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A COMPARISON OF FARM BANKRUPTCIES IN CHAPTER 11 AND THE NEW CHAPTER 12

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No one can doubt that many farmers are in severe financial straits. Falling land values, reduced farm exports, low commodity prices, recent high interest rates and extensive debt have made it increasingly difficult for many of them to continue to farm. A number of farmers are drifting toward insolvency. For example, in 1984 17.7% of all farms and 21.8% of cash grain farms had debts equal to 40% or more of assets.[1] In 1985 the percentage of all farms with a 40% or more debt-equity ratio had climbed from 17.7% to 18.9%, and the percentage of cash grain farms with a 40% or more debt-equity ratio had climbed from 21.8% to 24.3%.[2] Of these, the farms with a debt-equity ratio over 70% climbed from 6% of all farms in 1984 to 7.3% in 1985.[3] For cash grain farms the increase was from 7.6% to 10%.[4] In addition, in 1985, 3% of all farms were insolvent, their debts exceeded assets.[5] A farm with a 70% debt-equity ratio is likely to be facing insolvency and reorganization or liquidation; a farm with a 40% debt load is facing serious financial problems.

Nor is anyone predicting that the farm financial crisis is going to end in the near future. Farmland values continued to decline in 1987.[6] Although commodity prices are up in 1988, many farms are experiencing drought conditions which will reduce yields. As a result, many farmers are liquidating the farm enterprise in and outside of bankruptcy. Many of these liquidations are not out of choice but out of necessity; in part because few farmers have been able to continue to farm and rehabilitate the farm enterprise under Chapters 11

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1. *Financial Characteristics of U.S. Farms, January 1985*, Agriculture Information Bulletin No. 495, 10 (available from the Economic Research Service division of the United States Department of Agriculture).

2. *Id.*

3. *Id.*

4. *Id.*

5. *Id.*

6. *Lenders' Farm-Land Holdings Continue to Rise, Arguing More Price Declines*, Wall St. J., Mar. 2, 1987, at 23, col. 1.

and 13 of the Bankruptcy Code. Before the recent legislation, Chapters 11 and 13 were the only bankruptcy chapters designed to allow a business to continue to operate while it readjusted its debts. Liquidation of the enterprise was not involved as long as the debtor was able to get a confirmed plan under which to operate the business. However, getting a plan confirmed in Chapter 11 and meeting the requirements of being a debtor in Chapter 13 have been difficult, if not impossible, for many farmers.

Chapter 13, which allows individuals a chance to restructure their debts, has not been helpful for a number of farmers because of the restrictions on who can be a debtor in a Chapter 13 proceeding. A Chapter 13 debtor can have no more than $100,000 in liquidated, noncontingent, unsecured indebtedness and no more than $350,000 in liquidated, noncontingent, secured indebtedness.[7] These debt restrictions tend to exclude distressed farmers. In addition, the Chapter 13 debtor must be an individual; partnerships and corporations are excluded.[8] Thus, even if the debt level of the farmer qualified for a Chapter 13, if the farmer did business in a partnership or corporate form, he or she could not file a Chapter 13 petition.

However, if a farmer's situation meets the Chapter 13 limitations, the farmer should consider a Chapter 13 filing. This is especially true if the farmer has debts that fall under section 523 of the Bankruptcy Code.[9] Although section 523 makes certain debts nondischargeable, a Chapter 13 debtor who completes the payments is discharged from all section 523 debts except alimony and child support claims.[10] This is not true of a Chapter 12 discharge.[11]

There are no similar debt or business structure limitations on a Chapter 11 debtor.[12] Most farmers wishing to keep the farm filed under Chapter 11, but few farmers made it through this chapter successfully. The lack of success with Chapter 11 has numerous causes and will be discussed below.

On October 27, 1986, the President signed a bill creating a new bankruptcy chapter, Chapter 12.[13] Chapter 12 is designed to make it easier for farmers to use bankruptcy to keep the farm and restructure

7. 11 U.S.C. § 109(e) (1982).
8. *Id.*
9. *Id.* § 523 (1982 & Supp. III 1985).
10. *Id.* § 1328(a) (1982).
11. *Id.* § 1228(a) (Supp. IV 1986).
12. *Id.* § 109(d) (Supp. III 1985).
13. Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, 100 Stat. 3088.

their debt. Congress modeled Chapter 12 after Chapter 13 and added some Chapter 11 concepts. The following analysis compares Chapter 11 with Chapter 12. It focuses on the aspects of a Chapter 11 proceeding that make it difficult for farmers to successfully reorganize. Chapter 12 is analyzed to assess the changes it will make on farm bankruptcies, especially in light of the problems Chapter 11 created for farmers.

I. WHO CAN FILE

Anyone in business may file in Chapter 11.[14] Only certain farmers may file in Chapter 12.[15] Chapter 12 is not limited to individuals as is Chapter 13. Individuals, corporations, or partnerships may file a Chapter 12 petition.[16] If the farmer is an individual or an individual and spouse, their aggregate debts cannot exceed $1,500,000.[17] Eighty percent of the noncontingent, liquidated debts must have arisen from a farm operation owned by the individual or the individual and his or her spouse.[18] However, the eighty percent requirement does not include any debts on the farmer's residence unless the debts arose out of the farming operation.[19] In addition, for the taxable year preceding the bankruptcy filing, the individual, or individual and spouse, must have received more than fifty percent of their gross income from the farm operation.[20]

The part of the Chapter 12 definition that may cause problems

14. In fact, the language of the statute, 11 U.S.C. § 109(d) (Supp. III 1985) does not limit the Chapter 11 debtor to businesses. However, three United States Courts of Appeals have limited Chapter 11 to businesses. Little Creek Dev. Co. v. Commonwealth Mortgage Co., (*In re* Little Creek Dev. Co.), 779 F.2d 1068, 1073 (5th Cir. 1986); Wamsganz v. Boatmen's Bank of DeSoto, 804 F.2d 503, 505 (8th Cir. 1986); *In re* Winshall Settlor's Trust, 758 F.2d 1136, 1137 (6th Cir. 1985). *Contra In re* Moog, 774 F.2d 1073, 1075 (11th Cir. 1985).

15. 11 U.S.C. § 109(f) (Supp. IV 1986) limits Chapter 12 to family farmers. 11 U.S.C. § 101(17) (Supp. IV 1986) defines who is a family farmer.

16. *Id.* § 101(17).

17. *Id.* § 101(17)(A). *See, e.g., In re* Baldwin Farms, 78 Bankr. 143 (Bankr. N.D. Ohio 1987); *In re* Budde, 79 Bankr. 35 (Bankr. D. Colo. 1987); *In re* Carpenter, 79 Bankr. 316 (Bankr. S.D. Ohio 1987); *In re* Labig, 74 Bankr. 507 (Bankr. S.D. Ohio 1987); *In re* Stedman, 72 Bankr. 49 (Bankr. D.N.D. 1987).

18. 11 U.S.C. § 101(17)(A) (Supp. IV 1986). *See, e.g., In re* Douglass, 77 Bankr. 714 (Bankr. W.D. Mo. 1987); *In re* Roberts, 78 Bankr. 536 (Bankr. C.D. Ill. 1987).

19. 11 U.S.C. § 101(17)(A) (Supp. IV 1986).

20. *Id.* § 101(17)(A). *See, e.g., In re* Faber, 78 Bankr. 934 (Bankr. S.D. Iowa 1987); Federal Land Bank of Columbia v. McNeal, 77 Bankr. 315 (S.D. Ga. 1987); *In re* Guinnane, 73 Bankr. 129 (Bankr. D. Mont. 1987); *In re* Maike, 77 Bankr. 832 (Bankr. D. Kan. 1987); *In re* McKillips, 72 Bankr. 565 (Bankr. N.D. Ill. 1987); *In re* Nelson, 73 Bankr. 363 (Bankr. D. Kan. 1987); *In re* Shepherd, 75 Bankr. 501 (Bankr. N.D. Ohio 1987); *In re* Wolline, 74 Bankr. 208 (Bankr. E.D. Wis. 1987).

for the farmer is the requirement that more than fifty percent of the farmer and spouse's income in the year preceding the year of the bankruptcy filing, must have come from farming. It is important to note that Chapter 12 income is gross income. Usually, the spouse of a farmer will be a cosigner on the farm debt. Therefore, the spouse will also need to be in bankruptcy, so that their gross income will be added for the fifty percent test.[21]

A corporation or partnership may file a Chapter 12 petition if at least fifty percent of the outstanding stock or equity is owned by one family or by the one family and its relatives.[22] The family or the relatives must conduct the farm operation.[23] In addition, more than eighty percent of the value of the corporation or partnership's assets must relate to the farm operation,[24] and the aggregate debts cannot exceed $1,500,000.[25] Eighty percent or more of the corporation or partnership's noncontingent, liquidated debts must arise out of the farm operation, but the eighty percent does not include a debt owed on the principal residence unless the debt arose out of the farm operation.[26]

A problem with this part of the definition could arise under the following fact pattern. Assume that the husband of a family along with his brothers runs a farm as a partnership. The wives have nonfarm jobs. Lenders have required the wives to cosign the farm debt. Now the partnership wants to enter Chapter 12. If the partnership meets the assets and debt limits it can file. The wives will need to file as well since they will be cosignatories on the debt, but the wives will not qualify for filing as individuals since fifty percent of their gross income the previous year did not come from farming.

If there is no formal partnership agreement, the parties may be able to argue that the wives are also partners. This analysis will be governed by the Uniform Partnership Act (in all states except Louisiana).[27] Section 7 of the Act sets out the rules that determine whether a partnership relationship exists.[28] The mere joint ownership of property, even if profits from use of the property are shared, does not itself

21. 11 U.S.C. § 101(17)(A) (Supp. IV 1986).
22. *Id.* § 101(17)(B).
23. *Id.*
24. *Id.* § 101(17)(B)(i).
25. *Id.* § 101(17)(B)(ii).
26. *Id.*
27. 6 U.L.A. 1, 2 (Supp. 1988) .
28. UNIF. PARTNERSHIP ACT § 7 (1914).

establish a partnership.[29] Nor does the sharing of gross returns establish a partnership.[30] But, the sharing of profits from a business is prima facie evidence of a partnership as long as the profits were not wages, debt installments, or similar payments.[31] Courts usually say the key is whether the parties intended to share the profits and losses and whether they participated in some way in the business.[32] If other evidence suggests no partnership was involved, the mere sharing of profits is, however, not enough to prove that a partnership existed.

The courts often emphasize management and control. Many cases point to the fact that the would-be partner worked in the business,[33] but this is not crucial. For example, *Drennan v. Peck (In re Drennan's Estate)*[34] held that a father and two sons had been involved in a farm partnership even though one of the sons lived in Chicago and did not actively participate in the farm enterprise.[35] The sons owned the farm equipment, and the court emphasized that the three men took roughly equal draws on the profit each year.[36] If one received more than his one third share he took less the next year. This arrangement continued for ten years until the father died.[37] The fact that one son did not participate in the business did not preclude that son from being a partner.

One should always determine whether a partnership tax return has been filed and who is listed as partners on the return. Section 6031(a) of the Internal Revenue Code requires partnerships to file a partnership tax return each year.[38] It must include the names and addresses of all individuals who would be entitled to share in any taxable income.[39] A partnership return that lists the wives as partners would be strong evidence that the wives were in fact partners. Courts often emphasize that a partnership tax return was filed.[40] However,

29. *Id.* § 7(2).

30. *Id.* § 7(3).

31. *Id.* § 7(4).

32. *See, e.g.*, Lyon v. MacQuarrie, 46 Cal. App. 2d 119, 115 P.2d 594 (1941); Cutler v. Bowen, 543 P.2d 1349 (Utah 1975); Raymonds S. Roberts, Inc. v. White, 117 Vt. 573, 97 A.2d 245 (1953).

33. *See, e.g.*, Greene v. Brooks, 235 Cal. App. 2d 161, 45 Cal. Rptr. 99 (1965); Lee v. Slovak, 81 A.D.2d 98, 440 N.Y.S.2d 358 (1981); Cutler v. Bowen, 543 P.2d 1349 (Utah 1975); Raymond S. Roberts, Inc. v. White, 117 Vt. 573, 97 A.2d 245 (1953).

34. Drennan v. Peck (*In re* Drennan's Estate), 9 Ill. App. 2d 324, 132 N.E.2d 599 (1956).

35. *Id.* at 327, 132 N.E.2d at 601.

36. *Id.* at 328-29, 132 N.E.2d at 601-02.

37. *Id.* at 325, 328-29, 132 N.E.2d at 600, 602.

38. 266 U.S.C. § 6031(a) (1982).

39. *Id.* § 6323(b).

40. *See* Cutler v. Bowen, 543 P.2d 1349 (Utah 1975); Puzich v. Pappas, 161 Ind. App.

failure to file a partnership return is not conclusive that a partnership does not exist. In *In re Drennan's Estate*,[41] the court found that a farming partnership existed even though the farm enterprise did not file a partnership return during the ten year period.[42] It may be more difficult to argue that the wives are partners if partnership returns are filed but never list the wives as partners.

From a policy standpoint, if a wife is obligated on the family farm debt, she should not be precluded from filing in Chapter 12 simply because she had nonfarm income and was not a partner in the farm partnership. If the wife is not in bankruptcy, the creditor can sue her for the debt and is not stayed from collecting as long as the debt is a business debt. Chapter 12 stays any action to collect from an individual not in bankruptcy who is liable on an obligation with a Chapter 12 debtor.[43] However, this protection applies only to consumer debt.[44] Surely Congress did not intend to create this situation. If the wife jointly owns farm property, which she usually will, then the creditor will be able to take farm property while the husband and brothers are trying to restructure debt in Chapter 12 to keep the farm enterprise afloat.

II. CONVERSION RIGHTS

There is considerable question whether a farmer who filed a Chapter 11 petition before the Act creating Chapter 12 became effective will be able to convert his or her case to a Chapter 12 petition. The Act amends section 1112(d) to provide for conversion of Chapter 11 cases to Chapter 12.[45] Before allowing conversion the court must find that the conversion would be equitable.[46] The problem is created by the fact that the section allowing conversion is in subtitle B of title II of the Act.[47] The Act provides that the amendments in subtitle B of title II of the Act "shall not apply with respect to cases commenced under title II of the United States Code before the effective date of this

191, 314 N.E.2d 795 (1974). In *Puzich*, the sister had worked in the business until her brothers kicked her out. For eight years the partnership tax return listed the sister as a 1/4 owner.

41. 9 Ill. App. 2d 324, 132 N.E.2d 599 (1956).

42. *Id.* at 330, 132 N.E.2d at 602.

43. 11 U.S.C. § 1201 (Supp. IV 1986).

44. *Id.*

45. *Id.* § 1112(d).

46. *Id.* § 1112(d)(3).

47. Section 256 of Pub. L. No. 99-554 amends § 1112(d) of the Bankruptcy Code to allow conversion from Chapter 11 to Chapter 12. Section 256 is located in subtitle B of title II of the Act. Pub. L. No. 99-554, § 256, 100 Stat. 3114 (1986).

Act."[48] The general effective date of the statute was set thirty days after the date of enactment.[49] The language would seem to clearly indicate that cases filed in Chapter 11 before the effective date of the Act cannot be converted.

The legislative history conflicts with this interpretation. The Conference Report for the legislation indicates that Congress intended that pending cases be available for conversion as long as it was equitable.[50] The report states "[i]t is not intended that there be routine conversion of Chapter 11 and 13 cases, pending at the time of enactment, to Chapter 12. Instead it is expected that courts will exercise their sound discretion in each case . . . ."[51] The issue is whether courts will allow clear legislative history to change clear statutory language. The first case to address the issue, *In re Tomlin Farms*,[52] held that where statutory language is clear there is no reason to examine legislative history.[53] The case involved three debtors who had previously filed Chapter 11 petitions. One filed a Chapter 11 petition on October 31, 1986, while the other two filed March 28, 1985, and April 2, 1984, respectively.[54] For the second two debtors, a conversion may not have been equitable since they had been in Chapter 11 for awhile; however, for the case filed October 31st, the issue was clearly focused. The court held that none of these farm cases could be converted to Chapter 12 because of the clear statutory language.[55]

Given the conflict between statutory language and legislative history, conflict among the courts was inevitable. Eight courts in seven states have allowed conversion if it is equitable.[56] A majority of courts, however, have agreed with *Tomlin Farms* that the statutory language must be given effect. These courts hold that cases filed

48. Bankruptcy Judges, United States Trustees and Family Farm Bankruptcy Act of 1986, Pub. L. No. 99-554, § 302(c)(1), 100 Stat. 3088, 3119 (1986).

49. Bankruptcy Judges, United States Trustees and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, § 302(a), 100 Stat. 3088, 3119 (1986).

50. H.R. Rep. No. 958, 99th Cong., 2d Sess. 4 (1986).

51. *Id.*

52. 68 Bankr. 41 (Bankr. D.N.D. 1986).

53. *Id.* at 42-43.

54. *Id.* at 42.

55. *Id.* at 43.

56. *In re* Anderson, 70 Bankr. 883 (Bankr. D. Utah 1987); *In re* Big Dry Angus Ranch, Inc., 69 Bankr. 695 (Bankr. D. Mont. 1987);*In re* Cobb, 76 Bankr. 557 (Bankr. N.D. Miss. 1987); *In re* Erickson Partnership, 68 Bankr. 819 (Bankr. D.S.D.), *aff'd*, 74 Bankr. 670 (D.S.D. 1987);*In re* Fischer, 72 Bankr. 634 (Bankr. D. Kan. 1987); *In re* Henderson, 69 Bankr. 982 (Bankr. N.D. Ala. 1987); *In re* Mason, 70 Bankr. 753 (Bankr. W.D.N.Y. 1987); *In re* Mason, 70 Bankr. 757 (Bankr. W.D.N.Y. 1987).

before November 26, 1986, cannot be converted to Chapter 12.[57]

Courts in two states that have not ruled on the conversion question have allowed debtors in Chapters 11 and 13 to dismiss their cases and refile in Chapter 12.[58] *In re Woloschak Farms*[59] is the more interesting case of the two because it involved dismissal from Chapter 11. In Chapter 11, unlike Chapter 13, a debtor does not have an unlimited right to dismiss his case.[60] A Montana court has allowed dismissal and refiling but Montana courts also allow conversion.[61]

III. FILING A PLAN

In any reorganization effort the farmer must file a plan which sets out how the indebtedness will be paid. In Chapter 11 the farm debtor has 120 days after the order for relief in which to file a plan.[62] In a voluntary case the order for relief occurs when the case is commenced with the filing of the petition.[63] The debtor then has 180 days to file a plan that is accepted.[64] These 120 and 180 day periods can be extended by court order for cause.[65] Only the debtor has a right to

57. *See, e.g., In re* Albertson, 68 Bankr. 1017 (Bankr. W.D. Mo. 1987); *In re* Barclay, 69 Bankr. 552 (Bankr. C.D. Ill. 1987); *In re* Council, 70 Bankr. 20 (Bankr. W.D. Tenn. 1987); *In re* Evans, 72 Bankr. 21 (Bankr. D. Or. 1987); *In re* Glazier, 69 Bankr. 666 (Bankr. W.D. Okla. 1987); *In re* Hughes, 70 Bankr. 66 (Bankr. W.D. Va. 1987); *In re* Keinath Bros. Dairy Farm, 71 Bankr. 993 (Bankr. E.D. Mich. 1987); *In re* Lindsey, 69 Bankr. 632 (Bankr. C.D. Ill. 1987); *In re* McDonald, 72 Bankr. 227 (Bankr. D.S.C. 1987); *In re* Petty, 69 Bankr. 412 (Bankr. N.D. Ala. 1987); *In re* Ray, 70 Bankr. 431 (Bankr. E.D. Mo. 1987); *In re* Rossman, 70 Bankr. 985 (Bankr. W.D. Mich. 1987); *In re* Solomon, 72 Bankr. 506 (Bankr. E.D. Ark. 1987); *In re* B.A.V., Inc., 68 Bankr. 411 (Bankr. Colo. 1986).

58. *In re* Gamble, 72 Bankr. 75 (Bankr. D. Idaho 1987); *In re* Woloschak Farms, 70 Bankr. 498 (Bankr. N.D. Ohio 1987).

59. 70 Bankr. 498 (Bankr. N.D. Ohio 1987).

60. 11 U.S.C. § 1112 (Supp. IV 1986) governs dismissal of Chapter 11 cases. Subsection (b) allows a court to dismiss a case on various grounds, all of which involve a debtor default. In the *Woloschak Farms* case the debtor failed to make payments under its Chapter 11 plan. 70 Bankr. at 499-500. This is a ground for involuntary dismissal under subsection (b)(8). The court granted the motion to dismiss the case and then rejected the creditor's argument that this amounted to an improper conversion. 11 U.S.C. § 1307 (Supp. IV 1986) governs dismissal of Chapter 13 cases. Subsection (b) gives the debtor an absolute right to dismiss a Chapter 13 case.

61. *In re* Big Dry Angus Ranch, Inc., 69 Bankr. 695 (Bankr. D. Mont. 1987) (allowed conversion); *In re* Turner, 71 Bankr. 120 (Bankr. D. Mont. 1987) (allowed dismissal).

62. 11 U.S.C. § 1121(b) (1982).

63. *Id.* § 301.

64. *Id.* § 1121(c)(3) (1982 & Supp. III 1985).

65. 11 U.S.C. § 1121(d) (Supp. III 1985) controls the granting of an extension of time in which the debtor has the exclusive right to file a plan. Bankruptcy courts have discretion. *In re* Tony Downs Foods Co., 34 Bankr. 405 (Bankr. D. Minn. 1983). One of the major grounds for extension of time is a showing by the debtor that he is making progress and that there is "some promise of probable success in formulating a plan of reorganization . . . ." *In re* Pine

file a plan within these time periods.[66] After these time periods have expired, and no extension has been granted by the court, any party in interest, including any creditor or creditors' committee, may file a plan.[67]

The problems created are based on the fact that some courts allow confirmation of a creditor's plan that provides for the liquidation of the farm enterprise, over the farmer's objections.[68] Farmers cannot be involuntarily brought into bankruptcy.[69] Yet, these decisions allow liquidation of a farm enterprise even though the creditors could not drag the farmer into a Chapter 7 proceeding, and even though the reason the farmer filed in Chapter 11 was to avoid liquidation.[70]

A. Tax Ramifications

Apart from the fact that the creditors may be able to force liquidation, liquidating under a creditor's plan in Chapter 11 instead of liquidating voluntarily in Chapter 7 may have adverse tax consequences on the farmer. The transfer of property voluntarily or involuntarily can create tax liability.[71] For example, transfers of farm land with a low adjusted basis will generate ordinary income on which taxes will be assessed,[72] and transfers of personal property may generate recapture of investment tax credits.[73] Although the 1986 Tax Reform Act eliminated regular investment tax credits on property placed in service after December 31, 1985, the recapture provisions were left in the Code.[74] This recapture tax is especially onerous because any

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Run Trust, Inc., 67 Bankr. 432, 435 (Bankr. E.D. Pa. 1986). In many cases this means a showing of a likelihood of successful negotiations with a major creditor. *In re* Musikahn Corp., 57 Bankr. 938 (Bankr. E.D.N.Y. 1986); *In re* Swatara Coal Co., 49 Bankr. 898 (Bankr. E.D. Pa. 1985).

66. 11 U.S.C. § 1121(b) (1982).

67. *Id.* § 1121(c) (1982 & Supp. III 1985).

68. Button Hook Cattle Co. v. Commercial Nat'l Bank & Trust Co. (*In re* Button Hook Cattle Co.), 747 F.2d 483 (8th Cir. 1984); Jasik v. Conrad (*In re* Jasik), 727 F.2d 1379 (5th Cir. 1984). A lower court has disagreed. *See In re* Lange, 39 Bankr. 483 (Bankr. D. Kan. 1984).

69. 11 U.S.C. § 303(a) (1982). In addition, farmers who have filed in Chapter 11 cannot have their case converted to a Chapter 7 without their consent. *Id.* § 1112(c). In Chapter 12, a family farmer case cannot be converted to Chapter 7 unless the farmer has committed fraud. *Id.* § 1208(d).

70. *Button Hook Cattle Co., Inc.*, 747 F.2d 483 (8th Cir. 1984); *Jasik*, 727 F.2d 1379 (5th Cir. 1984).

71. Flaccus, *Taxes, Farmers, and Bankruptcy and the Impact of the 1986 Tax Changes: Much Has Been Changed, But Much Remains the Same*, 66 NEB. L. REV. 459 (1987).

72. *Id.* at 459-60.

73. *Id.* at 467.

74. *Id.*

amounts recaptured are added directly to the farmer's tax liability.[75] For example, if $10,000 in investment tax credits are recaptured the farmer owes at least $10,000 in federal income taxes.

In a Chapter 7 liquidation the tax picture is somewhat changed. When the debtor files a Chapter 7 or 11 bankruptcy petition, a separate taxable entity is created.[76] The separate taxable entity is the bankruptcy estate, but the transfer of the property into the estate is not a taxable transfer.[77] In the Chapter 7 proceeding it is the estate that transfers the property as long as the trustee has not abandoned the asset to the debtor.[78] When the estate transfers the property, it is the estate, not the debtor, that receives the ordinary income.[79] To the extent that the estate does not pay the resulting taxes, the debtor is not liable for them.[80] The taxes incurred become administrative expenses under section 503(b)(1)(B).[81] They are thus entitled to first priority status among the unsecured claims.[82] The important fact from the farmer's perspective is that, to the extent that taxes remain unpaid, he or she is not responsible for them.

This analysis may not apply to tax liability arising from the recapture of investment tax credits.[83] The two cases that address the issue hold that the taxes resulting from a recapture of investment tax credits are a prepetition tax debt under section 507(a)(7)(A)(iii) not an administrative expense.[84] The effect of these holdings is to make the taxes nondischargeable. All of section 507(a)(7) taxes are nondischargeable.[85] The cases state that recapture of investment tax credits are merely a reinstatement of the tax liability owed before the petition but not paid because the investment tax credit was taken.[86] However, the reasoning in both cases is flawed. The first case, *In re Higgins*,[87]

75. *Id.* at 470-71.

76. 26 U.S.C. § 1398(f) (1982).

77. *Id.*

78. Flaccus, *supra* note 71, at 467-70, 482-84.

79. *Id.* at 467.

80. *Id.* at 467-70.

81. 11 U.S.C. § 503(b)(1)(B) (1982).

82. *Id.* § 507(a)(1).

83. Flaccus, *supra* note 71, at 470-75.

84. *In re* Higgins, 29 Bankr. 196 (Bankr. D. Iowa 1983); *In re* Davidson Lumber Co., 47 Bankr. 597 (Bankr. S.D. Fla. 1985).

85. Section 507 of the Bankruptcy Code sets out priority rules. Section 507(a)(7) are a number of generally prepetition taxes that are given a seventh priority. Section 523 of the Bankruptcy Code sets out nondischargeable debts. Section 523(a)(1)(A) makes § 507(a)(7) taxes nondischargeable.

86. *Higgins*, 29 Bankr. at 201; *Davidson Lumber Co.*, 47 Bankr. at 599.

87. 29 Bankr. 196. (Bankr. D. Iowa 1983).

was controlled by the law that existed before the effective date of the 1980 Bankruptcy Tax Act.

Prior to the Bankruptcy Tax Act the IRS took the position that the transfer of assets into the estate triggered the recapture of investment tax credit.[88] Under this interpretation it is easy to argue that the recapture occurred prepetition and was not incurred by the estate. The Bankruptcy Tax Act now controls this question and it provides that the transfer to the estate is not a taxable transfer.[89] The second case which holds that investment tax credit recapture taxes are prepetition taxes is *In re Davidson Lumber Co.*[90] Since this case was controlled by the 1980 Bankruptcy Tax Act it cannot be distinguished on the same basis, yet, the *Davidson* court for the most part merely follows *Higgins*. There is room for courts to disagree with these two cases.

A court could disagree with these cases on one of two bases.[91] First a court could hold that recapture of investment credit taxes are incurred by the estate, since it is estate action which triggers the recapture.[92] If this were the holding, the taxes would be administrative expenses and a liability of the estate not the debtor. Second, even if a court would hold that these taxes are not incurred by the estate because they are prepetition taxes, it could hold that these taxes are not section 507(a)(7)(A)(iii) taxes.[93] Section 507(a)(7)(A) taxes are taxes "on or measured by income or gross receipts."[94] The tax based on a recapture of an investment tax credit is based on the amount of taxes

88. Rev. Rul. 74-26, 1974; Mueller v. Commissioner, 60 T.C. 36, 47 (1973).

89. 26 U.S.C. § 1398(f)(1) (1982).

90. 47 Bankr. 597 (Bankr. S.D. Fla. 1985).

91. Flaccus, *supra* note 71, at 472-75.

92. *Id.*

93. *Id.* at 474-75.

94. 11 U.S.C. § 507(a)(7)(A) (Supp. III 1985) states:

> (7) Seventh, allowed unsecured claims of governmental units, only to the extent that such claims are for—
>
> (A) a tax on or measured by income or gross receipts—
>
> (i) for a taxable year ending on or before the date of filing of the petition for which a return, if required, is last due, including extensions, after three years before the date of the filing of the petition;
>
> (ii) assessed within 240 days, plus any time plus 30 days during which an offer in compromise with respect to such tax that was made within 240 days after such assessment was pending, before the date of the filing of the petition; or
>
> (iii) other than a tax of a kind specified in section 523(a)(1)(B) or 523(a)(1)(C) of this title, not assessed before, but assessable, under applicable law or by agreement, after, the commencement of the case;

Id.

previously not paid because the credit was taken.[95] It is not "on or measured by income or gross receipts."[96] If these taxes were prepetition taxes but not section 507(a)(7)(A) taxes, they would be discharged along with other Chapter 7 unsecured debt.[97] Thus, despite the *Higgins* and *Davidson* cases, a good argument can be made that a farmer should not owe recapture of investment tax credit taxes after bankruptcy.

As can be seen, liquidation inside a Chapter 7 proceeding can minimize the liquidation taxes the farmer will owe after bankruptcy. This may not be the case if the farm is liquidated under a Chapter 11 creditor plan, or if some property is liquidated under a Chapter 11 plan and the debtor later files a Chapter 7 petition.

The cases in the area deal with the following fact pattern: (1) a business files a Chapter 11 petition; (2) the plan proposed by the debtor in possession is confirmed; (3) taxes are incurred by the operation of the business after confirmation of the plan; and (4) the business fails despite the reorganization, so it files for Chapter 7 liquidation. Courts hold that the taxes accrued post confirmation are not incurred by the estate and therefore not administrative expenses from the Chapter 11 proceeding.[98] Section 348(d) of the Bankruptcy Code treats all claims, except administrative claims that arise after the order for relief but before conversion of the case, as if such claims had arisen immediately before the filing of the petition.[99] The effect is that taxes which are incurred after confirmation of the plan are treated like prepetition claims once the case is converted to Chapter 7.[100] This turns many of these taxes into section 507(a)(7) taxes which are given a seventh priority but are nondischargeable to the extent they are not

95. *Higgins*, 29 Bankr. at 201; *Davidson Lumber Co.*, 47 Bankr. at 599.

96. 11 U.S.C. § 507(a)(7)(A) (Supp. III 1985).

97. Only § 507(a)(7)(A) taxes are made nondischargeable. *Id.* § 523(a)(1)(A) (Supp. IV 1986). Other prepetition taxes would be discharged along with other prepetition unsecured debt. *Id.* § 727(b) (1982).

98. *In re* Westholt Mfg., 20 Bankr. 368 (Bankr. D. Kan. 1982), *aff'd*, 36 Bankr. 932 (Bankr. D. Kan. 1984).

99. Section 348(d) states:

> (d) A claim against the estate or the debtor that arises after the order for relief but before conversion in a case that is converted under section 1112, 1307, or 1208 of this title, other than a claim specified in section 503(b) of this title, shall be treated for all purposes as if such claim had arisen immediately before the date of the filing of the petition.

11 U.S.C. § 348(d) (Supp. IV 1986). Note that this statute deals also with conversion under § 1208. Thus, if transfers of property were made by the farmer under a Chapter 12 plan, when the case was converted to a Chapter 7, any resulting taxes would be prepetition debt.

100. S. REP. NO. 989, 95th Cong., 2d Sess. 48 (1978), *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5787, 5834.

paid.[101]

The only exception to this prepetition treatment under section 348(d) is for administrative claims.[102] Yet, postconfirmation claims, including tax claims, are not administrative claims because confirmation of the plan terminates the bankruptcy estate.[103] Section 1141(b) vests all the property of the estate in the debtor upon confirmation unless otherwise provided in the plan.[104] Administrative claims must be incurred by the estate.[105] The plan binds all parties and discharges the debtor from all debts arising prior to confirmation.[106]

The transfer of assets from the estate to the debtor after confirmation of the plan is itself not a taxable transfer.[107] However, if sales or exchanges of property are made under the plan, the resulting tax liability will not be an administrative expense.[108] If the case is converted to a Chapter 7 after the sale or exchange of property under the plan, the resulting taxes will be a prepetition liability in the Chapter 7.[109]

If the creditors get a Chapter 11 liquidation plan confirmed, so that liquidation is in Chapter 11, not Chapter 7, there is no conversion and section 348(d) does not apply. However, since the liquidation is taking place under a confirmed plan, any resulting transfer taxes would not be an administrative expense.[110] If the plan calls for the farmer to make the transfers, then the resulting transfer tax liability will be a liability of the farmer. The assets generated when the property is transferred will be used to pay off other creditors, not to pay off the tax liability. It is irrelevant that the transfer was an involuntary one because tax liability can be generated whether the transfer is voluntary or involuntary.[111]

Thus, in terms of filing a plan, Chapter 11 has a number of disadvantages. First a farmer may be involuntarily liquidated under a creditor's plan. Second, any transfer taxes generated by any sales or

101. *See supra* note 85.

102. 11 U.S.C. § 348(d) (1982).

103. *Id.* § 1141 (1982 & Supp. III 1985).

104. *Id.* § 1141(b) (1982).

105. *Id.* § 503(b) (1982 & Supp. III 1985).

106. *Id.* § 1141(d)(1)(A) (1982).

107. 26 U.S.C. § 1398(f)(2) (1982).

108. This is because the tax is not incurred by the estate. 11 U.S.C. § 503(b)(1)(B) (1982 & Supp. III 1985).

109. *See supra* notes 97-100 and accompanying text.

110. 11 U.S.C. § 503(b)(1)(B) (1982).

111. 26 U.S.C. § 1001 (1982 & Supp. III 1985).

exchanges of property under a confirmed plan will not be a tax of the estate but rather a tax of the farmer-debtor.

The filing of a plan in Chapter 12 avoids some of these difficulties. From a tax standpoint, the filing of a plan in Chapter 12 does not create a separate taxable entity.[112] Therefore, even if property is transferred before confirmation of the plan, any resulting taxes would be taxes of the debtor not the estate. In this respect, Chapter 11 is preferable. But this difficulty is greatly alleviated by the fact that confirmation of a plan should occur much earlier in a Chapter 12 proceeding than is normally the case in Chapter 11, and only the debtor can file a Chapter 12 plan. If things are not going well for the farmer in Chapter 12, he or she has an absolute right to dismiss the case.[113]

B. Requirements Between the Filing of the Petition and Confirmation of a Plan

A Chapter 12 debtor has 90 days after filing the petition to file a plan.[114] The confirmation hearing must, except for cause, conclude no more than 45 days after the plan is filed.[115] These shorter time limitations should accelerate confirmation. It should be noted that while Chapter 11 has short time limits for filing plan,[116] Chapter 11 cases can still drag on for years.[117] But there is a more fundamental difference which should greatly accelerate plan confirmation in Chapter 12 cases. In Chapter 11 the major cause of delay is the negotiation process which is at the heart of a Chapter 11 proceeding. The creditors in a Chapter 11 case have a right to approve or disapprove a plan if their claims are impaired.[118] If an impaired class of creditors disapproves the plan, the plan cannot be confirmed unless it meets the "cram down" requirements of the Code.[119] This has been a major

112. 26 U.S.C. § 1398(a) (1982) covers only cases arising under Chapters 7 and 11.

113. 11 U.S.C. § 1208(b) (Supp. IV 1986) gives the debtor an absolute right to dismiss the case.

114. *Id.* § 1221.

115. *Id.* § 1224.

116. *Id.* § 1121(b), (c) (1982 & Supp. III 1985).

117. *See supra* note 65.

118. Section 1124 states a class of claims is impaired unless the plan does one of three things. First, it can leave unaltered the contractual rights to which such claim entitles the holder of such claim. Second, it can cure defaults and reinstate the contractual terms. Third, it can pay on the effective date of the plan cash equal to the allowed amount of such claim. 11 U.S.C. § 1124(1), (2), (3) (1982 & Supp. III 1985). Section 1126 empowers the holders of claims and interests to vote on the plan. *Id.* § 1126 (1982). Confirmation requires that each class either accept the plan or not be impaired under the plan. *Id.* § 1129(a)(8) (1982 & Supp. III 1985).

119. If a plan cannot be confirmed solely because § 1129(a)(8) cannot be met, then

stumbling block in farm reorganizations.

A class of creditors is impaired when the creditors are not being paid the full amount of their allowed claims.[120] Because of the "cram down" requirements, farmers who wish to retain farm property and pay unsecured creditors less than the full amount of their claim cannot do so without the class approving the plan.[121] The need for class approval generates negotiation. If negotiations fail and an impaired class refuses to approve the plan, the only way of getting a confirmed plan is to "cram it down."

A "cram down" must pass the "fair and equitable"[122] test which incorporates, for the most part, the absolute priority rule under the Bankruptcy Act.[123] This means that no claimant junior in priority can retain or gain anything under the plan unless senior claimants are paid in full.[124] In the case of the farmer, if the farm is incorporated, the shareholders can not retain anything under the plan unless secured and unsecured creditors are receiving payment in full on their allowed claims. If the farm is not incorporated, then the owners, presumably the farmer and his wife, can not retain any of the farm assets unless the creditors are paid the allowed amount of their claims.

Since most ownership interests want to continue owning the assets of the business, the emphasis in Chapter 11 is on negotiated compromises. Most confirmed plans are approved by the creditors, not crammed down.[125] Negotiation can take time, and it is not unusual for Chapter 11 cases to drag on for over a year before any confirmation decision.[126] The delay is costly to both the debtor and creditors.

Just before the passage of Chapter 12 legislation, the United

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§ 1129(b) provides for a "cram down." If the "cram down" requirements can be met, then the plan can be confirmed even though § 1129(a)(8) has not been met. *Id.* § 1129(b) (1982 & Supp. III 1985).

120. *Id.* § 1124 (1982). *See supra* note 118 (There are three ways of keeping a class from being impaired).

121. This is the case now that the United States Supreme Court, in Norwest Bank Worthington v. Ahlers, 108 S. Ct. 963 (1988), reversed the Eighth Circuit decision. *In re* Ahlers, 794 F.2d 388, *reh'g denied*, 794 F.2d 414 (8th Cir. 1986), *rev'd*, 108 S. Ct. 963 (1988).

122. 11 U.S.C. § 1129(b)(1) (1982).

123. 11 U.S.C. § 1129(b)(2) (1982 & Supp. III 1985) defines what constitutes a fair and equitable plan.

124. For example, unsecured creditors must either be paid the allowed amount of their claim or the holder of any interest that is junior to the unsecured creditors can receive or retain no interest in any property. *Id.* § 1129(b)(2)(C)(ii) (1982). Ownership interests are junior to creditors.

125. Kenneth Klee, *All You Ever Wanted to Know About Cram Down Under the New Bankruptcy Code*, 543 AM. BANKR. L.J. 133 (1979).

126. United Savings Ass'n v. Timbers of Inwood Forest Assoc. (*In re* Timbers of Inwood Forest Assoc.), 808 F.2d 363, 382-83 (5th Cir. 1987) (Jones, J., dissenting) (en banc).

States Court of Appeals for the Eighth Circuit, in *In re Ahlers*,[127] placed a new wrinkle on the Chapter 11 "cram down" that would have helped farmers. The court held that a plan could be crammed down over dissenting classes and that the farmer could retain assets under the plan.[128] The Eighth Circuit reasoned that the United States Supreme Court has long recognized that business owners may retain interests in property if they contribute new funds to help in the rehabilitation process.[129] The typical case involves shareholders. Normally in a "cram down" the shareholders cannot retain their ownership interest in the business unless unsecured creditors are paid in full. However, if the shareholders contribute new funds, they are entitled to share in the ownership of corporate assets to the extent of the contributed funds. The new wrinkle added by the Eighth Circuit was to extend the concept of new value to include the value of the farmer's labor, including his or her experience and expertise in farming the land.[130]

The court noted that the Supreme Court has ruled that "money or money's worth" was sufficient.[131] Applying this rule, two things would have to be valued. First, the worth of the farmer's labor had to be calculated, including compensation for experience and expertise.[132] The court provided the following example. If the value each year of the farmer's input is $40,000 and the farmer receives yearly living expenses of $12,000, the farmer has added $28,000 per year in value for his or her retained ownership interest.[133] Second, the value of the business at the end of the plan must be estimated to determine the worth of the farmer's retained interest.[134] The court noted that this was a more difficult valuation but was not impossible.[135] Once these values have been established they can be compared.[136] As long as the farmer's retained interest was not worth more than the value of the farmer's input in the farming operation over the life of the plan, the plan could be confirmed even though unsecured creditors did not con-

127. 794 F.2d 388, *reh'g denied*, 794 F.2d 414 (8th Cir. 1986), *rev'd*, 108 S. Ct. 963 (1988).

128. *Ahlers*, 794 F.2d at 399-403.

129. *Id.* at 401-02.

130. *Id.* at 399-403.

131. *Id.* at 401 (quoting Case v. Los Angeles Lumber Prods. Co., 308 U.S. 106, 121 (1939)).

132. *Id.* at 402.

133. *Id.* at 403 n.17.

134. *Id.* at 402-03.

135. *Id.* at 402.

136. *Id.*

sent and would not receive payment in full.[137]

Had *Ahlers* remained the law, this would have removed a major stumbling block for farmers reorganizing in Chapter 11. In March 1988, however, the Supreme Court[138] reversed the Eighth Circuit's ruling. The Supreme Court held that a farmer's work and experience were not "money or money's worth" for purposes of the "fair and equitable" test.[139] The ruling reinstates the need for a negotiated settlement if the farmer wants to keep the farm assets. It will be very difficult for most farmers to obtain a confirmed plan in Chapter 11 unless their creditors are willing to bend.

In a Chapter 12 case there is no "cram down" and no "absolute priority rule" because the creditors, both secured and unsecured, have no right to approve or disapprove a plan. Once the plan meets the requirements of section 1225 for court confirmation, the plan will bind creditors whether they object or not.[140]

The filing and confirmation of a plan should be considerably easier in Chapter 12 than in Chapter 11. If the farmer cannot construct a confirmable plan the worst thing that can happen is that this case will be dismissed.[141] The farm enterprise will not be subject to liquidation under a creditor's plan. The main drawback of dismissal is that the farmer may be precluded from refiling bankruptcy under another chapter for 180 days after the dismissal.[142] Section 109, which defines who can and cannot be a debtor under the various bankruptcy chapters, was amended in 1984 to preclude a debtor, whose case was dismissed, from refiling in bankruptcy for the next 180 days.[143] This 180 day bar applies only to specified dismissals, such as dismissals by the court for failure to abide by court orders or failure to appear in proper prosecution of the case,[144] and dismissals by the debtor following a creditor's request for relief from the stay.[145] It is this latter type of dismissal that is most likely to occur in a farm bankruptcy when the farmer is finding it difficult to draw up a plan.

To avoid the 180 day bar and the inconvenience of renewed creditor action once the stay is lifted, a farmer who cannot get a Chapter

137. *Id.* at 403.
138. Norwest Bank Worthington v. Ahlers, 108 S. Ct. 963 (1988).
139. *Id.*
140. 11 U.S.C. § 1227(a) (Supp. IV 1986).
141. *Id.* § 1208(c)(3).
142. *Id.* § 109(g).
143. *Id.* § 109(f).
144. *Id.* § 109(g)(1).
145. *Id.* § 109(g)(2).

12 plan confirmed should seriously consider liquidation before dismissal. If liquidation of the farm enterprise is going to happen once the bankruptcy stay is removed, conversion to a Chapter 7 bankruptcy liquidation should be evaluated.[146] If liquidation is inevitable, it may be better to liquidate in bankruptcy. The bankruptcy discharge should be considered, and the farmer's postbankruptcy liquidation tax picture should be evaluated. The tax burden of liquidation in bankruptcy might be considerably lighter than in liquidation outside of bankruptcy.[147]

IV. LOST OPPORTUNITY COSTS

Until very recently a big debate was occurring among the courts over whether an undersecured creditor in Chapter 11 could be compensated for lost opportunity costs. An oversecured creditor is entitled to include interest accruing postpetition to his or her claim up to the value of the collateral.[148] As long as the value of the collateral supports it, the fully secured creditor can also be compensated for costs and charges provided by the parties' agreement.[149] In contrast, the undersecured creditor is not entitled to postpetition interest.[150] In fact, postpetition interest is specifically excluded from an undersecured creditor's allowable claim.[151]

In the 1984 case, *Crocker National Bank v. American Mariner Industries*,[152] the United States Court of Appeals for the Ninth Circuit held that undersecured creditors were entitled to be compensated for the money they would have received had they been able to repossess the collateral, sell the property, and reinvest the proceeds. The Ninth Circuit reasoned that the creditor was precluded from realizing these sums because of the bankruptcy stay and should be compensated for this loss.[153] The court found statutory support for its analysis in section 361 of the Code.[154] Section 361 defines adequate protection.[155] If a creditor's interest is not being adequately pro-

146. *Id.* § 1208(a).

147. *See* Flaccus, *supra* note 71.

148. 11 U.S.C. § 506(b) (Supp. III 1985).

149. *Id.*

150. Section 506(b) only applies to the extent that an allowed secured claim "is secured by property the value of which . . . is greater than the amount of such claim . . . ." *Id.* § 506(b) (1982).

151. *Id.* § 502(b)(2) (Supp. III 1985).

152. 734 F.2d 426 (9th Cir. 1984).

153. *Id.* at 431.

154. *Id.*

155. 11 U.S.C. § 361 (1982 & Supp. III 1985).

tected, this is grounds for relief from the stay whether or not the property is necessary for an effective reorganization.[156]

After *American Mariner* came down, the United States Courts of Appeals for the Fourth and Eighth Circuits followed the holding with minor variations.[157] However, in 1986 the Fifth Circuit, in a well reasoned opinion, held that lost opportunity costs could not be awarded to an undersecured creditor.[158] Finding that lost opportunity costs were really compensation for postpetition interest, the United States Supreme Court, in January 1988, affirmed the Fifth Circuit's denial of opportunity costs.[159] Now that the debate has been settled, creditors may actually fare better in Chapter 12.

Farmers in Chapter 12 proceedings have never had to worry about how the debate over opportunity costs was resolved. The drafters of Chapter 12 wished to eliminate the opportunity cost problems for farmers, so they made section 361 inapplicable to Chapter 12 cases and defined adequate protection in section 1205(b) for Chapter 12 cases.[160] The Joint Conference Report explains that payment of lost opportunity costs often "throttles" farm cases at the beginning because the farmer can not make the periodic payments.[161] The Report explains that this is why the "indubitable equivalent" language was taken out and that the change "makes it clear that what needs to be protected is the value of the property, not the value of the creditor's 'interest in property.' "[162]

Section 1205 provides four specified ways of providing adequate protection.[163] The first two are similar to subsections 1 and 2 in section 361. They provide for periodic payments and/or replacement liens to compensate the secured creditor for a decrease in value of the collateral.[164] The fourth provision provides, in general, for adequately protecting the value of the collateral other than by providing

156. Section 362(d) sets out the grounds for relief from the stay. One of these grounds is for "cause, including lack of adequate protection of an interest in property of such party in interest . . . ." *Id.* § 362(d)(1) (Supp. III 1985).

157. Grundy Nat'l Bank v. Tandem Mining Corp., 754 F.2d 1434 (4th Cir. 1985); *In re* Briggs Transp. Co., 780 F.2d 1339 (8th Cir. 1985).

158. United States Ass'n v. Timbers of Inwood Forest Assoc., (*In re* Timbers of Inwood Forest Assoc.), 793 F.2d 1380 (5th Cir. 1986), *aff'd*, 108 S. Ct. 626 (1988).

159. *Timbers of Inwood Forest Assoc.*, 108 S. Ct. 626 (1988). 11 U.S.C. § 506(b) (Supp. III 1985) permits post petition interest to accrue only for oversecured creditors.

160. H.R. CONF. REP. No. 958, 99th Cong., 2d Sess. 49-50 (1986).

161. *Id.* 99th Cong., 2d Sess. at 50.

162. *Id.*

163. 11 U.S.C. § 1205 (Supp. IV 1986).

164. *Id.* § 1205(1), (2).

administrative expense priority.[165] All three of these provisions base compensation on the decrease in value of the collateral. Subsection three does not. It provides "such adequate protection may be provided by . . . paying to such entity for the use of farmland the reasonable rent customary in the community where the property is located, based upon the rental value, net income, and earning capacity of the property . . . ."[166]

Section 1205 arguably provides a form of opportunity costs. If a secured creditor could foreclose on the land, one of the ways it could reinvest would be to rent out the land. This section, unlike the other sections, is not tied to the decrease in the value of the collateral. Therefore, even if the value of the farmland were not declining, subsection three seems to authorize payment to the mortgagee of the reasonable rental value of the land. If subsection three is construed by the courts to allow such payments when the value of the farmland is not declining, an anomaly is created. In section 1205, it is the only form of adequate protection not tied to decrease in value, yet it is limited to mortgagees. This suggests that the farm equipment lender is entitled to compensation only when the value of the equipment is declining, and this would be giving mortgagees special treatment. Nothing in the conference report suggests this was intended, yet it is arguably what the statutory language suggests.

If the Chapter 12 time periods, 90 days for filing a plan and 45 days after that for the final confirmation hearing, are strictly followed, the period between petition filing and confirmation of the plan should be relatively short.[167] This should lessen the importance of any opportunity costs even if section 1205 is construed to provide them. In fact, in the view of some judges, one of the functions of awarding creditors lost opportunity costs in Chapter 11 is to hasten the negotiation process. As the dissenters in the en banc opinion in *In re Timbers of Inwood Forest Associates, Inc.*[168] note, payment for lost opportunity costs does not begin immediately, and, to the extent that it puts pressure on the debtor and unsecured creditors, payment may hasten confirmation of a plan if such is possible.

It is interesting that the award to mortgagees of fair rent could place the mortgagees in a better position than they would have been in

165. Section 1205(b)(4) states that "adequate protection may be provided by . . . granting such other relief . . . as will adequately protect the value of property securing a claim or of such entity's ownership interest in the property." *Id.* § 1205(b)(4).

166. *Id.* § 1205(b)(3).

167. *Id.* §§ 1221, 1224.

168. 808 F.2d 363, 375-84 (5th Cir. 1987) (Jones, J., dissenting) (en banc).

Chapter 11. It is doubtful that Congress intended this result. Since the time periods between the filing of the petition and plan confirmation should be short, however, payment of reasonable rent should not place the Chapter 12 farmer at a disadvantage.

V. POSTPETITION FINANCING AND USE OF COLLATERAL

Since the whole purpose of filing in Chapter 12 is to keep the farm enterprise functioning, each case will have "use, sale, or lease" questions and a concern about the procurement of postpetition credit. All ongoing businesses in bankruptcy fall under the "use, sale, or lease" restrictions of section 363.[169] No section in Chapter 12 preempts the application of section 363, therefore, the use, sale or lease of property in Chapter 12 should be much like its counterpart in Chapter 11. The one exception is that section 1206 allows the preconfirmation sale of certain property free and clear of the interests of creditors as long as the secured party gets a lien on the proceeds.[170] However, obtaining postpetition credit in Chapter 12 may be no easier than in Chapter 11.

To illustrate these two problems, consider the following facts which are not atypical in farm bankruptcies. Farmer Brown filed in Chapter 12 on March 1, 1986, because no lender was willing to lend Farmer Brown money to finance his 1986 crop. Now that bankruptcy has been filed, Farmer Brown needs to find capital to finance the crop. Capital can be found two ways: (1) postpetition credit and (2) the sale of farm property. Section 364 provides certain "carrots" to entice lenders to extend postpetition credit.[171] First, it should be noted that section 364 refers to action by a trustee. However, it specifically refers to section 1203.[172] Section 1203 gives the debtor in possession, the farmer, all the powers of a trustee operating the business, with a few exceptions, such as the right to compensation.[173] Thus, the farmer is able to take advantage of section 364's "carrots."

The first "carrot" is that postpetition unsecured credit incurred in the ordinary course of business is treated as an administrative expense.[174] As an administrative expense, these unsecured creditors have first priority after secured creditors.[175] It should be noted, how-

169. 11 U.S.C. § 363 (1982 & Supp. III 1985).
170. *Id.* § 1206 (Supp. IV 1986).
171. *Id.* § 364 (1982).
172. *Id.*
173. *Id.* § 1203 (Supp. IV 1986).
174. *Id.* § 364(1) (1982).
175. Administrative expenses are given a first priority by § 507. *Id.* § 507(a)(1). Section

ever, that some courts have held that the credit must also have been beneficial to the estate,[176] as is the requirement for administrative expenses in section 503(b).[177]

Even if the postpetition creditor's claim is treated as an administrative expense, the creditor's interest could remain unpaid. Administrative expense treatment gives the creditor priority over prepetition unsecured debt in a Chapter 7 petition.[178] As will be seen, however, some of the "carrots" in section 364 give other postpetition creditors priority over administrative claims. These "carrots" are available only upon court approval. One of the "carrots" is a grant to a postpetition creditor of a "priority over any or all administrative expenses of the kind specified in section 503(b) or 507(b) of this title . . . ."[179] In *General Electric Credit Corp. v. Levin & Weinbtraub*[180] the court held that attorneys and accountants of the debtor were entitled to have their fees treated as administrative claims. General Electric Credit Corporation (GECC) financed the debtor's day-to-day operations under an order giving it section 364(c)(1) priority.[181] The Second Circuit held that GECC had priority over the attorneys and accountants. Since no assets remained once GECC was paid, there were no assets left to pay anyone else.[182] Thus, postpetition creditors entitled to an administrative expense priority under section 1364(a) are at risk of not getting paid because section 364(c)(1) gives priority over the administrative claims in sections 503(b) and 507(b).[183] Attorney and accountants claims are made administrative expenses by section 330. Section 503(b)(2) specifically refers to section 330 claims.[184] Section 503(b) does not specifically refer to section 364(a) but it does refer to actual costs of preserving the estate.[185] Thus, the section 364(a) claimant may lose priority to a section 364(c)(1) claimant as happened in the *General Electric* case.

1222(a)(2) requires all Chapter 12 plans to pay § 507 claims in full under the plan. *Id.* § 1222(a)(2) (Supp. IV 1986).

176. *See, e.g., In re* Dakota Indus., Inc., 31 Bankr. 23, 26 (Bankr. S.D. 1983).

177. Section 503(b)(1)(A) includes "the actual, necessary costs and expenses of preserving the estate . . . ." 11 U.S.C. § 503(b)(1)(A) (Supp. III 1985).

178. Section 726 sets up the distribution scheme in Chapter 7. Section 726(a)(1) distributes property first to priority claimants under § 507. Only after all priority claims have been paid will other unsecured claims be paid. *Id.* § 726(a)(1), (2) (1982).

179. *Id.* § 364(c)(1).

180. 739 F.2d 73 (2d Cir. 1984).

181. *Id.* at 74.

182. *Id.* at 73-76.

183. 11 U.S.C. § 364(c)(1) (1982).

184. *Id.* § 503(b)(2) (Supp. III 1985).

185. *Id.* § 503(b)(1)(A).

Administrative claimants may also lose to a section 364(c)(2) or (3) claimant. These subsections give the postpetition creditor either a lien on unencumbered assets or a junior lien on encumbered assets.[186] Any time equity is encumbered, it potentially removes assets that would otherwise be available to pay unsecured creditors, including prioritized unsecured creditors. The danger to the postpetition administrative claimant also stems from the fact that in Chapter 12, unlike Chapter 11, administrative claims do not need to be paid in full before confirmation of the plan.[187] Section 1222(a)(2) states that the plan must pay section 507 claims in full, but can be done in deferred cash payments.[188] Administrative claims are section 507(a)(1) claims.[189]

If the farmer cannot complete plan payments the administrative claims may not get paid. This danger of not getting paid despite having an administrative claim means that the granting of administrative expense status may not be enough to attract postpetition credit. If there is no equity in any of the farm assets, section 364(c)(2) or (3) cannot be used, which may make it difficult for the farmer to attract credit. Section 364(d)(1) authorizes the court to grant a lien to a postpetition credit extender that is superior or equal to existing liens.[190] This is the most attractive "carrot" to the postpetition creditor. It is granted only sparingly, however, and can be granted only if there is adequate protection for the liens already on the property.[191] Therefore, farmers should not count on the availability of section 364(d)(1) to attract postpetition credit.

Another area of possible crop funding is the proceeds from the sale of stored farm products. The use of these assets for future production, however, will not be any easier in Chapter 12 than it is in Chapter 11. The difficulty is created when a secured party has a security interest in the stored farm products because the secured party often objects to sale. Although section 363(c)(1) allows a debtor in possession to use and sell assets in the ordinary course of business without court approval,[192] such sale will not be free of the secured

186. *Id.* § 364(c)(1), (2) (1982).

187. Section 1129(a)(9)(A) requires administrative claims, § 507(a)(1) claims, to be paid in cash on the effective date of the plan. *Id.* § 1129(a)(9)(A) (1982 & Supp. III 1985). In contrast, § 1222(a)(2) requires all § 507 claims, which include administrative claims, to be paid in full over the life of the plan. *Id.* § 1222(a)(2) (Supp. IV 1986).

188. *Id.* § 1222(a)(2) (Supp. IV 1986).

189. *Id.* § 507(a)(1) (1982).

190. *Id.* § 364(d)(1).

191. *Id.*

192. *Id.* § 363(c)(1).

party's lien unless one of the grounds in section 363(f) is met.[193] Section 363(f) allows sales free and clear of liens under certain circumstances such as creditor consent.[194] If the secured party does not consent to the sale at the time of the hearing, authorization for the sale might be found in places other than the security agreement. Usage of trade and course of dealing might be used to find authorization for the sale conducted.[195]

If the secured party has not consented to the sale there are other grounds in section 363(f) on which a court can allow sales free and clear of liens.[196] The language in section 363(f)(5) is the most applicable,[197] but the statutory language in section 363(f)(5) suggests that if the property to be sold is worth less than the debt it cannot be sold.[198] Yet, Collier argues that section 363(f)(5) should be read to allow a sale as long as the secured party is given a lien on the proceeds of the sale.[199] Cases dealing with farm products have allowed their sale free and clear of liens as long as the secured party is given a lien on the proceeds.[200]

Chapter 12 settles this issue for farmland and farm equipment sales.[201] For the sale of farmland and farm equipment, section 1206 allows a farmer to sell such property free and clear of liens under section 363(b) and (c) as long as the lien holder is given a lien in the proceeds.[202] This section does not, however, apply to the sale of farm products.[203] To sell farm products free and clear of an unconsenting creditor's lien, the debtor will have to rely on Collier and similar cases that allow a sale under section 363(f)(5).

Even if the farmer can sell the farm products free and clear of the

193. Section 363(f) states: "The trustee may sell property under subsection (b) or (c) of this section free and clear of any interest in such property of an entity other than the estate, only if . . . ." *Id.* § 363(f) (1982 & Supp. III 1985).

194. *Id.* § 363(f)(2) (1982).

195. U.C.C. § 9-307(1) has been effectively changed by § 1324 of the 1985 Farm Bill. Now the question of whether a sale cuts off a security interest is more complicated. If the sale is authorized, however, the sale cuts off the security interest. U.C.C. § 9-306(2) (1978). Agreements can be formed not only by explicit language but also by the party's course of dealing, usage of trade and course of performance. *Id.* § 1-201(3).

196. 11 U.S.C. § 363(f)(1), (3), (4), (5) (1982 & Supp. III 1985).

197. *Id.* § 363(f)(5) (1982).

198. Section 363(f)(5) states: "[S]uch entity could be compelled, in a legal or equitable proceeding, to accept money satisfaction of such interest." *Id.* § 363(f)(5).

199. 2 COLLIER, BANKRUPTCY, 363-31, 32 (1985).

200. *See, e.g., In re* Frank, 27 Bankr. 748, 751 (Bankr. S.D. Ohio 1983); *In re* Nikolaisen, 38 Bankr. 267 (Bankr. D.N.D. 1984), *rev'd, In re* Berg, 42 Bankr. 335 (Bankr. D.N.D. 1984).

201. 11 U.S.C. § 1206 (Supp. IV 1986).

202. *Id.*

203. *Id.* It applies only to the sale of farmland and farm equipment.

secured party's lien, the lien attaches to the proceeds. Under state law, section 9-306(2) of the Uniform Commercial Code allows the security interest to attach to identifiable proceeds in spite of the absence of any such clause in the security agreement.[204] Section 552(b) of the Bankruptcy Code allows a prepetition security interest to reach "proceeds, product, offspring, rents or profits" of the collateral acquired postpetition.[205] Moreover, section 363(e) requires adequate protection of a secured party's interest if the secured party objects to the sale.[206]

Once the farm products are sold and the creditor is given a lien on the proceeds, the collateral is cash collateral, and may not be used, even in the ordinary course of business, unless the court approves such use.[207] Here farmers can run into difficulty. The issue at the hearing is whether the secured party's lien will be adequately protected if the secured party is given a lien on the future crops. Unlike the situation where cars are sold and the cash is used to buy new cars, the existence, amount, price, and quality of future crops are contingent on a number of factors, many of which are outside the farmer's control. For example, a secured party with a security interest in 10,000 bushels of corn which was turned into cash, may find itself after the next harvest with a security interest in 5,000 bushels of corn. Despite these problems, however, a number of courts have allowed the farmer to use the cash for planting as long as the secured party is given a lien on the future crops and the farmer takes out crop insurance.

In *In re Sheehan*[208] debtors had a 16,703 acre farm which was used for growing irrigated corn and raising cattle. The court noted that the cash was to be used exclusively for the corn, and not the cattle operation.[209] The farmer, provided a detailed budget including crop projects, a replacement lien on future crops, payment of interest on the use of the money, all-risk crop insurance on 100% of the crop, services of an accountant, reasonable inspection rights for the secured party, a new professional experienced management team, ten experienced farmhands, and a promise to deposit cash until used in a solvent bank.[210] At the hearing, the accountant testified to the reliability

204. U.C.C. § 9-306(2) (1978).
205. 11 U.S.C. § 552(b) (Supp. III 1985).
206. *Id.* § 363(e) (1982).
207. *Id.* § 363(c)(2).
208. 38 Bankr. 859 (Bankr. D.S.D. 1984).
209. *Id.* at 865 n.1.
210. *Id.* at 865.

of the budget figures,[211] and testimony was provided concerning the historical bases for the figures.[212] The court also noted that the debtor's crop income had always exceeded the costs of production[213] and discussed the background of key workers.[214] Based on these factors the court held that the secured parties were adequately protected.

In contrast is the case of *In re Frank*,[215] where the court refused to allow the debtors to use the proceeds from their stored soybeans to buy cattle. The cattle were to be raised in Tennessee even though the farm and grain were located in Ohio. The debtors did not testify at the hearing.[216] The court found that the proposed plan was too speculative.[217] It emphasized that the debtors had not even provided a detailed plan as to how all the costs associated with raising the cattle were to be paid.[218] Most importantly, the court noted that the farmers were proposing to enter a different line of farming without justifying that such a move was a sensible and sound business decision.[219] Thus, the court held that the creditor was not adequately protected.[220]

In *In re Berens*[221] a Minnesota bankruptcy court allowed the use of cash collateral to plant crops on land the farmers owned but prohibited the use of the cash to grow crops on rented land. It should also be noted that the court allowed use of the cash on the owned land despite the fact that only hail and not "all-risk" insurance was provided.[222] A significant projected profit may have influenced the court.[223] The court's refusal to allow use of cash collateral on the rented land was supported by a number of factors. First, rent of $45,000 was due on the land.[224] With the rent expense factored in, the profit margin was very low.[225] Moreover, if the rent was not paid, the crop lender's lien would have a priority conflict with the landlord

211. *Id.* at 865-66.
212. *Id.* at 866.
213. *Id.*
214. *Id.*
215. 27 Bankr. 748 (Bankr. S.D. Ohio 1983).
216. *Id.* at 749.
217. *Id.* at 750.
218. *Id.*
219. *Id.*
220. *Id.*
221. 41 Bankr. 524 (Bankr. D. Minn. 1984).
222. *Id.* at 526-27.
223. *Id.* at 527.
224. *Id.*
225. *Id.*

lien.[226] Second, the farmers were unable to get all-risk crop insurance.[227] Third, based on the total expenses needed, the budget projected a $59,000 shortfall.[228] The court noted that the farmer's way of dealing with the shortfall would result in lower crop yields which in turn would reduce profit.[229]

In *In re Martin*[230] the United States Court of Appeals for the Eighth Circuit reversed a bankruptcy court's allowance of the use of cash collateral because the trial court's analysis was too superficial.[231] The bankruptcy court had found that a replacement lien and crop insurance guaranteed protection to the creditor.[232] Providing little, if any, analysis, the court merely noted that the secured party was adequately protected.[233] The Eighth Circuit's analysis suggests that among the bankruptcy decisions discussed above,[234] only the *Sheehan* court made a sufficiently detailed examination of the issues.[235] First, the Eighth Circuit held that it was error not to specifically value the secured party's current rights.[236] Next the court delineated the factors that needed to be considered to ensure that the current value of the secured party's interest was protected.[237] The court noted that even all-risk crop insurance does not eliminate all risks[238] and found that crop insurance does not protect the secured party from avoidable consequences,[239] because the policy disclaims loss due to neglect or failure to follow good husbandry practices.[240] Thus, the court listed various factors to consider in determining whether the secured party was completely protected.

First, the bankruptcy court was instructed to consider the anticipated yield given the productivity of the land and the husbandry practices of the farmers.[241] Included within this analysis would be an

226. *Id.*
227. *Id.*
228. *Id.* at 527-28.
229. *Id.* at 527.
230. 761 F.2d 472 (8th Cir. 1985).
231. *Id.* at 473.
232. *In re* Nikolaisen, 38 Bankr. 267 (Bankr. D.N.D.), *rev'd*, *In re* Berg, 42 Bankr. 335 (Bankr. D.N.D. 1984).
233. *Id.*
234. *See supra* text accompanying notes 208-29.
235. *In re* Martin, 761 F.2d 472, 477 (8th Cir. 1985).
236. *Id.*
237. *Id.*
238. *Id.*
239. *Id.*
240. *Id.*
241. *Id.*

examination of crop yields from previous years, the health and reliability of the farmer, the condition of machinery and whether it might be repossessed before harvest.[242] Second, the court was instructed to determine whether the secured party's lien on the growing crop could be competing with other encumbrances on the crop.[243] Last, an analysis of anticipated market prices at harvest and the possible variations therein had to be considered.[244] The court noted that the list was not exhaustive,[245] but it provides a good indication of the type of evidence a farmer should provide. The farmer has the burden of proof on the issue of adequate protection.[246]

In Chapter 12, since a creditor's approval of the plan is not needed and an expedited court hearing is provided, farmers may be able to get a plan confirmed before needing credit. Once the plan is confirmed, Chapter 12 does provide some added flexibility over what is available in Chapter 11. Section 1111(b) in Chapter 11 allows an undersecured creditor to elect to have his or her full debt considered a secured claim.[247] This election eliminates any unsecured claim, but it does not require the Chapter 11 debtor to pay the full amount of the claim under the plan.[248] This is because section 1129(a)(7)(B) requires the plan to pay the creditor an amount equal to the present value of that creditor's interest in the collateral, not the present value of the creditor's claim.[249] A section 1111(b) election does, however, restrict the debtor's freedom by precluding the cashing out of a claim at the beginning of the plan.[250] For example, a farm debtor might want to sell some farm equipment not needed on the restructured farm, but if the secured party with a security interest in the equipment were undersecured, the secured party could block the sale by electing section 1111(b) treatment. Thus, the debtor is precluded from selling

242. *Id.*

243. *Id.*

244. *Id.*

245. *Id.*

246. 11 U.S.C. § 363(o)(1) (Supp. III 1985).

247. *Id.* § 1111(b)(2) (1982).

248. Section 1129 sets out the requirements for the contents of the plan. Section 1129(a)(7)(B) makes it clear that the plan need pay secured creditors only the present value of the collateral. *Id.* § 1129(a)(7)(B) (Supp. III 1985).

249. *Id.*

250. *Id.* § 1124(3)(A). Of course, if the debtor were willing to pay the secured party the full amount of its claim, the debtor could do so. The § 1111(b) election precludes the elimination of a claim by payment at the beginning of the plan, the present value of the collateral. Section 1129(a)(7)(B) only authorizes payments under the plan with interest. *Id.* § 1129(a)(7)(B).

the collateral at the beginning of the plan and paying the proceeds to the creditor. This preclusion has restricted some restructuring efforts.

There is no counterpart to section 1111(b) in Chapter 12. Therefore, if a farmer were in Chapter 12 and wanted to sell the equipment and pay the undersecured secured party the proceeds from the sale, he or she would be free to do so.[251] This ability to sell collateral and pay off creditors might free up some of the future income, and thus may be a way of funding the farm. Other than this, Chapter 12 does not seem to make credit raising any easier than it was in Chapter 11.

Under the heading "Post Confirmation Credit," the Conference Report suggests that the key to credit in Chapter 12 is that under section 1227(c) the property vesting in the debtor once the plan is confirmed is free and clear of any claim of a creditor provided for in the plan.[252] The exception to this rule is in section 1225(a)(5)(B).[253] If a secured creditor has not accepted the plan, then in order to be confirmed, the plan must allow the secured party to retain a lien on the debtor's property and must pay to the secured creditor the present value of the allowed amount of the secured claim.[254] Section 506(a) defines allowable secured claims as equal to the creditor's interest in the estate's interest in property.[255] In other words, a secured claim is limited to the value of the collateral. Therefore, after confirmation, the liens that existed prior to confirmation will remain undisturbed by confirmation. Unless the debtor had assets free and clear before confirmation, the confirmation of the plan is not likely to make assets available. Without equity to secure postpetition credit, the farmer will have to rely on the limited "carrots" provided in section 364.

Apart from the elimination of section 1111(b) rights in Chapter 12, obtaining both pre and postconfirmation credit may prove to be as difficult for farmers as it was in Chapter 11. This could prove to be the Achilles heel to the usefulness of Chapter 12.

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251. Section 1225(a)(5)(C) allows the debtor to require the creditor to accept the property in exchange for the allowed secured claim. *Id.* § 1225(a)(5)(c) (Supp. IV 1986). This would merely release the lien on the property. An undersecured creditor has an unsecured claim as well, and the creditor would be entitled to whatever payments were being made on unsecured debt.

252. H.R. REP. NO. 958, 99th Cong., 2d Sess. 6 (1986) (*reprinted in* 1086 U.S. CODE CONG. & ADMIN. NEWS 5251-52); 11 U.S.C. § 1227(c) (Supp. IV 1986).

253. 11 U.S.C. § 1225(a)(5)(B) (Supp. IV 1986).

254. *Id.*

255. *Id.* § 506(a) (1982).

VI. TREATMENT OF SECURED AND UNSECURED INDEBTEDNESS

Many farmers have undersecured creditors. This is especially true for farmland lenders since the price of farmland has fallen so substantially. In 1984 farmland value declined twelve percent nationally and twenty percent in the corn belt, lake states, and northern plain.[256] After peaking in 1981, land values have declined by nearly fifty percent in Iowa and Nebraska, and by approximately forty percent in Ohio, Illinois, Indiana, Minnesota, and Missouri.[257] Chapter 12, like Chapter 11, allows the debtor to reduce the secured party's secured claim to the value of his or her share of the collateral.[258] The main difference between the two chapters is the elimination of section 1111(b) creditor rights in Chapter 12. It has already been mentioned that the elimination of section 1111(b) rights allows the Chapter 12 farmer to pay off the secured party by paying the value of the secured party's interest in the collateral at the beginning of the plan.[259] It may also have another effect.

Under section 506(d) the debtor has the power to avoid liens to the extent they are not allowed secured claims.[260] Allowed secured claims are defined in section 506(a),[261] which states, "[a]n allowed claim of a creditor secured by a lien on property . . . is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property . . . ."[262] Assume that there are three mortgages on farmland that is currently worth $400,000. The debt of the first mortgage is $250,000, the second, $100,000, and the third, $150,000. The first two are fully secured, but the third is undersecured. In Chapter 11, section 1111(b) would allow the third creditor to elect treatment as fully secured.[263] Section 1111(b) overrides section 506(a).[264] Therefore, the debtor could not avoid $100,000 worth of the third creditor's lien under section 506(d).[265] The

256. *Financial Characteristics of U.S. Farms, January 1985*, Agriculture Information Bulletin No. 495, 2 (available from the Economic Research Service division of the United States Department of Agriculture).

257. *Id.*

258. 11 U.S.C. § 1225(a)(5)(B)(ii) (Supp. IV 1986).

259. *See supra* note 251.

260. 11 U.S.C. § 506(d) (Supp. III 1985).

261. *Id.* § 506(a) (1982).

262. *Id.*

263. *Id.* § 1111(b)(2).

264. *Id.*

265. Once an undersecured creditor elects § 1111(b) treatment, that creditor's allowed claim is the full amount of the claim, even though the collateral is worth less. Section 506(d) allows avoidance of a lien only to the extent that the lien secures a claim that is not an allowed

debtor's advantage in avoiding $100,000 of the third mortgagee's lien is that it allows the debtor to retain the benefit of the value of the land while preventing the third mortgagee from benefiting from property appreciation under the plan.

Since a section like section 1111(b) is not part of Chapter 12, a farmer can and should use section 506(d) to avoid the lien on any unsecured part of a creditor's debt. Under the plan the farmer need only pay the present value of the creditor's interest in the property.[266] In the hypothetical just discussed, creditor one would receive the present value of $250,000, creditor two, the present value of $100,000, and creditor three the present value of $50,000. One hundred thousand dollars worth of the third creditor's lien can be avoided under section 506(d), leaving the third mortgagee with a $100,000 unsecured claim. If the farm land appreciates in value under the plan, the increase in value goes to the farmer and not to the third mortgagee. Since the secured creditor has no voting rights in Chapter 12, the third creditor can not withhold his vote in an attempt to get the farmer to pay more.

The length of a Chapter 12 plan cannot exceed five years.[267] In fact it may only last three years unless the court approves a four or five year plan.[268] If a farmer were forced to complete plan payments to secured creditors by the end of a five year plan, very few farmers could successfully reorganize in Chapter 12. However, section 1222, which delineates what the plan must include, provides for the payment of secured debt over a period exceeding the period of the plan.[269] It applies only to secured debt with an original term that extended beyond the last date under the plan.[270]

The ability to scale down secured debt to the value of the collateral is one of the bigger advantages of bankruptcy. The farmer had this same right in Chapter 11,[271] but as can be seen, there were a

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secured claim. Section 1111(b) election should preclude § 506(d) avoidance. *Id.* §§ 1111(b), 506 (d).

266. *Id.* § 1225(a)(5)(B)(ii) (Supp. IV 1986).

267. *Id.* § 1222(c).

268. *Id.*

269. *Id.* § 1222(b)(9).

270. *Id.* § 1225(b)(5), (9).

271. *Id.* § 1129(b)(2)(A) (1982 & Supp. III 1985). This is applicable in "cram down" situations. 11 U.S.C. § 1129(a)(7)(A)(ii) (1982 & Supp. III 1985) requires that parties receive at least the amount they would have received in a Chapter 7 liquidation. Scaling down an undersecured debt makes that creditor's claim impaired. *Id.* § 1124. Once a class of claims is impaired, then, if it does not accept the plan, the plan must be crammed down because § 1129(a)(8) has not been met. *Id.* § 1129(a)(8).

number of impediments to obtaining a confirmed plan in Chapter 11. A number of these impediments have been removed in Chapter 12, so more farmers should be able to use this bankruptcy advantage.

The treatment of unsecured debt is where Chapter 12 has a big advantage for the debtor over Chapter 11. Both Chapters 11 and 12 require that unsecured creditors receive only the amount they would receive if the farm enterprise were liquidated in a Chapter 7 proceeding.[272] The difference lies in the right of unsecured parties to vote on the plan in Chapter 11.[273] Although a farmer may think he or she does not have much unsecured debt, he or she should recall that an undersecured creditor is in part an unsecured creditor. If these creditors as a class do not approve the plan, the plan must meet the "cram down" requirements of section 1129(b).[274] As noted above, in a "cram down", if an entity below the objecting creditor is to receive anything under the plan, the plan must be "fair and equitable" and the senior creditor must be paid in full.[275] The *Ahlers* decision, allowing a farmer to retain property at the end of the plan equal to the value of his or her labor, experience, and expertise, was a short lived exception to this rule.[276] The Supreme Court's reversal of *Ahlers*, however, makes it clear that labor and experience can no longer be used to meet the fair and equitable test.[277]

There is no "cram down" in Chapter 12 proceedings and no absolute priority rule. Creditors, secured and unsecured, have no right to vote on the plan. The farmer can keep farm assets, scale down secured debt[278] and pay unsecured creditors the amount they would have received had the farm been liquidated in a Chapter 7.[279] If the farmer has few unencumbered, nonexempt assets, then the amount that must be paid on unsecured debt under a confirmed plan will be small.

There are a couple of exceptions to this basic picture. First, all unsecured priority debt must be paid in full under the plan.[280] Since

272. *Id.* § 1129(7)(A)(ii) (1982 & Supp. III 1985); *Id.* § 1225(a)(4) (Supp. IV 1986).

273. If an unsecured creditor class is paid less than the allowed amount of its claim, the claims in the class are impaired. *Id.* § 1124 (1982 & Supp. III 1985). A plan cannot be confirmed, absent a cram down, unless impaired classes have approved the plan. *Id.* § 1129(a)(8).

274. *Id.* § 1129(b).

275. *Id.* § 1129(b)(2)(B). *See supra* discussion accompanying notes 152-54.

276. *In re* Ahlers, 794 F.2d 388, *reh'g denied*, 794 F.2d 414 (8th Cir. 1986), *rev'd*, Norwest Bank v. Ahlers, 108 S. Ct. 963 (1988).

277. Norwest Bank v. Ahlers, 108 S. Ct. 963 (1988).

278. 11 U.S.C. § 1225(a)(5)(B)(ii) (Supp. IV 1986).

279. *Id.* § 1225(a)(4).

280. *Id.* § 1222(a)(2).

the plan should be confirmed relatively quickly, administrative expenses, which have first priority,[281] should not be high.[282] The second priority applies only in involuntary bankruptcies,[283] and farmers cannot be involuntarily brought into bankruptcy.[284] If the farmer had no employees, there will be no third or fourth priorities.[285] The fifth and sixth priorities would also be inapplicable.[286] The main priority expense, if there are any, could be section 507(a)(7) taxes.[287] These are primarily prepetition taxes ranging from income,[288] excise,[289] and property taxes[290] to employee taxes.[291] Depending on the situation before bankruptcy, these taxes could be substantial, and they must be paid in full under the plan along with any other priority claim.[292] All priority claims can be paid by deferred payments under the plan.[293]

The second exception applies if a creditor objects to the plan.[294] If a creditor objects to the plan, section 1225(b) requires the farmer to devote all disposable income during the plan period to payments under the plan.[295] Thus, if disposable income allows greater payments to creditors than those called for under the plan, unsecured creditors would be paid more. Disposable income is defined as income not reasonably necessary for the maintenance or support of the debtor and his or her dependents and income not reasonably necessary for the continuation, preservation, and operation of the debtor's

281. Administrative expenses must be incurred by the estate. *Id.* § 503(b) (1982 & Supp. III 1985).

282. *Id.* § 507(a)(1) (1982).

283. *Id.* § 507(a)(2) (1982). This refers to section 502(f) claims. These are claims in an involuntary case that arise between the filing of the petition and the order of relief or the appointment of a trustee, whichever occurs first. *Id.* § 502(f).

284. *Id.* § 303(a).

285. The third priority items are wage claims up to $2,000. *Id.* § 507(a)(3) (1982 & Supp. III 1985). The fourth priority claims are for unpaid contributions to an employee benefit plan. These too can be for $2,000 per individual, but subtracted from this sum are certain amounts including amounts paid out in wage claims. *Id.* § 507(a)(4).

286. The fifth priority is given to farmers and fishermen whose farm products or fish are being claimed by a bankrupt storage facility. *Id.* § 507(a)(5) (Supp. III 1985). This too, is limited to $2,000. The sixth priority is given for deposits made for the purchase or lease of property or the purchase of services. Both the property and services are limited to consumer property and services. This priority is limited to $900 per individual. *Id.* § 507(a)(6).

287. *Id.* § 507(a)(7).

288. *Id.* § 507(a)(7)(A).

289. *Id.* § 507(a)(7)(E).

290. *Id.* § 507(a)(7)(B).

291. *Id.* § 507(a)(7)(C), (D).

292. *Id.* § 1222(a)(2) (Supp. IV 1986).

293. *Id.*

294. *Id.* § 1225(b).

295. *Id.*

business.[296] The Conference Report recognizes that in addition to the farm enterprise, farmers may have a minor business not directly related to the farming operation.[297] The Report states that "[t]he conferees intend that the term 'debtor's business' in section 1225 include such businesses."[298] This allows the farmer to arrive at disposable income by deducting the expenses reasonably necessary for the operation of the minor business from gross income.

The requirement that disposable income be paid out under the plan should not be a problem for farmers. It was added to Chapter 13 in 1984 to curb perceived abuses.[299] Before it was added, the statute allowed individuals with relatively high incomes to pay only a small part of unsecured debt.[300] The disposable income requirement was designed to prohibit this inequity.

VII. CURING DEFAULT

One of the advantages of filing either in Chapter 11 or 12 is the ability to cure defaults.[301] In Chapter 11, sections 1123(a)(5) and (6) allow the plan to provide for the cure or waiver of any default.[302] Since the plan must be approved by creditors or meet the "cram down" requirements, the debtor's freedom to waive defaults is restricted. Since creditors have no approval rights in Chapter 12, the constraints to waiver of defaults do not exist in Chapter 12. It should be noted that Chapter 12's statutory language is different. Section 1222(b)(3) provides for the curing or waiving of any default.[303] However, section 1222(b)(5) provides for "the curing of any default within a reasonable time and maintenance of payments while the case is pending on any unsecured claim or secured claim on which the last payment is due after the date on which the final payment under the plan is due."[304] Since no plan may continue more than five years, this section would apply to any debt payments under the plan which fall within the period of the plan and which extend beyond five years. There is no provision allowing waiver of these defaults.

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296. *Id.* § 1225(b)(2).

297. H.R. CONF. REP. NO. 958, 99th Cong., 2d Sess. 5 (1986).

298. *Id.*

299. Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 353, 98th Cong., 2d Sess. § 317, 98 Stat. 356 (1984).

300. 11 U.S.C. § 1325 (1982 & Supp. III 1985).

301. *Id.* § 1123(a)(5), (6) (1982); *Id.* § 1222(b)(3), (5) (Supp. IV 1986).

302. *Id.* § 1123(a)(5), (6) (1982 & Supp. III 1985).

303. *Id.* § 1222(b)(3) (Supp. IV 1986).

304. *Id.* § 1222(b)(5).

Even if a debt is in default when a bankruptcy petition is filed and even if the loan has been accelerated and is in foreclosure when bankruptcy is filed, the Chapter 12 debtor can deaccelerate the debt and cure the default by making payments while the case is pending.[305] Since secured debt can be modified, the payment schedule on this debt can be set in the plan. If the last payment on any debt is after the last payment under the plan, then defaults must be cured within a reasonable time by making payments along with regular plan payments.[306]

VIII. DISCHARGE

In Chapter 11 it is the confirmation of the plan that triggers the discharge.[307] Since the discharge applies to all debts that arise prior to the date of confirmation,[308] not only prepetition debts but debts that arise after the petition but prior to confirmation are subject to discharge. The inclusion of postpetition claims is not unfair to these claimants. For the most part, postpetition claims will be administrative expenses. In a Chapter 11 case, administrative expenses must be paid in full upon plan confirmation.[309] There are a few exceptions to this Chapter 11 discharge. First, an individual is not discharged from section 523 claims.[310] Second, if the plan calls for a liquidation and the debtor does not engage in business after confirmation, the debtor will be denied a discharge if the discharge would have been denied under section 727(a).[311] For example, partnerships and corporations which are barred from discharge under section 727(a) would be barred from discharge in Chapter 11.[312] An individual who would have been barred from discharge under one of the other subsections of section 727(a) is also barred from discharge.[313] Third, the plan or

305. Similar language exists for Chapter 13 proceedings. The main difference is that section 1322(b)(2) precludes modification of the rights of home mortgagees. *Id.* § 1322(b)(2) (Supp. III 1985). This complicates the Chapter 13 picture somewhat. Despite § 1322(b)(2), courts have allowed the plan to cure defaults, including deaccelerating debt, even on home mortgages. Since § 1222(b)(5) has no such limitation it should be allowed to deaccelerate debts. *Id.* § 1222(b)(5) (Supp. IV 1986).

306. *Id.* § 1222(b)(5) (Supp. IV 1986).

307. *Id.* § 1141(d)(1)(A) (1982).

308. *Id.*

309. *Id.* § 1129(a)(9)(A) (1982 & Supp. III 1985).

310. *Id.* § 1141(d)(2) (1982).

311. *Id.* § 1141(d)(3). Section 727(a) sets out situations in which the debtor is barred from discharge completely. One of these is where the debtor has received a discharge in Chapters 7 or 11 within the previous six years. *Id.* § 727(a)(8) (1982 & Supp. III 1985).

312. *Id.* § 727(a)(1) (1982).

313. *Id.* § 727(a)(1)-(10) (1982 & Supp. III 1985).

order of confirmation can condition or restrict a discharge.[314] Other than these three exceptions, the discharge in Chapter 11 is a broad one.

The discharge rules in Chapter 12 are primarily based on Chapter 13 with some changes.[315] As is the case in section 1328, there are two types of discharges in Chapter 12. Once the farmer makes all of the payments under the plan, he or she will be entitled to a discharge under section 1228(a).[316] Unlike the Chapter 11 discharge, the section 1228(a) discharge only occurs after all plan payments have been made. There are several types of debts that are excepted from the section 1228(a) discharge. First are long term debts, the final payment on which will take place after the last payment under the plan.[317] These are debts included in section 1222(b)(5) of the new chapter.[318] Since many farm debts are long term debts which will fall under section 1222(b)(5), the section 1228(a) broad discharge will not apply to many debts, even though the farmer has made all the payments under the plan.

The statute is confusing as to the second type of debt not subject to discharge. Section 1228(a)(1) refers to section 1222(b)(10) which covers the vesting of property of the estate in the debtor.[319] It makes no sense for section 1228(a)(1) to preclude from discharge the vesting of property in the debtor. No doubt Congress meant to include section 1222(b)(9) debts as nondischargeable debts, and not section 1222(b)(10) debts.[320] Subsection (b)(9) debts are long term secured debts for which payment is due after plan payments have ended.[321] Since the secured party will not have received the value of the collateral when the plan payments terminate, these debts should be nondischargeable. Therefore, the debt should not be subject to discharge.

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314. *Id.* § 1141(d)(1) (1982).

315. *Id.* § 1328 (1982 & Supp. III 1985) contains the discharge rules for Chapter 13. *Id.* § 1228 (Supp. IV 1986) contains the discharge rules for Chapter 12.

316. *Id.* § 1228(a) (Supp. IV 1986).

317. *Id.* § 1228(a)(1).

318. *Id.* § 1222(b)(5).

319. *Id.* § 1228(a)(1). Section 1222(b)(10) allows the plan to: "provide for the vesting of property of the estate, on confirmation of the plan or at a later time, in the debtor or in any other entity . . . ." *Id.* § 1222(b)(10).

320. Section 1222(b)(9) allows the plan to "provide for payment of allowed secured claims consistent with section 1225(a)(5) of this title, over a period exceeding the period permitted under section 1222(c) . . . ." *Id.* § 1222(b)(9). Section 1222(b)(5) allows the curing of defaults on long term indebtedness. *Id.* § 1222(b)(5). Section 1222(c) states that except as provided in subsections (b)(5) and (b)(9), plan payments cannot continue past the length of the plan. This is a standard three years, unless the court allows a longer period up to five years. *Id.* § 1222(c).

321. *Id.* § 1222(b)(9).

This is in fact what section 1328(a)(1) does in Chapter 13.[322] Since section 1228 seems to be modeled on section 1328, a court should find no difficulty in concluding that Congress meant to include section 1222(b)(9) debts as nondischargeable. The reference to section 1222(b)(10) makes no sense, and a technical corrections bill should correct this language.

The last type of debt not discharged under section 1228(a) is section 523(a) debt.[323] This is a major difference between a Chapter 12 and a Chapter 13 discharge.[324] In Chapter 13, alimony and child support found in section 523(a)(5)[325] are the only debts which are not discharged upon completion of the Chapter 13 plan payments.[326] All otherwise nondischargeable debts are discharged under section 1328(a).[327] In contrast, section 1228(a) excepts all nondischargeable debts from the Chapter 12 discharge,[328] so a farmer with any section 523 nondischargeable debt will not be able to discharge that debt in Chapter 12.

Nondischargeable debts cover a wide range of debts. One that may appear frequently in a farm situation is a conversion claim.[329] Conversion claims occur when a farmer sells property that is collateral for a loan and the sale is in violation of the security agreement.[330]

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322. *Id.* § 1328(a)(1) (1982) merely refers to § 1322(b)(5) which is the counterpart of § 1222(b)(5) on curing defaults on long term debt. Section 1322 has no subsection like 1222(b)(9).

323. *Id.* § 1228(a)(2) (Supp. IV 1986).

324. *Id.* § 1328(a)(2) (Supp. 1982).

325. *Id.* § 523(a)(5) (1982 & Supp. III 1985).

326. *Id.* § 1328(a)(2) (1982).

327. *Id.* § 1328(a). Arguments have been made that unsecured creditors with § 523(a) nondischargeable debts should receive more under a Chapter 13 plan than they would have received in a Chapter 7 liquidation proceeding. Section 1325(a)(4) requires a Chapter 13 plan to pay unsecured creditors the amount they would have received, had the estate of the debtor been liquidated in Chapter 7. The creditors argued that because their debts were nondischargeable in Chapter 7, they could have collected from the debtor after bankruptcy. This, they argued, would give them more than they would receive from the liquidation of the debtor's property. This argument has not found favor with the courts. *See, e.g., In re* Rimgale, 669 F.2d 426 (7th Cir. 1982); *In re* Syrus, 12 Bankr. 605, 608 (Bankr. D. Kan. 1981).

328. 11 U.S.C. § 1228(a)(2) (Supp. IV 1986). Section 523(a) was also amended to make it clear that a § 1228 discharge does not discharge § 523 debts. Bankruptcy Judges, United States Trustees and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, § 257(n), 100 Stat. 3088, 3115 (1986).

329. A conversion is a wrongful appropriation of someone else's property. The unauthorized transfer of someone else's property is a common form of conversion. PROSSER & KEETON, TORTS, § 15, at 96-98 (5th Ed. 1984).

330. *See, e.g., In re* Adametz, 53 Bankr. 299 (Bankr. W.D. Wis. 1985); *In re* Pommerer, 10 Bankr. 935 (Bankr. D. Minn. 1981); *In re* McCloud, 7 Bankr. 819, 822-26 (Bankr. M.D. Tenn. 1980).

Section 523 does not specifically list conversion claims, but it does include claims for willful, malicious injury.[331] Since a conversion is an intentional tort, willfulness is easily shown.[332] However, the courts have disagreed over what constitutes a malicious injury.

The courts basically take three approaches. The one that is most difficult to prove and is therefore the best for the farmer, requires proof that the farmer intended to hurt the secured party by the sale.[333] The last two approaches start out the same. They find the transfer to be malicious if the debtor knew that the sale would harm another.[334] Some courts say that maliciousness will be presumed if the debtor has read the security agreement or the debtor is in business.[335] One court has even presumed such knowledge by the fact that the consumer debtor had entered into numerous secured transactions.[336] A farmer could easily fall under the businessman category and therefore be presumed to have known the sale was in violation of the security agreement. Even if courts do not put farmers in the category of businessmen, they would fall under the category of a debtor who had entered into many secured transactions. Thus, farmers are at risk of having nondischargeable claims. Despite this risk, there are a number of cases that hold that even though a technical conversion of farm property has taken place, there is no maliciousness.[337] Many of the farming cases that find maliciousness have special circumstances.[338] However, if a farmer has a nondischargeable debt, a Chapter 13 filing should be considered if possible.

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331. 11 U.S.C. § 523(a)(6) (1982).

332. *See, e.g., In re* Ries, 22 Bankr. 343, 346 (Bankr. W.D. Wis. 1982); *In re* Giantvalley, 14 Bankr. 457, 458 (Bankr. D. Nev. 1981); *In re* Meyer, 7 Bankr. 932, 933 (Bankr. N.D. Ill. 1981); *In re* McCloud, 7 Bankr. 819, 825-26 (Bankr. M.D. Tenn. 1980).

333. *See, e.g., In re* Gentis, 10 Bankr. 209, 213 (Bankr. S.D. Ohio 1981); *In re* McLaughlin, 14 Bankr. 773 (Bankr. D. Ga. 1981); *In re* Nelson, 10 Bankr. 691 (Bankr. N.D. Ill. 1981); *In re* Harris, 8 Bankr. 88 (Bankr. M.D. Tenn. 1980); *In re* Hawkins, 6 Bankr. 97 (Bankr. W.D. Ky. 1980) (continuation of loan payments); *In re* Hodges, 4 Bankr. 513, 517 (Bankr. W.D. Va. 1980) (selling to raise money for living purposes shown no intent to harm).

334. *See, e.g., In re* Adametz, 53 Bankr. 299, 302-05 (Bankr. W.D. Wis. 1985); *In re* Donofrio, 19 Bankr. 734 (Bankr. N.D. Ohio 1982); *In re* Giantvalley, 14 Bankr. 457, 458 (Bankr. D. Nev. 1981); *In re* McCloud, 7 Bankr. 819, 825-26 (Bankr. M.D. Tenn. 1980).

335. *See, e.g., In re* Donny, 19 Bankr. 354, 359 (Bankr. W.D. Wis. 1982); *In re* Ricketts, 16 Bankr. 833 (Bankr. N.D. Ga. 1982).

336. *See In re* Ries, 22 Bankr. 343, 348 (Bankr. W.D. Wis. 1982).

337. *See, e.g., In re* Cline, 52 Bankr. 301 (Bankr. W.D. Ken. 1985); *In re* Nelson, 67 Bankr. 491 (Bankr. D. Minn. 1985); *In re* Johnson, 42 Bankr. 755 (Bankr. E.D. Mo. 1984); *In re* Dino, 17 Bankr. 316 (Bankr. M.D. Fla. 1982); *In re* Harris, 8 Bankr. 93, 94 (Bankr. M.D. Tenn. 1980).

338. *In re* Boren, 47 Bankr. 293 (Bankr. W.D. Ky. 1985) (misrepresentation); *In re* Simpson, 29 Bankr. 202, 213 (Bankr. N.D. Iowa 1983) (sale after appointment of receiver); *In re* Donny, 19 Bankr. 354 (W.D. Wis. 1982) (farmer had no ownership interest in cattle sold).

The other type of discharge provided in section 1228 is what Chapter 13 terms a hardship discharge.[339] A debtor may be eligible for a hardship discharge when the debtor cannot complete payments under the plan, and such inability is due to circumstances for which the debtor should not be held accountable.[340] A hardship discharge also requires that the amount the creditors actually received under the plan is at least equal to the amount they would have received had the debtor's property been liquidated in a Chapter 7 proceeding.[341] Lastly, the debtor must show that modification of the plan under section 1229 would not be practicable.[342]

This hardship discharge does not discharge sections 1222(b)(5) and (10) debts or section 523(a) nondischargeable debts.[343] This raises the question of how the hardship discharge differs from what should be a broader discharge upon completion of plan payments. Section 1228(a) discharges all debts "provided for by the plan allowed under section 503 . . . or disallowed under section 502 . . . ."[344] Section 1228(b) on the other hand discharges "all unsecured debts provided for by the plan or disallowed under section 502 . . . ."[345] The first difference is clear: section 1228(b) only discharges unsecured debt, whereas section 1228(a) discharges both secured and unsecured debt.[346] This makes sense because in the case of a hardship discharge, secured parties will not have received what they would have received in a Chapter 7 liquidation. Therefore, these debts should not be discharged. The second difference, the reference in section 1228(a) to debts allowed under section 503, is unclear.[347] Section 503 does not allow or disallow debts,[348] but it sets out what claims are to be treated as administrative claims.[349] Thus, a good argument can be made that Congress meant to refer to section 502 not section 503. Court guidance is needed on this point since the Conference Report does not address it.

If a farmer cannot complete the payments called for by the plan,

339. 11 U.S.C. § 1228(b) (Supp. IV 1986).
340. *Id.* § 1228(b)(1).
341. *Id.* § 1228(b)(2).
342. *Id.* § 1228(b)(3).
343. *Id.* § 1228(c).
344. *Id.* § 1228(a).
345. *Id.* § 1228(c).
346. *Id.* § 1228(a), (b).
347. *Id.* § 1228(a).
348. *Id.* § 503 (1982 & Supp. III 1985).
349. *Id.*

he or she should try for a hardship discharge.[350] If the farmer can qualify, at least unsecured creditors' debts will be discharged.

IX. ROLE OF A TRUSTEE

The one disadvantage readily apparent under a Chapter 12 proceeding, as opposed to a Chapter 11 proceeding, is the role of the trustee and the trustee's fee. A trustee is not normally appointed in a Chapter 11 proceeding.[351] Trustees are regularly appointed in Chapter 13 proceedings,[352] and will also be appointed in Chapter 12 proceedings.[353] The Chapter 12 trustee does not manage the farm.[354] He or she has administrative duties.[355] It should be noted, however, that the farmer can be removed from the position of debtor in possession if a court finds that the debtor committed fraud, acted dishonestly, or incompetently or grossly mismanaged the farm's affairs either before

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350. *Id.* § 1228(b) (Supp. IV 1986).

351. Section 1104 sets out the grounds for appointment of a trustee in a Chapter 11 proceeding. *Id.* § 1104 (1982). Grounds include fraud, dishonesty, incompetence or gross mismanagement of the affairs of the debtor by the current management. The court may order the appointment of a trustee upon a finding that such would be in the interest of creditors and equity holders. Section 1107 gives the debtor in possession, absent the appointment of a trustee, most of the rights of a trustee. *Id.* § 1107(a) (Supp. III 1985).

352. *Id.* § 1302 (1982) requires the appointment of a trustee in Chapter 13 cases.

353. *Id.* § 1202(a) (Supp. IV 1986) states:

> (a) If the United States trustee has appointed an individual under section 586(b) of title 28 to serve as standing trustee in cases under this chapter and if such individual qualifies as a trustee under section 322 of this title, then such individual shall serve as trustee in any case filed under this chapter. Otherwise, the United States trustee shall appoint one disinterested person to serve as trustee in the case or the United States trustee may serve as trustee in the case if necessary.

354. 11 U.S.C. § 1202(b) (Supp. IV 1986) gives the trustee administrative duties. It states:

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

Id.

355. *Id.*

or after the commencement of the case.[356]

Since the typical Chapter 12 trustee will not manage the farm, his or her duties are limited to accounting for property received, ensuring the debtor has performed as intended under section 521(2)(B), examining proof of claims and objecting to improper ones, opposing the discharge of the debtor if advisable, appearing at hearings, ensuring that the debtor commences making timely payments under a confirmed plan and making payments to creditors under the plan unless the plan provides otherwise.[357] If the court for cause orders, the trustee is also empowered to investigate the acts, conduct, assets, liabilities, and financial condition of the debtor; the operation of the debtor's business; the desirability of continuing the business; and to make a report on the investigation.[358]

The trustee's fee in a Chapter 12 should be the same as it would be in a Chapter 13 proceeding.[359] The amount of the trustee's fee that is paid out under the plan may depend on the type of trustee involved in the case. The United States trustee is empowered to appoint standing trustees for the judicial region if the number of Chapter 12 cases justifies such appointment.[360] If a standing trustee is appointed for Chapter 12 cases in that region, the statute requires that a portion of that standing trustee's compensation be taken from plan payments.[361] The fee is deducted from each disbursement made under the plan.[362] The maximum that can be taken from plan payments is ten percent of the first $450,000 in payments made under a family farmer plan.[363] After plan payments exceed $450,000, three percent is the maximum percentage that can be taken from payments.[364] The percentages are based on the maximal annual compensation fixed for such trustee and

356. *Id.* § 1204(a). Unlike 11 U.S.C. § 1104 (1982), § 1204(a) does not include as a ground for removal, the best interests of creditors and equity holders.

357. 11 U.S.C. § 1202(b) (Supp. IV 1986) sets out many of these duties. 11 U.S.C. § 1226(c) (Supp. IV 1986) states: "[e]xcept as otherwise provided in the plan or in the order confirming the plan, the trustee shall make payments to creditors under the plan."

358. 11 U.S.C. § 1202(b)(2) (Supp. IV 1986) sets out as part of the trustee's duties in a Chapter 12 an obligation to perform the duties set out in subsections 1106(a)(3), (4) if the court for cause so orders. 11 U.S.C. § 1106(a)(3) (1982) sets out the duty of the trustee to investigate. 11 U.S.C. § 1106(a)(4) (1982) requires the trustee to file a timely report of his or her investigation.

359. This is because compensation for the trustee in both chapters is governed by 11 U.S.C. § 326(b) (Supp. IV 1986).

360. *Id.* § 586(b).

361. *Id.* § 586(e)(1)(B)(ii).

362. *Id.* § 586(e)(2).

363. *Id.* § 586(e)(1)(B)(ii)(I).

364. *Id.* § 586(e)(1)(B)(ii)(II).

the actual, necessary expenses incurred by the individual serving as standing trustee.[365] The Attorney General, not the court, fixes the percentages.[366]

An issue arose in the pilot United States trustee districts, as to whether the trustee's fees in individual Chapter 13 cases could be reduced by the court if the services of the trustee did not justify the fixed percentage award.[367] The litigation arose in Rhode Island. The bankruptcy court ruled that judges retained the power to lower Rhode Island's ten percent fee, when the size of the payments made the fee too large when compared with work performed.[368] At issue was the statutory language in title 28, section 586(e) and section 15326 of the Bankruptcy Code.[369] The bankruptcy court noted that if plan payments were large, the ten percent fee would over compensate the trustee for the actual time spent on the case, whereas in nonpilot

365. *Id.* § 586(e)(1).

366. *Id.*

367. *See, e.g., In re* Savage, 67 Bankr. 700 (Bankr. D.R.I. 1986); *In re* Tartaglia, 61 Bankr. 439 (Bankr. D.R.I. 1986); *In re* Sousa, 46 Bankr. 343 (Bankr. D.R.I. 1985). Note, all of these cases are from the same judicial district in Rhode Island. It had a pilot United States Trustee Program.

A number of earlier court decisions allowed the court to reduce the standing trustee's fee. In *In re* Eaton, 1 Bankr. 433 (Bankr. M.D.N.C. 1979), a business was involved in a Chapter 13 proceeding. The monthly plan payments were $6,000, and the court found that allowing the nine percent standing trustee fee would be unconscionable. *Id.* The court held that it had the power to reduce the fee if the fee generated by the standard percentage was too large. *Id.* at 434. The Fifth Circuit in *In re* Foster, 670 F.2d 478 (5th Cir. 1982), relied on *Eaton* and suggested that the bankruptcy court should reduce the percentage fee if the debtor acts as disbursement agent, since the trustee would perform fewer services. *Id.* at 491-92.

These cases can be distinguished because they did not involve pilot United States Trustee Districts. The statutory language before the *Eaton* and *Foster* courts was in § 1302(e) which authorized the court to appoint standing trustees and to set the standing trustee's fees. 11 U.S.C. § 1302(e) (1982). In pilot districts the statutory fee was fixed under § 586(e) of title 28 in which the Attorney General, not the court, was authorized to set the standing trustee's fee. 28 U.S.C. § 586(e) (1982). This was the statute before the *Savage* court. The Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986 repealed the pilot districts and set up United States Trustees across the country. Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986. Pub. L. No. 99-554, § 231, 100 Stat. 3088, 3103 (1986). The language relied on by the *Eaton* and *Foster* courts in section 1302(e) was also repealed. *Id.* § 228(2). Now, all standing trustees are appointed by the United States Trustees, not the courts. 28 U.S.C. § 586(b) (Supp. IV 1986). Now, § 586 of title 28 fixes the fee for standing trustees in all Chapter 12 and 13 cases. *Id.* § 586(e). It is the Attorney General, in consultation with the United States trustee who appointed the standing trustee, who is empowered to set the percentage fee. *Id.* The courts are no longer involved, so a much better argument can be made that courts now have no power to adjust the fixed percentage fee.

368. *See In re* Tartaglia, 61 Bankr. 439 (Bankr. D.R.I. 1986); *In re* Sousa, 46 Bankr. 343 (Bankr. D.R.I. 1985).

369. 28 U.S.C. § 586(e) (1982); 11 U.S.C. § 15326 (1982).

districts, fees would be based on work done.[370] It also stressed that if courts could not adjust the fees of standing trustees then different fees would be taken depending on the type of trustee involved.[371]

In *In re Savage*[372] the debtor sold real estate and made enough money to make all the payments called for in the plan in one payment. The trustee withheld approximately $6,000 as his statutory percentage fee,[373] but the bankruptcy court reduced the fee.[374] The *Savage* decision was appealed to the district court and reversed.[375] The language involved in *Savage* is the same in relevant aspects to the language controlling the issue for Chapter 12 cases.[376] Central to the issue is the fact that section 326(b) (section 15326 in *Savage*), states that the "court may not allow compensation for services or reimbursement of expenses of the United States trustee or of a standing trustee appointed under section 586(b) of Title 28 . . . ."[377] Section 586(e) gives the Attorney General the power to fix the salary of standing trustees appointed under section 586(b).[378] This fee is to be set at a governmental employees grade GS-16 step 1 level and a percentage fee "based on such maximum annual compensation and the actual, necessary expenses incurred by such individual as standing trustee."[379] The district court in *Savage* held that the standing trustee fee was to be spread over all of the Chapter 13 cases handled by the United States trustee.[380] The court noted that this meant there may be more paid by one debtor and less paid by another.[381] However, the court also noted a standing trustee's difficulty in keeping time records for all the cases in which he or she was involved.[382] If this decision

370. *In re* Sousa, 46 Bankr. 343, 344-45 (Bankr. D.R.I. 1985).

371. *Id.*

372. 67 Bankr. 700, 701 (Bankr. D.R.I. 1986).

373. *Id.*

374. *In re* Savage, 60 Bankr. 10 (Bankr. D.R.I.), *rev'd* 67 Bankr. 700 (D.R.I. 1986).

375. *Id.*

376. The statutory language at issue in *Savage* was in § 15326 of title 11 and § 586(e) of title 28. 11 U.S.C. § 15326 (1982); 28 U.S.C. § 586(e) (1982). The language in § 15326 is now the language in 11 U.S.C. § 326(b) (Supp. IV 1987) with some minor changes, including the reference to the new Chapter 12. Section 15326, as does § 326(b), stated that the court cannot award a trustee fee for a trustee appointed under § 586(b) of title 28. 28 U.S.C. § 586(b) (1982 & Supp. IV 1986). United States trustees appoint trustees under § 586(b) as did the pilot United States trustees. *Id.* The fee for all trustees appointed pursuant to § 586(b) is set out in § 586(e). *Id.* § 586(e).

377. 11 U.S.C. § 326(b) (Supp. IV 1986).

378. 28 U.S.C. § 586(e)(1) (Supp. IV 1986).

379. *Id.*

380. *In re* Savage, 67 Bankr. 700, 707 (Bankr. D.R.I. 1986).

381. *Id.* at 706-07.

382. *Id.* at 707.

stands, the fee will not be adjustable per case, but if a large number of cases with substantial payments are involved in Chapter 12, in any region, then the fee should be lower than the ten percent maximum.

If a standing trustee has not been appointed in the judicial region, under section 586(b), the United States trustee is empowered to appoint a trustee for a particular Chapter 12 case.[383] The compensation for this type of trustee is structured differently.[384] Here, the fees are expenses under section 330(a) of the Code. Section 330(a) expenses are made administrative expenses by section 503(b)(2).[385] Section 1226(b) specifies that administrative expenses are to be paid before or at the time of each payment to creditors under the plan.[386] This fee is based on the actual, necessary services and expenses,[387] but section 326(b) limits the fee to a maximum of five percent of plan payments.[388]

Either fee could be a significant amount, and if this is the case, the farmer may want to keep certain payments outside of the plan. The standing trustee fees are authorized to be taken from all payments received by the trustee.[389] The nonstanding trustee's fee is based on actual services rendered and will be paid as an administrative expense.[390] Under Chapter 13, some courts have recognized ways of avoiding or at least reducing the trustee's fees. If the district court's opinion in the *Savage* case is upheld, the first approach would merely reduce the fee in cases that do not involve a standing trustee. Chapter 13 and 12 trustees are authorized to make the plan payments unless the plan specifies otherwise.[391] In *Foster v. Heitkamp*[392] the United States Court of Appeals for the Fifth Circuit recognized that a Chapter 13 debtor could elect to make certain payments himself or herself instead of the trustee making the payments.[393] The debtor in

383. 11 U.S.C. § 1202(a) (Supp. IV 1986).

384. 11 U.S.C. § 326(b) (Supp. IV 1986) sets the fee for trustees appointed under § 1202(a). *Id.* § 1202(a).

385. The fees for trustees appointed under § 1202(a) and set by § 326(b) are made administrative expenses by inclusion in § 330. *Id.* § 330 (Supp. III 1985). Section 326(b) specially refers to § 330. *Id.* § 326(b) (Supp. IV 1986). Section 330 compensation claims are treated as administrative claims by their inclusion in § 503(b)(2). *Id.* § 1202(a) (Supp. IV 1986); *Id.* § 503(b)(2) (1982 & Supp. III 1985).

386. *Id.* § 1226(b) (Supp. IV 1986).

387. *Id.* § 330(a)(1) (Supp. III 1985).

388. *Id.* § 326(b) (Supp. IV 1986).

389. 28 U.S.C. § 586(e)(2) (Supp. IV 1986).

390. 11 U.S.C. § 330(a)(1) (Supp. III 1985).

391. *Id.* § 1226(c) (Supp. IV 1986); *Id.* § 1326(c) (Supp. III 1985).

392. 670 F.2d 478 (5th Cir. 1982).

393. *Id.* at 486-88.

Foster wished to act as disbursement agent for his mortgage payment.[394] The court held that the trustee's fee would still be taken from these payments but that the fee should be reduced since the trustee's fee was based on the amount of time expended on the case.[395]

If courts have no authority to lower a standing trustee's fee, and it is not based on the amount of work in a particular case, a debtor will not reduce the trustee's fee by acting as disbursement agent. However, a second way of eliminating the percentage fee on particular payments may work against the standing trustee.

The *Foster* court also addressed the issue of when, if ever, the debtor may treat some payments as outside of the plan and outside of the trustee's fee on such payments.[396] The *Foster* court held that a bankruptcy judge could allow payments outside the plan but only if the debtor was not paying off arrearages under the plan.[397] Relying on section 1322(b)(5), the court noted that the statute provided for paying off a default while making regular payments on long term indebtedness.[398] The court concluded that section 1322(b)(5) required that debt payments be made inside of the plan if arrearages were being paid under the plan.[399] Moreover, the court noted that a bankruptcy court could allow a payment outside the plan only if the judge determined that the plan was still feasible.[400] Factors relevant in allowing the debtor to act as disbursement agent are whether the debtor will make the payments and make them on time as well as how the payments will affect the debtor's ability to make plan payments.[401] The *Foster* analysis has been followed by Chapter 12 cases.[402]

Since many farmers will have long term debt, the issue arises whether they will be able to treat some of these payments outside of the plan to avoid the trustee's percentage fee. Even if the plan is not paying arrearages on this debt under section 1222(b)(5), a modification of secured debt under section 1222(b)(2) may preclude treatment of the debt outside of the plan.[403] However, the scaling down of secured debt under section 506(a) to the value of the collateral should

394. *Id.*
395. *Id.* at 491.
396. *Id.* at 488-90.
397. *Id.* at 490.
398. *Id.* at 489.
399. *Id.*
400. *Id.* at 489-90.
401. *Id.* at 486-87.
402. *See, e.g., In re* Hildebrandt, 79 Bankr. 427 (Bankr. D. Minn. 1987); *In re* Lenz, 74 Bankr. 413 (Bankr. C.D. Ill. 1987).
403. 11 U.S.C. § 1222(b)(2), (5) (Supp. IV 1986).

not be a modification under section 1222(b)(2).[404] Section 1222(b) talks in terms of modifying a secured claim,[405] and section 506(a) states that an allowed claim is a secured claim to the extent of the creditor's interest in the property.[406] Thus, scaling down secured debt should not be a modification under section 1222(b).

There are two cases involving changes in the interest rate, the length of the loan, and the payment schedule that hold that despite these modifications the debts can be paid outside of the plan to avoid the payment of a trustee's fee on these amounts.[407] *In re Land* is the better reasoned case. The *Land* court focuses on language in section 586(e)(2).[408] This language allows the trustee to collect the fee "from all payments received by [the trustee] under plans."[409] The court concluded that once payments were made directly to the creditor they were no longer received by the trustee and therefore no fee could be exacted from them.[410] Whether other courts accept this line of reasoning remains to be seen.

Needless to say, a number of issues in this area need to be resolved. But, if a farmer does not need to use the plan to cure a default on long term indebtedness, or a court follows the *Land* court, the farmer should consider trying to treat such payments outside of the plan if the trustee's percentage fee can be reduced. Since these claims are long term debts, and long term debts are excepted from the Chapter 12 discharge,[411] paying the claim outside of bankruptcy should not affect the discharge under the plan.[412]

X. CONFIRMATION OF A PLAN

Section 1225 governs the confirmation of a Chapter 12 plan,[413] and it states that a plan shall be approved by a court if six requirements have been met.[414] A number of these have already been men-

404. *Id.* § 506(a) (1982).

405. *Id.* § 1222(b)(2) (Supp. IV 1986) states "the plan may . . . modify the rights of holders of secured claims . . . ."

406. *Id.* § 506(a) (1982).

407. *In re* Land, 82 Bankr. 572 (Bankr. D. Colo. 1988); *In re* Erickson Partnership, 77 Bankr. 738 (Bankr. D.S.D. 1987).

408. *Land*, 82 Bankr. at 579-80.

409. 28 U.S.C. § 586(e)(2) (Supp. IV 1986).

410. *Land*, 82 Bankr. at 579-80.

411. Even if plan payments are completed, long term debt is not discharged. 11 U.S.C. § 1228(a)(1) (Supp. IV 1986).

412. *Id.*

413. *Id.* § 1225.

414. *Id.* § 1225(a).

tioned. The plan must provide for payment of a value as of the effective date of the plan that at least equals what unsecured creditors would have received in a hypothetical Chapter 7 liquidation held on the same date.[415] The amount paid here will depend on the value of the farmer's unencumbered, nonexempt assets. Secured creditors can be treated one of three ways.[416] The debtor might surrender the collateral to the secured party.[417] If the farmer wishes to keep the property then he must do one of two things. The farmer can get the secured party to agree to a particular treatment.[418] If the secured party does not give consent, however, the plan must provide for the retention of the secured party's lien[419] and must pay the secured party an amount at least equal to the allowed amount of its claim as of the effective date of the plan.[420] Recall that 506(a) defines an allowed secured claim, and it is limited to the value of the collateral.[421] Therefore, the plan must propose to pay unsecured creditors what a Chapter 7 liquidation would have paid them plus interest and must pay secured creditors the value of their collateral plus interest.

In addition, section 1225 requires the plan to have been made in good faith and in compliance with other code sections.[422] These requirements should cause no problems for farmers. All court fees must also be paid before confirmation.[423] This too should not be hard to do. The last of the requirements may cause the greatest difficulty. The court must find that the debtor will be able to make the payments under the plan and comply with the plan.[424] If after scaling down the debt the plan is still not feasible, the farmer should consider a Chapter 7 conversion.

If a creditor objects, the plan must show that all disposable income is being paid under the plan.[425] As discussed, disposable income is income received, minus sums reasonably necessary to support the debtor or any dependents.[426] It does not include sums reasonably necessary for the payment of expenditures necessary for the continua-

415. *Id.* § 1225(a)(4).
416. *Id.* § 1225(a)(5).
417. *Id.* § 1225(a)(5)(C).
418. *Id.* § 1225(a)(5)(A).
419. *Id.* § 1225(a)(5)(B)(i).
420. *Id.* § 1225(a)(5)(B)(ii).
421. *Id.* § 506(a) (1982).
422. *Id.* § 1225(a)(1), (3) (Supp. IV 1986).
423. *Id.* § 1225(a)(2).
424. *Id.* § 1225(a)(6).
425. *Id.* § 1225(b)(1)(B).
426. *Id.* § 1225(b)(2)(A).

tion, preservation, and operation of the debtor's business.[427] Thus, for a three to five year period the financial flow of the farm enterprise will be controlled by the plan.[428] Once the plan meets these requirements the court must confirm it, and a confirmed plan binds the debtor and the creditors whether they agreed to the plan or not.[429]

XI. CONCLUSION

As can be seen, Chapter 12, with no right to vote for creditors has many advantages over Chapter 11 for a farm debtor. With no absolute priority rule and no lost opportunity costs, confirmation of a plan should be easier in Chapter 12 than it was in Chapter 11. The biggest question is post filing credit. Even if a farmer does not need operating capital before confirmation, credit will be needed after confirmation. At this point, the credit community is unsettled. Upon reflection, they may find that Chapter 12 is no worse than a liquidation and may be better. If postpetition credit is available, Chapter 12 should help farmers stay in business. How many will be helped remains to be seen.

427. *Id.* § 1225(b)(2)(B).

428. 11 U.S.C. § 1225(a) (Supp. IV 1986) states: "[e]xcept as provided in subsection (b), the court shall confirm a plan if . . . ."

429. *Id.* § 1227(a).