. However, these four debts do not appear to "arise out of a farming operation."[93] Rather, they appear to arise out of property dispositions resulting from family matters, no different from non-farmers. Death and divorce do not come to mind as integral parts of a farming operation. Treated as such, divorcees lost the value of their settlements and beneficiaries lost their inheritances.

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86. *See id.* at 705.
87. *Id.*
88. *Id.* at 705-06
89. *Id.* at 706.
90. *Id.* (quoting *In re* Armstrong, 812 F.2d 1024, 1026 (7th Cir. 1987)).
91. *In re* Rinker, 75 B.R. 65, 68 (Bankr. S.D. Iowa 1987); *See In re* Van Fossan, 82 B.R. 77, 80 (Bankr. W.D. Ark. 1987). See *infra* Part V for further discussion.
92. *See, e.g.*, *In re Marlatt*, 116 B.R. at 706.
93. 11 U.S.C. § 101(18)(A) (2006).

B. *The Risk Test*

1. In re Van Fossan

There is a lone exception to bankruptcy courts applying the *In re Rinker* "but for" test. Independent of the previous line of cases, *In re Van Fossan* involves another divorce agreement between a farmer and his former wife.[94] Here, the husband farmer agreed to pay his ex-wife $295,000 and subsequently filed for Chapter 12 bankruptcy with debts totaling more than $700,000.[95] Because the debt the farmer owed his wife accounted for more than 20% of his total debt, his Chapter 12 eligibility turned on whether this debt was considered to be farm-related.[96]

The court ruled the divorce settlement was not farm-related, as it did not occur because of a "risk or activity" of a farming operation under 11 U.S.C. § 101(21).[97] Rather, the court described this debt as a distribution of marital property, an act entirely separate from the farm.[98] The "risk or activity" language used by this court to evaluate what constitutes debt arising out of a farming operation became known as the "risk test" by subsequent courts.[99] However, no courts have followed the holding of *In re Van Fossan*.[100] The "but for" test and its retinue remain the dominant tests when determining whether debts caused by inheritance or divorce are farm-related.

V. SECOND GROUPING OF CASES: FARMS WITH OTHER BUSINESS VENTURES

The second grouping of cases involves debt arising from farmers' diversified business interests outside the scope of more traditional family farm debts.[101] Compared to the broad interpretations by bankruptcy judges for debts in the family law context arising out of a farming operation, debts from other business ventures have been interpreted narrowly under the statute. As a result, a struggling farmer who sought extra income beyond his farm income was consequently denied the benefits of having that debt count toward his Chapter 12 qual-

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94. *In re Van Fossan*, 82 B.R. at 78.
95. *Id.*
96. *Id.* at 79.
97. *Id.* at 80.
98. *Id.*
99. *See In re* Marlatt, 116 B.R. 703, 706 (Bankr. D. Neb. 1990).
100. *See, e.g.*, *id*. (concluding that the risk test was not applicable in the Eighth Circuit).
101. The phrase "diversified business interests" is meant to depict business ventures beyond one farmer farming by himself, on his own land, and deriving his income entirely from that activity.

ifications. A narrow interpretation in this realm of cases created perverse incentives for farmers attempting to escape the economic malaise of the farm crisis. It reduced the incentive for struggling farmers to seek other ways to support their farming operations when they should have been encouraged to do so.

A. In re Douglass

The first case in the other business venture line interpreting the "arise[s] out of a farming operation" statutory language came from Missouri, a state in the throes of the farm crisis by 1987.[102] The Douglass family had inherited a service station, which they mortgaged to help keep their farming operation afloat.[103] The amount of the loan on the service station was large enough to dictate whether Chapter 12 bankruptcy was available to the Douglass family.[104]

Because *In re Douglass* was a case of first impression, the court was free from precedent in creating a two-factor test to determine whether the debt created by mortgaging the service stations qualified as "'arising out of a farming operation.'"[105] The first factor the court examined was the Douglass' "purpose for which the debt was incurred."[106] In conjunction with purpose, the second factor was determining "the use to which the borrowed funds were put."[107] Since the debt was secured by nonfarm property, the court placed the burden on the Douglass family to show that the loan money was used in their farming operation.[108] The court agreed with the Douglass family's arguments that the loan money had been used to further the farming operation.[109] Thus, the reason for the debt, to preserve the farm, was probative and the nature of the debt's collateral, several service stations, was not dispositive even though mortgaged service stations are distinctly nonfarm in nature.

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102. *See In re* Douglass, 77 B.R. 714 (Bankr. W.D. Mo. 1987); *see also* ECON. RESEARCH SERV., USDA, AGRICULTURAL FINANCE: SITUATION AND OUTLOOK REPORT 24-27 (1987), *available at* http://usda.mannlib.cornell.edu/usda/ers/AIS/1980s/1987/AIS-03-27-1987.pdf (documenting the deteriorating farm debt crisis in the U.S. during 1986).

103. *In re Douglass*, 77 B.R. at 715.

104. *Id.* at 714-15.

105. *Id.* at 715.

106. *Id.*

107. *Id.*

108. *Id.*

109. *Id.*

B. In re Easton

In re Easton involved the grandson of a farmer who wanted to build a hog confinement facility.[110] To help his grandson with his goal, the farmer sold his grandson the land on which the facility was to be constructed.[111] The farmer also guaranteed his grandson's loan, using a second mortgage on some of their farmland as collateral.[112] However, both grandson and grandfather became unable to make payments on the loan, and the grandfather subsequently filed for Chapter 12 bankruptcy.[113] The grandfather's eligibility for Chapter 12 hinged on the issue of whether the debt for his grandson's hog confinement facility was sufficiently related to the grandfather's farming operation under 11 U.S.C. § 101(18)(A).[114]

The court found that the debt for the hog confinement facility met the statutory definition for arising out of a farming operation.[115] Despite the ownership of the facility remaining unclear, the grandfather took part in its day-to-day management.[116] The "operational role" of the grandfather was deemed to be a significant enough relationship to the hog confinement facility for it to be considered part of his farming operation.[117]

C. In re Kan Corp.

The next case in the realm of other business venture cases involved a farmer who used his farmland as collateral for a loan [hereinafter first loan], which he primarily used to purchase a beer distributorship.[118] Later, the farmer secured a second loan, which he used to pay off his debt from the first loan.[119] He defaulted on the second loan and argued that its purpose was to save his farm from being taken by the creditors on his first loan.[120] All payments on the second loan had been made from his farm income.[121] The loan was large enough to be more than 20% of the farmer's total debt, so the farmer's eligibility for Chapter

110. *In re* Easton, 118 B.R. 676, 678 (Bankr. N.D. Iowa 1990).
111. *Id.*
112. *Id.*
113. *Id.* at 678-79.
114. *Id.* at 681.
115. *Id.* at 683.
116. *Id.* at 682-83.
117. *Id.*
118. *In re* Kan Corp., 101 B.R. 726, 726 (Bankr. W.D. Okla. 1988).
119. *Id.*
120. *Id.* at 726-27.
121. *Id.* at 726.

12 hinged on the loan's conformity with debt arising out of a farming operation.[122]

Mirroring the holding in *In re Douglass*, the court did not agree with the farmer's argument that his loan should be characterized by the nature of the collateral.[123] The court similarly ignored the argument that the motive of the debtor should control, holding instead that the loan proceeds must be actually used in the operation of the farm.[124] An important lesson to glean from this case: paying off a loan used for other business purposes but for which your farmland is collateral does not count as arising out of a farming operation under the statute.

D. In re Saunders

In this case, the farmer used his farmland as collateral for a loan which he used to operate a car dealership.[125] The debtor gave no indication that the profits from the car dealership were used to keep the farm going.[126] Looking at the purpose of the loan, the court held that operating a car dealership was not within the statutory definition of a "farming operation" and the car dealership was "wholly unrelated to farming."[127] By implication, if profits from the car dealership were used to support the farm operation, it would seem that the loan debt might have qualified him for Chapter 12.[128]

However, *In re Kan Corp.* explicitly disqualifies one from Chapter 12 if the profits from the non-agriculture venture are funneled back into the farm.[129] Additionally, both *In re Kan Corp.* and *In re Saunders* agree that farmers who use their farmland as collateral for loans to finance businesses unrelated to farming sacrifice any valid claim to Chapter 12 bankruptcy if the proceeds from the loan are not immediately put back into the farm.[130]

However, this may not be an absolute rule. The *In re Douglass* and *In re Easton* cases demonstrate that if the secondary, nonfarm business interest involves another family member, then debt related to the other business is considered to have arisen from the debtor's farming operation.[131] The business ventures

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122. *Id.* at 726-27.
123. *Id.* at 727; *In re* Douglass, 77 B.R. 714, 715 (Bankr. W.D. Mo. 1987).
124. *Id.*
125. *In re* Saunders, 377 B.R. 772, 773 (Bankr. M.D. Ga. 2007).
126. *Id.* at 776.
127. *Id.*; *see* 11 U.S.C. § 101(21) (2006).
128. *In re Saunders*, 377 B.R. at 776.
129. *See In re Kan Corp.*, 101 B.R. 726, 727 (Bankr. W.D. Okla. 1988).
130. *See id.*
131. *See In re* Easton, 118 B.R. 676, 678 (Bankr. N.D. Iowa 1990); *In re* Douglass, 77 B.R. 714, 715 (Bankr. W.D. Mo. 1987).

in *In re Kan Corp.* and *In re Saunders* both lacked the familial connection found in *In re Douglass* (the service station was inherited) and *In re Easton* (the hog confinement facility was initiated by a grandson). Most importantly, this line of cases demonstrates that a farm-preservation motive behind starting another business venture is irrelevant in determining Chapter 12 bankruptcy eligibility.[132]

With the sole exception of *In re Van Fossan* applying the risk test, bankruptcy courts have consistently given a broad interpretation to the phrase "arise out of a farming operation" when the debt in controversy has involved a family member.[133] Debts arising from deaths and divorces were included as farming operation debts.[134] It may be said that when interpreting a statute designed to help the family farmer, bankruptcy judges have sacrificed the family to save the farm.

This type of result is not a foregone conclusion. While beer distributing and car dealing were not among listed farming operations in 11 U.S.C. § 101(21),[135] other courts have been willing to add other seemingly nonfarm operations to the list.[136] While logging is admittedly more similar to the activities listed in the statute, a farmer simultaneously operating a beer distributorship or a car dealership for which debt was incurred to keep the farming operation afloat is much closer to debt arising from a farming operation under the statute than those debts created by deaths or divorces.

VI. WIND ENERGY

Across the country, farmers are increasingly participating in the wind energy industry.[137] More and more farmers are generating electricity with wind turbines and are either using it for their own operations or are selling it back to the utility company.[138] Despite allegorical descriptions like "harvesting the wind" or "farming the wind," energy production is a decidedly non-agricultural operation.[139] It involves something entirely separate and distinct from agriculture. The

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132. *In re Saunders*, 377 B.R. at 776; *In re Kan Corp.*, 101 B.R. at 727.

133. *See* discussion *supra* Part IV.

134. *Id.*

135. 11 U.S.C. § 101(21) (2006).

136. *See, e.g.*, *In re* Sugar Pine Ranch, 100 B.R. 28, 34 (Bankr. D. Or. 1989) (finding that the debtor's "harvesting of merchantable timber on a sustained yield basis" is a "farming operation" for Chapter 12 purposes).

137. *See, e.g.*, Joseph Murphy, *Farmer-Owned Turbines Harness the Wind*, 73 IOWA FARM BUREAU SPOKESMAN, June 27, 2007, at 1.

138. *Id*.

139. *See, e.g.*, JESSICA A. SHOEMAKER, FARMERS' GUIDE TO WIND ENERGY: LEGAL ISSUES IN FARMING THE WIND 5-22 (Karen R. Krub ed., 2007), *available at* http://www.flaginc.org/topics

wind industry uniquely appeals to farmers because they have so much of what the industry needs—land.[140] As is predictable, the question becomes whether this emerging industry will be considered a "farming operation" for Chapter 12 qualification.

The initial cost of constructing a steel tower and mounting a wind turbine would likely require a farmer to get a loan or grant.[141] To obtain a loan, the farmer would likely have to put his farmland up as collateral. If a bankruptcy court followed the holdings in *In re Kan Corp.* and *In re Saunders*, where the proceeds of a farmland-based loan were used in a non-farming business, the debt would not be considered towards qualification for Chapter 12 bankruptcy.[142] Like a car dealership or a beer distributorship, generating electricity would not likely be considered part of the "farming operation," so the debts incurred would likely not be counted toward the 50% minimum statutory qualification.[143]

Such a stance will dissuade farmers from owning and developing wind projects, which would be more profitable for both the farmer and the rural local economy than a land-lease agreement from a large utility.[144] It will also disqualify farmers from a bankruptcy chapter specifically designed for them simply because they are trying to diversify their operations by taking advantage of an additional natural resource.[145]

One can hope that because debts arising out of a farming operation have been interpreted with such variability, a court will interpret these types of loans as part of a "farming operation." Bankruptcy judges may find that selling clean and renewable energy is a more sympathetic trade than selling cars or beer. Nevertheless, this statutory ambiguity in the bankruptcy code is stifling investment in an industry the federal government is subsidizing. A statute written more clearly to indicate what nonfarm activities will be considered to be debt arising out of a farming operation would avoid sending this mixed signal to farmers.

/pubs/wind/FGWEcomplete.pdf (alerting farmers considering starting a wind production operation that they may lose farm program eligibility for the non-agricultural use).

140. Susan Thompson, *Wind Energy Potential*, WALLACE'S FARMER, Feb. 2008, at 4.

141. *Id.*

142. *See In re* Saunders, 377 B.R. 772, 776 (Bankr. M.D. Ga. 2007); *In re* Kan Corp., 101 B.R. 726, 727 (Bankr. W.D. Okla. 1988).

143. 11 U.S.C. § 101(18)(A) (2006).

144. Dan Campbell, *Harvesting the Prairie Wind*, RURAL COOPERATIVES, Nov.-Dec. 2007, at 4, *available at* http://www.rurdev.usda.gov/rbs/pub/nov07/nov07.pdf.

145. Dan Piller, *Smaller Wind Producers Call for More Perks*, DES MOINES REG., Jan. 11, 2009, at D1, *available at* 2009 WLNR 16855628.

It is commonplace to read glowing reviews of the positive effects wind energy could have on rural economies.[146] To ensure farmers invest in profitable industries like the emerging wind industry, a more precise definition of what will be considered a "farming operation" debt in Chapter 12 is needed.

VII. MODEL STATUTE

As mentioned previously, the macro legislative intent of Chapter 12 bankruptcy was to revitalize the farm economy; arguably, this has already been accomplished by keeping "several thousands of farmers in business."[147] However, by keeping some of these farmers in business via Chapter 12, bankruptcy judges have created harsh outcomes, both for farmers with multiple business interests and for the ex-spouses and the siblings of indebted farmers.

A statute to alleviate these harsh effects is not far off from the current version. The changes from 2005 broadening Chapter 12 should be kept. In addition, the phrase "excluding debts caused by a divorce settlement, will, and testamentary instrument" should be added to exclude the *In re Rinker* line of cases and force bankruptcy courts to follow the decision of *In re Van Fossan*. In addition, the language of "farming operation" should be broadened by adding "or businesses created with farm assets to complement or supplement a continuing farming operation," so those debts can be considered in the family farmer's minimum debt percentage calculation. These changes would follow the intent of Chapter 12, which is to support rural economies.[148]

VIII. CONCLUSION

Future bankruptcy cases involving debts related to divorce or deaths in the family should follow the court's reasoning in *In re Van Fossan*. The "but for" test makes little sense, because even the broadest interpretations of debts "aris[ing] out of a farming operation" do not call to mind divorce settlements or inheritances.[149]

Future bankruptcy cases involving debts from non-agricultural business ventures should interpret the phrase "farming operation" broadly. Congress' intent to stop the displacement from farming communities would have been sig-

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146. *See, e.g.*, Richard Doak, Op-Ed., *Wind Carries Big Economic Boost*, DES MOINES REG., Dec. 3, 2006, *available at* 2006 WLNR 24983497.

147. Jonathan K. Van Patten, *Chapter 12 in the Courts*, 38 S.D. L. REV. 52, 54 (1993) (citation omitted).

148. *See* 132 CONG. REC. 9896 (1986).

149. 11 U.S.C. § 101(18)(A) (2006).

nificantly helped had bankruptcy judges allowed farmers to bolster their incomes from other business ventures with the assurance that if they failed, the benefits of Chapter 12 were still available. Under a broader interpretation, these farmers would have continued farming. With more family farmers on their land, rural economies would have been strengthened as Congress intended them to be.