Troubled Times: The Farm Debtor Under the Amended Bankruptcy Code

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TROUBLED TIMES: THE FARM DEBTOR UNDER THE AMENDED BANKRUPTCY CODE

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TROUBLED TIMES: THE FARM DEBTOR UNDER THE AMENDED BANKRUPTCY CODE

MARGARET ROSSO GROSSMAN*

Introduction

For many years, debt has been an important element in the farm economy. Recently, however, the indebtedness of American agriculture has assumed drastic proportions.¹ Farmers have suffered from the effects of falling land values, high real interest rates, and diminished international trade in agricultural commodities. Farm firms have weakened financially from adverse weather conditions, low commodity prices, and casualty losses. These conditions have combined to create the most serious financial problems faced by American agriculture in a half century.² As some measure of the severity of the crisis, the deflation in farmland prices in early 1985 alone has ranged from 20 to 40 percent in midwestern farm states where the problem is concentrated.³

Prospects for the near future are bleak. The United States Department of Agriculture estimated net farm income for 1984 at $29 to $33 billion and the debt that year at $215 billion. The picture for 1985 is worse—an estimated $24 billion income compared to a debt of $213 billion.⁴ The farm credit problem is not universal: two-thirds of the nation’s farmers have manageable debt loads or are debt free.⁵ Other farmers, however, face substantial debt. In 1984, for example, 17.7 percent of all farms (21.8 percent of cash grain farms) had debt equal to 40 percent or more of assets. And 6.6 percent of farms (7.6

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Editor's Note: Congress made substantial revisions to the Bankruptcy Code in 1984. Because of these changes, citation to the U.S.C. will be both to the 1982 version and to the Supp. II 1984. This is because the 1984 revisions must be read in conjunction with the 1978 Act, which appears in the 1982 U.S.C.

1. During the week of February 18, 1985, the volatile issue of farm debt exploded in Congress when farm-state legislators blocked Senate business in an effort to force the Reagan administration to aid financially troubled farms. Wehr, Farm Credit Filibuster Deadlocks Senate, 43 CONG. Q. WEEKLY REP. 335 (1985).
3. Wehr, supra note 1, at 337.
4. Id. at 335.
5. Id. at 337.
percent of cash grain farms) had debt-equity ratios of more than 70 percent. In the corn-belt region the number of farmers heavily in debt is particularly high. For many of these debt-ridden and imperiled farmers, liquidation or some type of reorganization may be almost inevitable. This financial crisis has not affected only the inexperienced or small-scale farm operator. Indeed, statistics indicate that the average farmer who has given up his land is 47.6 years old, and has farmed about 402 acres for almost eighteen years. For many of these established farmers, bankruptcy looms on the horizon.

Of course, every farmer who experiences financial difficulty will not enter bankruptcy. Many will opt for private settlements or work-outs. Normally, their creditors prefer to avoid the trustee fees, the legal fees, and the generally higher collection costs and delays associated with bankruptcy, if they can reach a fair out-of-court settlement. Struggling farmers themselves hope to avoid the social stigma attached to bankruptcy, if they have any other realistic chance of solving their financial problems.

Many farmers, however, have done little about their increasing debt, letting their creditors pursue state and common law remedies on a first-in-time, first-in-right basis. Often, farmers who do nothing are waiting "just one more year" to see if they can become profitable. Others simply cannot face the prospect of selling or losing the land that has been in the family for generations. But this passive approach only leaves the farmer deeper in debt. Moreover, it may leave the debtor personally liable for deficiency judgments, crippling any prospect for a fresh start in farming or in another occupation. In this situation, bankruptcy is often a preferable solution. A Chapter 7

6. Econ. Res. Serv., U.S. Dep't of Agric., Agricultural Finance, Outlook and Situation Report 7-8 (AFO-25 Dec. 1984). A commercial farmer with a debt-equity ratio of 40 percent or higher is quite likely to be facing financial stress. Those with a ratio of 70 percent will probably be forced to reorganize or liquidate.


10. "There is certainly a social stigma applied to bankruptcy. [Bankrupt farmers are] still going to have to go into the coffee shop and their friends may be looking at them and treating them somewhat differently than before." Moratzka, An Attorney Discusses Farm Bankruptcies, Farm Money Mgmt. 14, 111 (3d Q. 1982).

On the other hand, debtors gaining bankruptcy discharges are protected from discriminatory treatment by governmental units or private employers based solely on the fact of their bankruptcy. See 11 U.S.C. § 525 (1982 & Supp. II 1984). Section 525 contains exceptions to the general rule against state discrimination on the basis of bankrupt status, but these are primarily for the benefit of farmers and ranchers. The Perishable Agricultural Commodities Act of 1930, 7 U.S.C. §§ 499a-499k (1982), and the Packers and Stockyards Act of 1921, 7 U.S.C. §§ 181-229 (1982), were enacted in part to ensure that farmers and ranchers receive true market value for their produce and livestock. Bankrupt stockyard dealers and perishable commodities brokers cannot object to the consideration of their past bankruptcies if their licenses or registrations are denied, revoked, or suspended on such grounds.

11. Creditors receive fair treatment in part through the trustee's avoiding powers to be discussed infra text accompanying notes 194-316. The debtor is assured the fresh start, not so much because
liquidation can ensure creditors fair treatment and normally will guarantee the debtor a fresh start, free from most debts.\textsuperscript{11}

Other farmers may have a sound farming operation that is faced with short-term financial crisis. These farmers may not want to liquidate, but must still deal with creditors. Short of bankruptcy, creditors may be willing to grant extensions of time, especially if the farmer's future income has potential for improvement. Creditors, if promised fair treatment, may even scale down the debt to avoid court costs. But all of a farmer's creditors must assent to this type of treatment to ensure its success.\textsuperscript{12} Unfortunately, no mechanism outside of bankruptcy exists to force an objecting creditor to approve an extension or scale-down of debt. Thus, one dissenting creditor could proceed to seize assets of the debtor that were essential to his successful operation, frustrating creditors who had compromised their claims and ruining the farmer's chance for rehabilitation. This difficulty is avoided in bankruptcy. Chapter 11, or Chapter 13 for eligible farmers, can require creditor cooperation and thereby facilitate a successful reorganization, to the benefit of both creditors and debtor.

Thus, many of the thousands of farmers in financial crisis will enter—or have already entered—bankruptcy. Recent years have seen a significant increase in reported farm bankruptcy decisions, and many other cases are pending. In the context of an overview of farm bankruptcy, this article presents an analysis of many of the nontax issues central to farm bankruptcy. It focuses first on issues connected with filing a bankruptcy petition: eligibility, protection for the farmer, discharge, and the automatic stay. It then turns to property of the estate, the debtor's exemptions, and the avoiding powers used to enhance the estate. The article also analyzes pertinent provisions involved in liquidation and reorganization, focusing in particular on recent decisions involving agricultural bankruptcies.

I. Filing for Bankruptcy

Eligibility

The farmer who is considering bankruptcy as a solution to financial difficulties will have two, or perhaps three, forms of bankruptcy from which to choose. Chapter 7 involves liquidation of the farm business, whereas Chapter 11 provides a means for reorganizing the farming operation, with a view toward continued activity. In some instances, the farmer may also qualify for Chapter 13, which regulates the adjustment of debts of an individual with regular income.

Farmers operating as individuals, partnerships, or corporations are eligible 

\textsuperscript{11} The reorganization plan outside of bankruptcy is known as a composition. A composition is a contract between a debtor and at least two creditors in which the creditors agree to take less than full payment or to extend time of payment in satisfaction of their claims. Two creditors are needed to make the composition valid because the mutual benefit the creditors receive as a result of the composition is consideration for the contract. See D. Epstein, Debtor-Creditor Law 127-28 (2d ed. 1981).
for either Chapter 7 liquidation or Chapter 11 reorganization. Thus, Chapter 13, however, is available only to an individual, or to an individual and that individual's spouse. Thus, farm partnerships and corporations cannot use Chapter 13 as a means of reorganization. Moreover, Chapter 13 imposes other eligibility requirements that may exclude farmers from qualification.

Under Chapter 13, relief is available only to "an individual with regular income." Thus, it is available to an individual (or an individual and spouse) whose income is sufficiently stable and regular to make payments according to a plan required under Chapter 13. Some commentators had speculated that farmers might be ineligible for Chapter 13 because the income of a farmer who sold a single crop harvested annually might not be considered sufficiently stable and regular. Congress, however, indicated that the term "individual with regular income" was intended to be interpreted expansively. Likewise, bankruptcy courts have not suggested that farmers are ineligible for Chapter 13 on the basis of irregular income. Indeed, at least one court has acknowledged that a farmer with an annual income from farming business qualified, although his future annual income could not be predicted accurately.

A more serious problem with the farmer's eligibility for Chapter 13 under present law is that Chapter's maximum debt limitation. To be eligible for Chapter 13, an individual, or the individual and spouse, must have noncontingent, liquidated unsecured debts of less than $100,000 and noncontingent, liquidated secured debts of less than $350,000. The relatively high debt levels that often characterize modern farming operations, in particular those operations in financial difficulty, may prevent many farmers from qualifying for Chapter 13.

Protection for the Farmer

The Bankruptcy Code provides mechanisms for both voluntary and involuntary bankruptcy. Although a Chapter 13 proceeding is always initiated by the debtor and is thus voluntary, both Chapter 7 and Chapter 11 filings usually can be involuntary proceedings initiated by creditors. The farmer, however, receives special protection. The Code provides that a farmer cannot be forced

15. Id. In In re Cole, 3 Bankr. 346 (Bankr. S.D. W. Va. 1980), the court held that a debtor without steady income from a single job is eligible for Chapter 13 relief if he works at odd jobs, shows that he has received some income from these jobs, and shows that his motivation and opportunities are adequate.
19. 11 U.S.C. § 109(e) (1982). Thus, a person with a large but unliquidated tort claim pending should file before the claim goes to court to keep his unliquidated unsecured claims below the $100,000 limit of Chapter 13.
20. See supra text accompanying notes 1-12.
into bankruptcy through an involuntary proceeding brought by creditors.22

The Code defines "farmer" as a person who received more than 80 percent of gross income during the taxable year immediately prior to the taxable year of the bankruptcy proceeding from a farming operation owned or operated by that person.23 "Farming operation" includes "farming, tillage of the soil, dairy farming, ranching, production or raising of crops, poultry, or livestock, and production of poultry or livestock products in an unmanufactured state."24

Although the issue of whether the debtor is a farmer for purposes of protection from involuntary bankruptcy has not been litigated frequently under the Code, several courts have considered the question. At one extreme, debtors who received approximately $1,500 monthly income from law practice and only $40 monthly from the farm did not qualify as farmers under the Code.25 At the other extreme, a large farming corporation may qualify as a farmer. For example, a corporation that earned income from processing, packaging, and marketing of eggs and that owned all the laying hens located on thirty or forty farms qualified as a farmer.26

The debtor's status as farmer is a question of fact. If creditors initiate an involuntary bankruptcy case against a farmer, the farmer must appear and plead that he qualifies as a farmer under the Code.27 If he fails to appear, he has consented to the involuntary proceeding. If the issue is controverted, the creditors bringing the case bear the burden of proving the debtor does not qualify as a farmer.28 If the debtor is a farmer under the statutory definition, the involuntary case will be dismissed. A recent decision suggests that courts may interpret the statutory definition somewhat literally. *Potmesil v. Alexandria Production Credit Association* involved debtors in an involuntary Chapter 7 case who had received 84.9 percent of their 1982 gross taxable in-

22. *Id.* § 303(a). Charitable corporations also enjoy this protection. This protection also prevents involuntary conversion of a case from Chapter 11 or Chapter 13 to Chapter 7. *Id.* §§ 1112(c), 1307(e). See *In re Cattle Complex Corp.*, 54 Bankr. 50 (Bankr. D.N.M. 1985). Debtor feedlot, which was paid to feed and water cattle but grew little of the feed, was held to be a farmer engaged in a "farming operation" and thus protected from involuntary conversion to Chapter 7. The court relied on legislative history suggesting a broad interpretation of the farmer protection, and on a Tenth Circuit decision finding a feedlot to be a farmer under U.S. Treasury regulations. High Plains Enters., Inc. v. Commissioner, 496 F.2d 520 (10th Cir. 1974).

23. 11 U.S.C. § 101(17). The definition of "farmer" applies to determine whether the debtor is protected from involuntary bankruptcy. But it may not apply in other determinations in the course of the bankruptcy proceeding. For example, the definition did not apply to determine whether the debtor could avoid liens on farm equipment under section 522 of the Code. *In re Decker*, 34 Bankr. 640, 641-42 (Bankr. N.D. Ind. 1983). See infra text accompanying notes 164-186. Nor did it prevent a debtor from claiming the exemption for implements and other tools of the farming trade, in a case in which the debtor earned over half his income through employment at a hospital, but nonetheless was a bona fide farmer. *In re Yoder*, 32 Bankr. 777, 780 (Bankr. W.D. Pa. 1983). See also *In re Pommere*, 10 Bankr. 935 (Bankr. D. Minn. 1981).

24. 11 U.S.C. § 101(18) (1982). The definition of "person" includes individuals, partnerships, and corporations. *Id.* § 101(33) (Supp. II 1984). Thus, the definition of farmer in section 101(18) includes farming corporations and agribusinesses as well as individuals.


come from farming. They sold much of their farming operation in December 1982, and in September 1983 the PCA filed an involuntary Chapter 7. As an affirmative defense, the Potmesiels asserted their status as farmers. Despite the fact that the debtors had sold their farm, the court looked to the Code definition of farmer, which refers to the source of income for the preceding year, without any reference to the debtor's status at the time of the petition. The debtors fit within the definition, and the court dismissed the involuntary case against them.

This exception recognizes the cyclical nature of farming. It protects farmers from bankruptcy precipitated by the misfortunes of poor weather conditions and low prices. This protection, however, is not as extensive as it might appear. First, off-farm income, a significant component of many farmers' total income, may prevent farmers from meeting the 80 percent test. Second, the realities of a farm financial crisis may force the farmer to file voluntarily. The pressures of personal property repossessions, foreclosures on mortgages, and actions seeking judgments on debts will eventually force the farmer to come to terms with his creditors. At that point, the farmer may have no practical alternative other than bankruptcy. Some farmers determined to avoid voluntary bankruptcy may be able to negotiate alternative arrangements, such as an assignment for the benefit of creditors or a liquidating trust. In many situations, however, voluntary bankruptcy will provide the best means for the farmer to resolve intransigent financial problems. Bankruptcy may present the only realistic chance for an elimination of burdensome debt or a successful reorganization to continue the farming operation.

30. In February 1983, the PCA had challenged the land sale to the debtors' daughter as a sham. Id. at 732.
31. Id. at 733.
33. Because nonfarm income for the average farmer may exceed income from the farming operation, many farmers will not earn 80 percent of their income from the farming operation. Looney, supra note 16, at 514. See also Marsh, Farmers' Exemption From Involuntary Bankruptcy, 15 U.C.C. L.J. 162 (1982). Marsh concluded that because of the growing importance of non-farm income in the farm sector, the definition of farmer in the Code does not protect a significant number of average-size and smaller farmers from involuntary bankruptcy. It does, however, probably protect the large farm operations that provide the greater part of the nation's agricultural production.
34. An assignment for the benefit of creditors is a voluntary transfer of assets by a debtor to another person in trust. The duty of the assignee as trustee is to liquidate the assets and distribute the proceeds to the debtor's creditors. The common law assignment for the benefit of creditors does not discharge the creditor for any deficiency that is not covered by the assets transferred. For this reason, it is generally recommended for corporate debtors, to whom the discharge in Chapter 7 is not available. See Epstein, supra note 12, at 119-21.
Insolvency

The farmer who enters bankruptcy voluntarily need not be insolvent. Insolvency, as defined in section 101(29) of the Code, is not a requirement for filing under Chapters 7, 11, or 13. Nonetheless, a person in bankruptcy, though not necessarily insolvent, must owe debts. To prevent abuse in this area, the court has discretion to dismiss cases of solvent debtors. Section 305 allows the court to dismiss or suspend any case if the interests of the creditors and the debtor would be better served by suspension or dismissal. This decision is within the discretion of the bankruptcy court and is not subject to appeal. A farmer who is solvent is unlikely to enter bankruptcy to obtain a discharge. But the farmer with cash flow problems may use bankruptcy as a means of gaining time and relief from the pressure of creditors.

Initiating the Bankruptcy

The farmer who has decided to file bankruptcy voluntarily and has decided under which Chapter to file initiates the bankruptcy case by filing a petition under the appropriate Chapter with the bankruptcy court. Initiation of the case constitutes an order for relief. The order for relief triggers the requirement that the clerk of the bankruptcy court give notice to creditors and others pursuant to bankruptcy rules. The debtor must file, with the petition or shortly thereafter, a list of creditors, schedules of assets and liabilities, and statements of financial affairs and executory contracts. To be dischargeable, a debt must be scheduled. Moreover, intentionally omitting a debt from the schedule of liabilities may result in complete denial of discharge.


The Code defines insolvency in terms of the traditional balance sheet test. For entities other than partnerships, insolvent means a financial condition such that the sum of the entity's debts exceeds the entity's property, at fair valuation. The entity's property excludes property exempt under section 522 and property transferred, concealed, or removed to hinder, delay, or defraud creditors. 11 U.S.C. § 101(29) (Supp. II 1984).

36. In re Coastal Cable T.V., Inc., 709 F.2d 762, 764 (1st Cir. 1983).

37. 11 U.S.C. § 305 (1982). Other relevant dismissal provisions are at id. §§ 707, 1112(b), 1307.

38. Id. § 305(c).


43. Id. § 727(a)(4). A debtor who expects to pay a debt in full may not want to schedule that debt. The proper approach would be to include the debt on the schedule and then reaffirm it. On reaffirmation, see 11 U.S.C. § 524(c)(d) (1982 & Supp. II 1984). Only the debtor may seek court approval of a reaffirmation agreement. People's Bank of Pound v. Newsome (In
Discharge

The availability of discharge protection against continued personal liability on debts incurred prior to bankruptcy filing is not a prerequisite to filing a bankruptcy petition. Indeed, the Code restricts both the kinds of debtors eligible for discharge and the kinds of debts that can be discharged. The provisions affecting discharge vary somewhat, depending on whether the bankruptcy proceeding is a liquidation, a reorganization, or an adjustment of debts.

Under Chapter 7, a discharge is available only to an individual. Corporations and partnerships that liquidate cannot receive a discharge.44 In addition, even the individual debtor faces obstacles to discharge through both objections and exceptions to discharge.45 For example, under section 727, certain conduct of the debtor may provide creditors with an objection to discharge.46 If an objection is proved successfully, discharge will be denied, and all creditors will be able to attempt collection of their debts. These objections focus, for the most part, on fraudulent or negligent behavior with respect to property of the debtor or of the estate. For example, discharge can be denied to a farmer-debtor who has intentionally concealed his property (within one year before the bankruptcy) or property of the estate.47 A farmer who has unjustifiably failed to keep accurate financial records of his farm operation can likewise be denied discharge.48 Moreover, a debtor who has been granted a discharge in a Chapter 7 or Chapter 11 case commenced within six years before the date of the filing of the new petition cannot receive a discharge.49 At the outset of the case, therefore, the farmer and his attorney must ascertain whether a discharge will be available to avoid the embarrassment of making the discovery at a later stage in the proceedings.50

Even if no objection to discharge is successful, certain debts are excepted from discharge. When a debt is excepted from discharge, the creditor to whom that debt is owed (but not all other creditors) will be able to attempt collection. Section 523 of the Code lists the debts that cannot be discharged.51 These include certain taxes and other government debts, debts incurred through false pretenses, unscheduled debts, maintenance or child support, certain educational loans, and liability incurred through the debtor's operation of a motor vehicle while legally intoxicated. Also nondischargeable are debts for the debtor's willful and malicious injury to another entity or its property. But

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46. Id. §§ 727(a)(2)-(7); 727(c).
47. Id. § 727(a)(2) (1982).
48. Id. § 727(a)(3).
49. Id. § 727(a)(9).
the mere failure to pay over money received from the sale of secured property (for example, farm products subject to a security interest), does not always constitute willful and malicious conversion under this provision. Moreover, several recent cases have suggested that the sale of property subject to a security interest and use of the proceeds for subsistence is not willful and malicious conversion that will bar discharge.

If a thorough examination indicates that an individual farmer will be ineligible for discharge under section 727, then that farmer should consider Chapter 11. The farmer who has numerous debts—or even one large debt—that cannot be discharged under section 523 should probably consider Chapter 13, if he is eligible.

Under Chapter 11, the rules for discharge are somewhat different than under Chapter 7. Section 1141 provides that confirmation of a plan of reorganization discharges the debtor from debts arising before the date of the confirmation, with some limitations. Under Chapter 11, this discharge is available to partnerships and corporations, as well as individual debtors. For individual debtors, however, the exceptions under section 523 continue to apply. Moreover, discharge can be denied, even under Chapter 11, if the plan provides for the liquidation of all (or substantially all) of the property of the estate, the debtor does not engage in business after the liquidating plan is consummated, and one of the section 727 objections would apply if the case were a Chapter 7 bankruptcy. Thus, the objections to discharge may remain relevant to some farmers using Chapter 11 reorganization.

The farmer who uses Chapter 13 will receive a discharge after completion of all payments under the plan. This discharge, called the section 1328(a) discharge, will not be subject to most of the exceptions listed in section 523. But a Chapter 13 debtor cannot be discharged from debts arising from claims for maintenance or child support. In addition, certain debts on which payments are due after the completion of the plan are not discharged.

A Chapter 13 debtor can also receive a "hardship" discharge under section


55. See infra text accompanying notes 585-589.


57. Id. § 1141(d)(2).

58. Id. § 1141(d)(3)(A)-(C). In addition, discharge can be withheld if provided in the plan or in the order confirming the plan. Id. § 1141(d)(1).

59. Id. § 1328(a).


61. Id. §§ 1328(a)(1); 1322(b)(5) (1982).
1328(b). This discharge is available when the debtor has not completed payments under the plan if his failure to complete payments is due to circumstances beyond his control, unsecured claimants have received at least the amount they would have received under a Chapter 7 liquidation, and modification of the plan is not practicable.\textsuperscript{62} A debtor who receives a hardship discharge will not be discharged from those debts excepted from discharge under section 523,\textsuperscript{63} or those on which payments are due after completion of the plan.\textsuperscript{64}

Under all three Chapters, a debtor can waive discharge. Waiver, which must be approved by the court, is accomplished by a writing executed by the debtor after the order for relief.\textsuperscript{65} The requirement prevents creditors from imposing waiver of discharge as a condition for extending credit to the farmer. Moreover, a discharge may be revoked, normally for debtor fraud or failure to cooperate.\textsuperscript{66}

\textit{Automatic Stay}

The filing of any bankruptcy proceeding stays the commencement or continuation of all judicial and nonjudicial actions against the debtor or the debtor's property.\textsuperscript{67} The automatic stay prevents the debtor's property from being seized by the debtor's most aggressive creditors and helps ensure an orderly and equitable distribution of the debtor's assets to all creditors. Actions by creditors affected by the stay included judicial, administrative, or other proceedings against the debtor; the enforcement of prebankruptcy judgments; acts to obtain possession or control of property; acts to create, perfect, or enforce liens against the estate and liens securing prepetition claims against the debtor's property; acts to collect, assess, or recover prepetition claims; certain setoffs; and proceedings before the U.S. Tax Court.\textsuperscript{68} Although the list of actions stayed seems extensive, the automatic stay does not apply to every action against the debtor. Among the exceptions are criminal actions or proceedings against the debtor,\textsuperscript{69} and the collection of alimony, maintenance, or support from property not part of the estate.\textsuperscript{70} Several other exceptions, some focusing on the actions of governmental entities, are also included.\textsuperscript{71}

Normally, the automatic stay against property of the estate continues until

\textsuperscript{62} Id. §§ 1328(b)(1)-(3).
\textsuperscript{63} Id. § 1328(c)(2).
\textsuperscript{64} Id. §§ 1328(c)(1); 1322(b)(5).
\textsuperscript{65} Id. §§ 727(a)(10); 1141(d)(4); 1328(a).
\textsuperscript{66} Id. §§ 727(d), (e); 1328(e) (1982 & Supp. II 1984). A creditor or trustee must object to a discharge obtained through fraud within one year.
\textsuperscript{67} Id. § 362(a) (1982 & Supp. II 1984).
\textsuperscript{68} Id.
\textsuperscript{69} Id. § 362(b)(1).
\textsuperscript{70} Id. § 362(b)(2).
\textsuperscript{71} Id. § 362(b)(1)-(11). Actions excepted from the stay include the commencement or continuation of an action by a governmental unit to enforce police or regulatory power; the enforcement of a government judgment, other than a money judgment, obtained in a police or regulatory proceeding; setoffs of claims that are commodity futures contracts, options, or warrants; perfection of a purchase money security interest or a mechanic's lien; and the issuance of notices of tax deficiencies.
the property is no longer part of the estate.\textsuperscript{72} The stay against other actions continues until the case is dismissed, closed, or a discharge is granted or denied.\textsuperscript{73} But in appropriate circumstances, a party in interest—normally a creditor—may request relief from the automatic stay. The relief available includes terminating, annulling, modifying, or conditioning the stay.\textsuperscript{74} In litigation over a motion to lift an automatic stay, the creditor must establish that he has a valid and perfected security interest in the debtor's property.\textsuperscript{75} Under section 362(d)(1), the court must grant relief from the stay "for cause."\textsuperscript{76} Although the Code does not define "cause," the Code states that "cause" does include lack of adequate protection.\textsuperscript{77} Under section 362(d)(2), the court must also grant relief from a stay against property if the debtor has no equity in the property and if the property is not necessary to an effective reorganization.\textsuperscript{78} For example, in a Chapter 7 case, if a secured creditor had a lien on farm property in which the debtor had no equity, the court would terminate the stay to allow the creditor to proceed against the property.\textsuperscript{79} In a Chapter 11 case, the court would be less likely to terminate the stay for the same creditor.

The Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, added two exceptions from the automatic stay. 11 U.S.C. 362(b)(10), (11) [erroneously designated as (9), (10)]. The more important, for agricultural purposes, states that the stay does not apply to an act by a lessor of nonresidential real property to obtain possession of that property, when the lease has terminated by the expiration of its stated term before or during a bankruptcy case. This provision may prove helpful to lessors of farmland, who will enjoy more certainty about the status of the lease if the debtor declares bankruptcy. See infra note 477. The other new exception applies to presentment of a negotiable instrument and giving notice of and protesting dishonor of the instrument.

73. ld. § 362(c)(2).
74. ld. § 362(d). The bankruptcy court has exclusive authority to grant relief from the automatic stay. Cathey v. Johns-Manville Sales Corp., 711 F.2d 60 (6th Cir. 1983).
75. In re Irving A. Horns Farms, Inc., 42 Bankr. 832, 836 (Bankr. D. Iowa 1984) (unsecured creditor on equipment and livestock not entitled to have stay lifted or to receive adequate protection.)
77. Id. § 362(d)(1). On the meaning of adequate protection, see infra notes 94-105, 410-438, 467-470.
78. Id. § 362(d)(2). A creditor, however, may obtain relief from the automatic stay under section 362(d)(1) (the "for cause" provision) even if the debtor had equity in the collateral. Bamerical Mort. & Fin. Co. v. Paradise Boat Leasing Corp. (In re Paradise Boat Leasing Corp.), 5 Bankr. 822 (D.V.I. 1980).
79. If a bankruptcy court has agreed to lift the automatic stay and the debtor plans to appeal that decision, the debtor should seek a stay pending the appeal. In Sewanee Land, Coal & Cattle, Inc. v. Lamb, 735 F.2d 1294 (11th Cir. 1984), the debtor's primary asset was 2,700 acres of land. Creditors with mortgages on the land requested that the automatic stay be lifted pursuant to section 362(d). The bankruptcy court agreed, but stayed its order pending appeal to the district court. The district court affirmed, but refused to grant a stay pending appeal. The appellate court also refused to grant a stay. The property was sold to the creditors at a foreclosure sale. Arguing that the bankruptcy court's lifting of the automatic stay was in error, the debtor asked that the sale be rescinded and the property returned. The Eleventh Circuit, however, dismissed the appeal. The failure to obtain a stay and the subsequent sale of the property made the case moot. The court was powerless to grant relief. See generally Greylock Glen Corp. v. Community Sav. Bank, 656 F.2d 1 (1st Cir. 1981); Miller v. Shaw (In re Shaw), 16 Bankr. 875 (9th Cir. 1982).
if the property were necessary for an effective reorganization of the farm business and if the creditor were assured of adequate protection. But even if the property is vital for the reorganization, the stay will be lifted when the debtor has no equity and offers no protection to the creditor. In re Tinsley & Groom involved claims of $638,458 against property worth at most $600,000, but more likely $515,000. The debtor made no attempt to offer adequate protection, and the court lifted the stay.

Several recent decisions have considered the meaning of the standard that the property should be "necessary for an effective reorganization." This requirement could be interpreted to refer either to the total impossibility of reorganization, or to the debtor's bald assertion that the property is needed to enhance the interest of the estate. Normally, however, the standard of proof is "a reasonable probability of a successful rehabilitation within a reasonable time and that the property sought to be foreclosed be critical to that effort." The standard should not require proof that a plan of rehabilitation can be achieved. Indeed, an effective reorganization could result in a liquidation. Nonetheless, though the debtor need not prove that rehabilitation is a certainty, the debtor must show a reasonable probability that he will propose a successful plan of reorganization in a reasonable time. The property involved is necessary for the reorganization if "it is necessary either in the operation of the business or in a plan, to further the interests of the estate through rehabilitation or liquidation."

Courts have disagreed over whether the section 362(d)(2) provision for re-

80. See, e.g., Prudential Ins. Co. v. Holt County Grain Storage, Inc. (In re Holt County Grain Storage, Inc.), 25 Bankr. 271 (Bankr. D. Neb. 1982), where the plaintiff, which had the first mortgage on the farm debtor's land, sought relief from the automatic stay under section 362(d) to proceed with a foreclosure sale. The court found that the debtor had no equity in the land because the land was valued at between $1.7 million and $1.8 million and was subject to liens of more than $1.9 million. Nonetheless, the court found that the land was necessary for an effective organization and that the plaintiff had adequate protection of its interest in the land. The plaintiff's mortgage was for approximately $1,664,000. With approximately $83,000 in cash held in escrow plus the potential accrual of up to $55,000 in proceeds from the sale of the 1982 crop, money was available to pay the $10,000 of unpaid real estate taxes. The court rejected the creditor's argument that the debtor would be unable to reorganize and thus refused to grant relief from the automatic stay.

Some courts have held the property must be necessary for an effective reorganization and there must also be a reasonable possibility of an effective reorganization within a reasonable time. See, e.g., Guaranty-First Trust Co. v. Accent Assocs., Inc. (In re Accent Assocs., Inc.), 8 Bankr. 933 (Bankr. D. Mass. 1981).

84. In re Hutton, 45 Bankr. 558, 561-62 (Bankr. D.N.D. 1984). In Hutton, the court lifted the stay because the debtors, who had no farm equipment and had leased out their land, had no reasonable prospect of reorganization.
85. In re Keller, 45 Bankr. 469, 472 (Bankr. N.D. Iowa 1984), quoting In re Koopmans, 22 Bankr. 395, 407 (Bankr. Utah 1982). Keller found 1,709 acres of farmland in which debtors had no equity necessary to an effective reorganization. The court found adequate protection to the creditor because the land would not decline in value in the immediate future and did not require the Chapter 11 debtors to pay rents to the creditor to ensure the benefit of the bargain.
fusing to terminate a stay when property is necessary for reorganization applies to Chapter 13 cases. The absence of the term "reorganization" anywhere but in Chapter 11 has led some courts to the conclusion that section 362(d)(2) applies only to Chapter 11 cases and not to Chapter 13 cases. Other courts have rejected this rationale, concluding that Congress could not have intended part of section 362(d) to apply to Chapter 13 cases and part not to apply.

Thirty days after a request for relief from the stay, the stay is terminated with respect to the party making the request, unless the court orders the stay continued in effect, pending, or as a result of, a final hearing and determination. The thirty-day hearing may be a preliminary hearing, or it may be consolidated with a final hearing. If the hearing is a preliminary hearing, the court must order the stay continued if the party opposing relief from the stay is reasonably likely to prevail at the final hearing. In addition, the final hearing must be commenced within thirty days of the preliminary hearing. The court may grant emergency relief from the stay without a hearing if a property interest will suffer irreparable damage before the opportunity for a notice and a hearing.

The crucial issue in many hearings where a creditor seeks to terminate the stay under section 362(d)(1) is whether the creditor's property interest has been given adequate protection. The Code defines three standards for pro-

45 Bankr. at 473. The court refused to follow In re American Mariner Indus., Inc., 734 F.2d 426 (9th Cir. 1984), discussed infra note 434.

Another decision focusing on the unlikelihood of depreciation of farmland as a form of adequate protection is In re Price, 40 Bankr. 578 (Bankr. N.D. Tex. 1984). Price involved both senior and junior liens on ranch property. Recent declines in the value of farmland make both of these decisions somewhat questionable.


88. In re Zellmer, 6 Bankr. 497 (Bankr. N.D. Ill. 1980). See also EMB Realty Corp. v. Pittman (In re Pittman), 7 Bankr. 760 (Bankr. S.D.N.Y. 1980), where the court applied section 362(d)(2) to a Chapter 13 case without discussing the issue.


90. Id.

91. Id.

92. Id. But using its equitable powers under section 105(a), the court can continue a stay beyond the statutory deadlines if necessary to protect the debtor's property. See John Deere Co. v. Kozack Farms, Inc. (In re Kozack Farms, Inc.), 47 Bankr. 399 (W.D. Mo. 1985) (stay on combine continued).

93. Id. § 362(f). In all hearings concerning relief from the stay, the party requesting relief has the burden of proof on the issue of the debtor's equity in the property; the party opposing the relief has the burden of proof on all other issues. Id. § 362(g) (1982).

viding adequate protection in section 361.95 One involves a cash payment, or periodic cash payments, to the extent that the stay under section 362 results in a decrease in the value of the creditor’s interest in the property.96 The second is providing an additional or replacement lien to compensate for the diminished value of the existing creditor’s lien.97 The third includes other relief that will let the creditor realize the “indubitable equivalent” of its interest in the property.98 Courts have shown flexibility in determining what constitutes adequate protection under section 362.99 Adequate protection is affected, of course, by the value of the creditor’s security interest, which depends on the value of collateral. Value may vary according to the purpose of valuation.100 Fair market value has been used in deciding whether a creditor was adequately protected for purposes of evaluating the stay under section 362.101 If the adequate protection does not completely compensate the creditor for any diminution in its property interest, the creditor has an administrative expense priority for the shortfall; under section 507(b) that claim has priority over other administrative claims.102

An informative analysis of adequate protection of a creditor’s interest in farmland appears in In re Greiman.103 In a Chapter 11 proceeding, a creditor, secured by a properly recorded deed of trust, asked relief from the automatic

The existence of adequate protection is a question of fact. In re Martin, 761 F.2d 472, 474 (8th Cir. 1985). But see, e.g., In re Schaller, 27 Bankr. 959, 962 (W.D. Wis. 1983).

95. 11 U.S.C. § 361 (1982 & Supp. II 1984). This section defines adequate protection for the purposes of sections 362, 363 (use, sale, or lease of property), and 364 (obtaining credit). For further discussion of adequate protection in the context of sections 363 and 364, see infra text accompanying notes 410-438, 467-470.

96. Id. § 361(1) (Supp. II 1984).
97. Id. § 361(2) (1982).
98. Id. § 363(3).
99. See, e.g., Pagni v. Pleasant Valley, Inc. (In re Pleasant Valley, Inc.), 6 Bankr. 13 (Bankr. D. Nev. 1980), where the court found that adequate protection existed when the property subject to the lien was increasing in value; Diversified Mort. Inv. v. Lake Tahoe Land Co. (In re Lake Tahoe Land Co.), 5 Bankr. 34 (Bankr. D. Nev. 1980), where the court held that a cushion between the amount of the debt and the market value of the land of 40 to 50 percent of the value constituted adequate protection; City Stores Co. v. A.L.S., Inc. (In re A.L.S., Inc.), 3 Bankr. 107 (Bankr. E.D. Pa. 1980), where the court held that paying the lessor all rents and charges as they became due under the lease and depositing with the lessor security equal to three months' rent provided the lessor with adequate protection; Citizens & Southern Nat'l Bank v. Feimster (In re Feimster), 3 Bankr. 11 (Bankr. N.D. Ga. 1979), where the court held that when the creditor had retained a lien on the secured property and under the debtor's Chapter 13 plan was to receive payments exceeding the value of the property, the creditor has been provided with adequate protection.


101. E.g., First Nat'l Bank of McDonough v. Shockley Forest Indus., Inc. (In re Shockley Indus., Inc.), 5 Bankr. 160 (Bankr. N.D. Ga. 1980), where the court held that when there was a reasonable likelihood of reorganization, the standard of valuation for determining adequate protection under section 362 was the fair market value of the collateral.

103. 45 Bankr. 574 (Bankr. N.D. Iowa 1985).
stay or adequate protection of its interest in Missouri farmland owned by the debtors in possession. Greiman, a highly educated farmer, owed the creditor approximately $1 million in principal and interest. At the time of the financing transaction, the property was valued at approximately $7 million; its fair market value during the bankruptcy proceeding was approximately $538,000, far less than the debt against the property.

The debtors had no equity in the farmland and did not prove that the land was necessary for an effective reorganization. In addition, they did not offer the creditor adequate protection. In making its determination on adequate protection, the court focused on the decline in the value of Missouri agricultural real estate and on the somewhat marginal Greiman farmland in particular. Testimony indicated that high interest rates, along with depressed crop and livestock prices, would result in a continued decline in the price of farmland, with marginal land suffering even greater decline.104 Two additional factors pointed toward further decrease in the value of the Grieman property. Although the best use of their land was livestock production, the Griemans devoted much of the land to row crop production. Despite the significant slope of the land (up to 20 percent), crops were planted, albeit using no-till techniques, up and down the hill rather than on the contour. Severe erosion was thus likely to waste the farmland and diminish its value. Further diminution in value was expected through deterioration of the improvements on the property. Having abandoned their livestock operation, the debtors had little incentive (or money) to make the necessary repairs on the buildings.105 The combination of declining land values, erosion, and deterioration indicated to the court that the creditor was not adequately protected. Thus, the court lifted the automatic stay, permitting the creditor to foreclose on the deed of trust.

II. The Estate

Property of the Estate

The concept of the estate is central to federal bankruptcy law. The estate includes the property available to satisfy claims of creditors against the farm debtor. Many provisions of the Code focus on maximizing the property constituting the estate. In a Chapter 7 case, the proceeds of the estate are distributed to the creditors; under Chapters 11 and 13, the reorganization plan either vests the estate in the debtor or describes the portion to be distributed to creditors.

An estate is created at the commencement of a bankruptcy case, that is, at the time the petition is filed.106 Subject to a few exceptions, the estate includes "all legal or equitable interests of the debtor in property as of the commencement of the case." 107 Section 541 of the Code defines property

104. Id. at 576.
105. Id. at 577.
107. Id. § 541(a)(1). This definition includes all the debtor's causes of action. In re Smith, 640 F.2d 888 (7th Cir. 1981).
broadly, though only the debtor's interest is part of the estate.\textsuperscript{108} The estate also includes property that the trustee recovers through the "avoidance powers."\textsuperscript{109} In addition to tangible and intangible property acquired before the filing of petition, the estate also includes property that the debtor acquires or becomes entitled to acquire within 180 days after the petition by inheritance, as the result of a property settlement or a divorce decree, or as the beneficiary of a life insurance policy.\textsuperscript{110} It also includes earnings from the property of the estate\textsuperscript{111} and property acquired after the commencement of a Chapter 13 case but before conversion to a Chapter 7 case.\textsuperscript{112} In a sense, the estate is the debtor's successor to the property that constitutes the estate. As such the estate has the benefit of any defenses that would have been available to the debtor. These include statutes of limitation, statutes of fraud, and other personal defenses.\textsuperscript{113}

The Code excludes several types of property interests from the estate. Any power that the debtor may exercise solely for the benefit of another entity besides the debtor need not be included in the estate.\textsuperscript{114} Moreover, the Code, as amended in 1984, excludes from the estate the debtor's interest as lessee of nonresidential real estate when the stated term of the lease has expired before commencement of the case. When the lease term expires during the case, the debtor's interest in the lease ceases to be part of the estate.\textsuperscript{115} This provision may prove relevant in cases involving a debtor who is a tenant under a farm lease.\textsuperscript{116} The Code excludes interests in spendthrift trusts from the estate, to the extent that the restrictions the trust imposes on the transfer of the debtor's interest are enforceable under applicable nonbankruptcy law.\textsuperscript{117}

Normally, if a trustee is serving in a case, the trustee will assemble the property of the estate.\textsuperscript{118} The debtor must cooperate and relinquish to the trustee all estate property in his possession.\textsuperscript{119} A farmer, like any other debtor, must turn over to the trustee all property, even property that can later be exempted. Both items of crucial practical importance (for example, farm im-


\textsuperscript{111} Id. § 541(a)(6) (Supp. II 1984).

\textsuperscript{112} Id. § 1306(a)(1) (1982).

\textsuperscript{113} Id. § 558 (Supp. II 1984). Any waiver made by the defendant after commencement of the case does not bind the estate.

\textsuperscript{114} Id. § 541(b)(1).

\textsuperscript{115} Id. § 541(b)(2).


\textsuperscript{117} 11 U.S.C. § 541(e)(2) (Supp. II 1984). Many other types of restrictions on property transfer will not protect a debtor's property from inclusion in the estate. See \textit{id.} § 541(c)(1).

\textsuperscript{118} Id. § 521(4).

\textsuperscript{119} Id.
plements) and articles of great sentimental value (for example, family heirlooms) must be made available to the trustee. Strict compliance with this requirement is essential. The debtor who refuses to comply may be denied a discharge\textsuperscript{120} or face prosecution for a bankruptcy crime.\textsuperscript{121}

The trustee must also receive property of the estate that is in the possession or control of other individuals or entities.\textsuperscript{122} This rule includes property that the trustee may use, sell, or lease for benefit of the estate and its creditors\textsuperscript{123} and property that the debtor will eventually exempt.\textsuperscript{124} Several exceptions to this requirement exist. Property that has inconsequential value or benefit to the estate need not be delivered to the trustee.\textsuperscript{125} In addition, an individual or entity without actual notice or knowledge of the bankruptcy case may, in good faith, transfer property of the estate or pay a debt owed to the debtor without incurring liability to the estate.\textsuperscript{126} Normally, however, those who transfer property of the estate after the bankruptcy petition has been filed will be liable to the estate for the value of the property.\textsuperscript{127}

Though the trustee must receive all the property of the estate, the trustee is not required to retain all of that property. After notice and hearing, the trustee may abandon any property that is burdensome or of inconsequential value to the estate.\textsuperscript{128} At the request of a party in interest, the court may order the trustee to abandon such property.\textsuperscript{129} For example, if a tractor is subject to valid liens that secure claims greater than the value of the tractor, the trustee can abandon it, allowing the creditors with valid liens to proceed against it. Of course, the assessment of value of property to the estate will vary according to the goal of the bankruptcy. In a farm reorganization, equipment that is totally encumbered may be of critical importance to the debtor's continued operation.

\textsuperscript{120} Id. \S 727(a)(3) (1982). See supra text accompanying notes 47-50.
\textsuperscript{121} 18 U.S.C. \S\S 151-155 (1982).
\textsuperscript{122} 11 U.S.C. \S 542(a) (1982).
\textsuperscript{124} See id. \S 522.
\textsuperscript{125} Id. \S 542(a) (1982). For example, in a situation where the debtor's interest in property was limited to the right of redemption of the property before sale and the right to receive notice of the sale, but did not include possession of the property, the property did not have to be turned over to the trustee. Winfrey Structural Concrete Co. v. I.R.S. (\textit{In re Winfrey Structural Concrete Co.}), 5 Bankr. 389 (Bankr. D. Colo. 1980).
\textsuperscript{126} 11 U.S.C. \S 542(c) (1982). \textit{But see} \S 549, dealing with avoidance of postpetition property transfer. Due to the interrelationship of sections 542(c) and 549(a), although the transferor may be protected, the transferee is not. The trustee may avoid the transfer under section 549(a)(2) and recover the property under section 550.

In addition, an entity that owes a debt to the estate need not pay the debt to the trustee to the extent that the entity is entitled to a setoff under section 553. Id. \S 542(b). A life insurance company may transfer property of the estate or the debtor to itself if the transfer is to pay a premium or to carry out a nonforfeiture insurance option that must be made automatically under a prepetition life insurance contract. Id. \S 542(d).
\textsuperscript{128} Id. \S 554(a) (Supp. II 1984).
\textsuperscript{129} Id. \S 554(b).
**Exemptions**

In bankruptcy proceedings involving an individual debtor, the estate initially includes all the debtor's interest in property. All of this property, however, will not be available for distribution to creditors. Instead, pursuant to Code section 522, the individual debtor is entitled to certain exemptions.\(^{130}\) These exemptions permit an individual debtor or the debtor and spouse to retain a limited amount of property free of prepetition claims of creditors.\(^{131}\) The exemption provision is designed to facilitate the "fresh start" envisioned by the drafters of the Code. The exemptions are available only to individuals and not to partnerships or corporations.

**Federal or State Exemptions**

The federal exemptions available to the farmer who has declared bankruptcy are set out in section 522(d).\(^{132}\) Some of the more significant exemptions are


\(^{131}\) Exempt property is, however, subject to some debts. *See id.* § 522(c). These include claims for taxes, under § 523(a)(1), and for alimony, maintenance, or support under § 523(a)(5).

\(^{132}\) *Id.* § 522(d). Section 522(b) provides an alternative: property exempt under federal nonbankruptcy law or certain state or local law, and certain exempt property held in joint tenancy or tenancy by the entirety. *Id.* § 522(b)(2)(A), (B).


The treatment of jointly held property will also vary widely from state to state for debtors who have selected, or who are limited to, the federal nonbankruptcy and state exemptions. These debtors may exempt any interest in joint tenancy or tenancy by the entirety property, to the extent that the interest is exempt under applicable nonbankruptcy law. 11 U.S.C. § 522(b)(2)(B) (1982 & Supp. II 1984). This exemption extends to personal as well as real property. *See Ackerly, Tenants by the Entirety Property and the Bankruptcy Reform Act*, 21 WM. & MARY L. REV. 701, 704 (1980). The property that falls under this exemption will be primarily tenancy by the entirety property. A tenancy by the entirety is a joint tenancy between spouses, and traditionally one of its characteristics has been that neither spouse can subject the property to individual debts. *Id.* at 702-03. As of 1980, twenty-six states recognized some form of tenancy by the entirety. *Id.* at 703. This exemption provision, however, applies only in those states following the traditional rule that tenancy by the entirety property cannot be subjected to individual debts. As of 1980, seventeen states still followed the traditional rule. *Id.* In those states, tenancy by the entirety property should be exempt from the bankruptcy proceeding if only one of the spouses is in bankruptcy. *See also Grilliot & Yocum, Tenancy by the Entirety: An Ancient Fiction Frustrates Trade and Creditors*, 17 AM. BUS. L.J. 341, 347 (1979).

*See Ragsdale v. Genesco, Inc.*, 674 F.2d 277 (4th Cir. 1982). *Ragsdale* involved a prebankruptcy judgment against husband and wife, with a judicial lien filed against tenancy in entireties property. The spouses' effort to use section 522(b)(2)(B) to protect the property in their joint bankruptcy failed. The property could be reached under Virginia law because both spouses were liable to the creditor; thus it could be reached in the joint bankruptcy proceeding. *See also 3 Bankr. Serv. (L. Ed.)* § 22.31 (1983).
the debtor's interest, not to exceed $7,500, in real or personal property used as a residence (the homestead exemption), and an interest, not to exceed $1,200, in one motor vehicle. The debtor can exempt his interest, up to $200 in value for particular items with an aggregate maximum of $4,000, in household or personal goods, animals, and crops held primarily for personal, family, or household use. Also exempt is an aggregate interest up to $500 in jewelry. The debtor can exempt his interest in any property, up to $400 plus up to $3,750 of any unused amount of the homestead exemption. Implements or tools of the trade are exempt, up to $750 in aggregate value. The Code also exempts several other types of tangible and intangible property interests.

The Code provides that an individual debtor may choose between its rather generous exemptions and the exemptions established under state law. But a debtor cannot maximize the available exemptions by selecting some from the federal list and some from state law. Instead, the debtor must use either the federal or the state exemptions. When husband and wife are both debtors, each individual is entitled to select his or her exempt property. When the spouses' estates are jointly administered, the spouses must choose the same set of exemptions.

The Code provides that individual states may prevent their domiciliaries from choosing the federal exemptions. In states that have exercised this option, the debtor must choose exempt property pursuant to state exemptions. A significant majority of states have mandated that debtors use state exemptions. Two generous provisions of the federal Code, as originally enacted, help to explain why so many states have "opted out" of the federal exemptions. First, federal law allowed a debtor to exempt any interest, not

134. Id. § 522(d)(2) (1982).
136. Id. § 522(d)(4) (1982).
137. Id. § 522(d)(5) (Supp. II 1984).
138. Id. § 522(d)(6) (1982). This exemption also includes professional books. See In re Yoder, 32 Bankr. 777 (Bankr. W.D. Pa. 1983). The debtor in Yoder did not come within the section 101(17) definition of farmer because he did not earn 80 percent of his income from farming. Nonetheless, he could exempt tools of the farming trade because he was a bona fide farmer.
140. Id. § 522(b) (1982 & Supp. II 1984). But see infra text accompanying note 144.
141. The debtor can change his exemption list choices so as to improve his position with regard to exemptions, so long as the final choice is made before others can be hurt by reliance on the debtor's initial choice. In re Cobb, 3 Bankr. 150 (Bankr. N.D. Cal. 1980).
143. Id. § 522(b) (1982 & Supp. II 1984). This provision was added as part of the 1984 amendments. If the parties fail to agree, the Code provides that section 522(b)(1) (the federal exemptions, unless the relevant state has decided otherwise) will apply.
144. Id. § 522(b)(1).
to exceed $200 per item, in household goods, wearing apparel, appliances, books, animals, crops, or musical instruments held for the personal family or household use of the debtor. Before the July 1984 amendments to the Code, there was no cumulative dollar limit to this exemption. A farmer who owned a number of animals held primarily for household use, for example, could have exempted all the animals if each had a value of $200 or less. This potential for abuse was eliminated by the July 1984 amendments that provide a $4,000 ceiling on the small item exemption.\textsuperscript{147} Second, the so-called "wild card" provision in federal law allowed a debtor to exempt the value of any property not to exceed $400 plus any of the unused amount of the $7,500 exemption for residential property.\textsuperscript{148} In joint cases, where the husband and wife held no homestead, the spouses could exempt up to $15,800 in any property they chose. Often this meant that the petitioners could exempt all their property. The July 1984 amendments have capped the "wild card" exemption at $400 plus up to $3,750 of the unused portion of the homestead exemption.\textsuperscript{149}

Although the liberal federal exemptions have now been tempered somewhat, many states still require their resident debtors to use state exemptions. The state exemptions vary considerably, and the relevant state exemptions must be studied carefully to ensure that the farmer-debtor can keep the maximum amount of property. Some of the state exemption laws have provisions quite similar to the federal provisions, although nothing requires the state provisions to provide analogous protection.\textsuperscript{150} Illinois, for example, is a state that requires debtors to use state exemptions.\textsuperscript{151} Like the Code, Illinois allows a $7,500 homestead exemption.\textsuperscript{152} Other exemptions closely track the federal list, but are somewhat less generous.\textsuperscript{153} For example, Illinois permits only $2,000, rather than $4,000, in miscellaneous personal property,\textsuperscript{154} and does not permit any of the unused homestead exemption to be used for personalty.

Some state exemption laws include provisions that are particularly attractive to farm debtors. The Iowa exemption statute, for example, provides that a resident debtor who is head of a family may exempt:

17. [T]he proper tools, instruments, or books of the debtor, if a farmer . . .
18. If the debtor is a . . . farmer, . . . a team, consisting of not more than two horses or mules, or two yoke of cattle, and the wagon or other vehicle, with the proper harness or tackle by the use of which he habitually earns his living, . . .\textsuperscript{155}

\textsuperscript{147} Id. § 523(d)(3) (Supp. II 1984).
\textsuperscript{148} Id. § 523(d)(5) (1982).
\textsuperscript{149} Id. § 523(d)(5) (Supp. II 1984). Apart from the changes in these two exemptions, the July 1984 amendments did not affect the exemptions listed in § 522(d).
\textsuperscript{150} In re Gauntt, 36 Bankr. 721 (Bankr. W.D. La. 1984).
\textsuperscript{152} Id. § 12-901.
\textsuperscript{153} Id. § 12-1001.
\textsuperscript{154} Id. § 12-1001(b).
\textsuperscript{155} Iowa Code Ann. § 627.6 (Supp. 1985).
The Iowa exemptions place no dollar limitation on the tools and instruments of a farmer. Thus, in *In re Hahn*, a farm-debtor selecting the Iowa exemptions was permitted to exempt a wide range of personal property such as tools and instruments. In addition, he was permitted to keep either a tractor-wagon combination or a truck-and-trailer combination.

Other state exemption laws also include helpful provisions. Oklahoma, for example, permits a homestead with a maximum size of 160 acres outside city limits and exempts "all implements of the husbandry used upon the homestead." Minnesota permits a homestead of 80 acres located in a rural area and imposes no monetary limit on its value. Texas law provides for a 200-acre rural homestead exemption. Clearly a farm debtor in a state that has not yet elected to opt out of the federal bankruptcy exemptions should scrutinize the state exemptions carefully to determine if the federal bankruptcy exemptions protect more property. And even if the state requires the farmer to use its exemptions, the farmer may find that essential property can be protected.

The debtor's property that is protected by either federal or state exemptions is generally not liable for any debt that arose before commencement of the case. In essence, this means the exempt property is not liable for any prepetition unsecured debt. Consensual liens on exempt property normally survive bankruptcy.

Avoiding Liens on Exempt Property

Pursuant to section 522(f), however, the debtor may avoid some liens against exempt property. First, the debtor may avoid judicial liens on personal or real property. Of course, a state court will not normally impose a lien on property exempt under state law, so the power to avoid judicial liens is relevant primarily when the federal exemptions apply and protect property not exempt under state law. Second, a debtor may also avoid nonpossessor, nonpurchase money security interests in several types of property. These in-

156. 5 Bankr. 242 (Bankr. S.D. Iowa 1980). The property exempt as tools and instruments included: special mechanic's tools, construction tools, carpenter tools, an 11-foot John Deere disk, a 4-section harrow and cart, a Lillston rear cultivator, a barge box and wagon, a side dump and wagon, a New Holland #68 baler, a New Holland #50 bale thrower, oil and antifreeze, farrowing houses, hog houses, a hog shelter, hog feeders, a pig creep, pig feeders and waterers, a hog waterer, a cattle lick tank, and an electric fence set.

157. Id.


159. Id. § 1(4).


163. Id. § 522(c)(2).

164. Id. § 522(f).


may not apply retroactively to property rights (liens acquired before enactment of the 1978 Code).

But see In re McFarland, 38 Bankr. 370 (Bankr. N.D. Iowa 1983), aff'd 38 Bankr. 374 (N.D. Iowa 1984), holding that section 522(f) may apply to liens created in the gap period between enactment and effective date of the section. McFarland also focused on the nature of possession. The creditor's security interest is possessory only if the agreement between debtor and creditor states that the creditor will possess the collateral; it is not possessory (therefore making the lien not avoidable under section 522(f)) merely because the creditor has repossessed the collateral. Id. at 373.


When the value of the property is greater than the allowed exemption, the debtor may only avoid the lien to the extent of the exemption, and the secured creditor cannot be prevented from enforcing the remainder of his lien. In re Morelock, 35 Bankr. 518 (Bankr. N.D. Ohio 1983); Sioux Falls Veterans Admin. Employees Fed. Credit Union v. Gorkum (In re Gorkum), 4 Bankr. 689 (Bankr. S.D. 1980).


167. 11 U.S.C. § 522(f)(2)(A) (1982 & Supp. II 1984). These include “household furnishings, household goods, wearing apparel, appliances, books, animals, crops, musical instruments, or jewelry that are held primarily for the personal, family or household use of the debtor or a dependent of the debtor.” Id.


170. One court has held that this section does not empower the debtor to avoid a lien on the debtor's automobile because the automobile is not considered part of the debtor's household goods. Abt v. Household Fin. Co. (In re Abt), 2 Bankr. 323 (Bankr. E.D. Pa. 1980). Generally courts have construed "household goods" broadly to include nonessential items such as television sets, stereo systems, and home entertainment systems, as well as necessities. See General Fin. Corp. v. Ruppe (In re Ruppe), 3 Bankr. 60 (Bankr. D. Colo. 1980); Coleman v. Lake Air Bank (In re Coleman), 5 Bankr. 76 (Bankr. M.D. Tenn. 1980).


172. E.g., In re LaFond, 45 Bankr. 195, 199-200 (Bankr. D. Minn. 1984); In re Decker, 34 Bankr. 640 (Bankr. N.D. Ind. 1983); In re Yoder, 32 Bankr. 777 (Bankr. W.D. Pa. 1983). Other courts have considered whether a debtor may exempt farming tools without reference to section
unfair to deny the exemption to those who actually farmed, but who could
not meet the 80 percent test because of nonfarm income. Nonetheless, the
court emphasized that the debtor had to be legitimately engaged in farming
to be able to exempt and avoid liens on farming tools under section 522(f).

Some farmers have attempted to characterize large farm machinery as tools
of the trade to avoid liens under section 522(f). The Code does not provide
a definition of tools of the trade, and courts have reached inconsistent con-
clusions. Some courts have stated that section 522(f)(2)(B) allows avoidance
of liens only on hand tools and small implements with nominal commercial
resale value, and not on farm implements of high value. In re O’Neal,173 for
example, applied this interpretation to a debtor who was a farmer and a peach
grower. Other courts, defining tools of the trade less restrictively, have per-
mitted avoidance of liens on large farm machinery.174 Indeed, one court noted
that a narrow construction of section 522(f) “punishes the farmer for being
inadvertently dependent on expensive tools of the trade as compared to other
trades more dependent on smaller hand tools.”175 And some courts, applying
a tools of the trade exemption in state law, have permitted lien avoidance
on large implements under section 522(f)(2)(B).176

A recent case decided by the Eighth Circuit illustrates the application of
the section 522(f)(2) lien avoidance provisions to nonpurchase money security
interests in livestock. In re Thompson involved a voluntary Chapter 11
reorganization filed by an Iowa farm couple.177 Iowa law requires Iowa debtors
to use the state exemptions in bankruptcy.178 Under Iowa law, a debtor may

W.D. La. 1977); In re Pommerer, 10 Bankr. 935 (Bankr. D. Minn. 1981); In re Hahn, 5 Bankr.
242 (Bankr. S.D. Iowa 1980).

an insurance agency, claimed to be a farmer, and sought to avoid liens on $5,000 worth of
farm equipment. Under Kansas law, a debtor who has more than one trade or profession may
exempt articles relevant for his or her primary occupation. Id. at 42. The court found the wife’s
primary occupation to be farming; thus, she was entitled to the tools of the trade exemption.
Id. at 43. See also Johnson v. Farmers Home Admin. (In re Johnson), 54 Bankr. 797 (Bankr.
W.D. Mo. 1985) (debtor wife who worked both on and off the farm, and applied her off-farm
income to the farm, was a farmer).

173. 20 Bankr. 13 (Bankr. E.D. Mo. 1982). (This decision was later superseded by statute).
See In re Lipe, 36 Bankr. 597, 599 (Bankr. W.D. Mo. 1983). See also Roberts v. John Deere
Co. (In re Roberts), 40 Bankr. 629 (Bankr. W.D. Mo. 1984); In re Yparrea, 16 Bankr. 33, 35

174. E.g., Augustine v. United States, 675 F.2d 582 (3d Cir. 1982). Augustine involved use
of the “wild card” exemption to avoid liens in excess of the $750 permitted by section 522(d)(6).
See Kunkel, Farmers’ Relief Under the Bankruptcy Code: Preserving the Farmers’ Property,

175. Middleton v. Farmer State Bank, 41 Bankr. 953 (D. Minn. 1984). See also In re LaFond,

avoidance on pickup and trailer to haul cattle and hay); In re Liming, 22 Bankr. 740 (Bankr.

177. 750 F.2d 628 (8th Cir. 1984).

claim an exemption on all pigs under six months.179 The Thompsons had 210 pigs under six months, but the pigs were subject to a security interest taken by a Production Credit Association (PCA). Because the security interest was not a purchase money interest, the Thompsons tried to use section 522(f)(2) to avoid the PCA’s lien on their exempt pigs. The bankruptcy court ruled that the Thompsons could not avoid the lien,180 and the Thompsons appealed to the Eighth Circuit.181

The Eighth Circuit affirmed the bankruptcy court’s decision. Although the Thompsons were subject to the Iowa exemptions, federal law determines the availability of lien avoidance. The court examined the legislative history of section 522(f)(2), noting that its primary purpose was to protect consumer debtors from coercive creditors who take security interests in all the debtor’s property and threaten repossession.182 Avoidance of the security interest in the Thompsons’ pigs did not further this purpose. The Thompsons were farmers and raised livestock on a commercial scale.183 The animals were not held for the “personal, family, or household use of the debtor,”184 as required by section 522(f)(2).

The Thompsons argued that the pigs were for personal use because some would have been consumed by the family and others sold to provide income for a fresh start. But they presented no evidence that the pigs were not part of a commercial enterprise. They also argued that the pigs represented the farmer’s “unrealized wages,” and that these “animal wages” should be exempt because they were necessary for a fresh start.185 In response, the court agreed that the exemption statutes were intended to facilitate the fresh start, but noted that the lien avoidance statute has a somewhat different objective: to prevent creditors from forcing debtors to reaffirm consumer debts. The PCA’s security interest was not consumer debt. Thus, the court rejected the Thompsons’ animal wages argument. The Eighth Circuit concluded that

179. Id. § 627.6(5).
183. The court quoted with approval the bankruptcy judge’s observation:
   The debtor is engaged in the business of farming. He is raising livestock on a commercial scale, and it cannot be argued that the livestock or animals are used as pets or for personal slaughter to be consumed by his family. The debtor is asking the court to effectively eliminate the requirement that these items be held for personal, family or household use for the debtor.
   The hogs of this debtor are a capital business venture, financed as such.
750 F.2d at 630, quoting In re Thompson, 46 Bankr. 1, 2 (Bankr. S.D. Iowa 1984).
185. 750 F.2d at 631.
only those personal goods necessary to the debtor's new beginning and of little resale value fit the federal bankruptcy philosophy embodied in section 522(f)(2). . . . [T]he Thompsons' pigs were not the sort of low value personal goods in which "adhesion contract" security interests are taken. The . . . nonpurchase-money security interest in the 210 pigs is not avoidable.\(^\text{186}\)

Another issue connected with section 522(f)(2)(B) lien avoidance is related to state exemptions. Even after the July 1984 amendments to the Code, states can continue to opt out of section 522(d).\(^\text{187}\) But section 522 does not make clear how opting out under section 522(b) affects section 522(f) lien avoidance.\(^\text{188}\) As some courts suggest, a state that opts out of the federal exemptions normally defines its own exemptions in terms of a debtor's equity interest in certain property.\(^\text{189}\) By definition, a debtor's equity interest is not subject to a lien. Thus the lien avoiding provision, section 522(f), will never be applicable because debtors can avoid liens only on property the states have declared exempt. The Fifth Circuit took this approach in *In re McManas*,\(^\text{190}\) and the Sixth Circuit accepted it in *In re Pine*.\(^\text{191}\) The Eleventh Circuit, however, in *In re Maddox*,\(^\text{192}\) said in dicta that it probably would not follow *McManas* because under the supremacy clause any conflict between state lien conservation provisions and the federal lien avoidance provision must be resolved in favor of federal law. The Code gives the states the choice of opting out of the federal exemptions, but not the lien avoidance provisions of section 522(f). Indeed, *In re Thompson* asserts that "federal law determines the availability of a lien avoidance."\(^\text{193}\)

\(^{186}\) *Id.* The court's emphasis on goods of "little resale value" and of "low value" raises some question about the value of goods on which liens may be avoided. The 210 pigs were worth only $4,500. *Id.* Under many exemption statutes that limit the value of exempt property, the question may not arise.


\(^{188}\) "[T]he debtor may avoid . . . a lien . . . to the extent that such lien impairs an exemption to which the debtor would have been entitled under subsection (b)." *Id.* § 522(f) (1982). Subsection (b) in effect is the state exemption provision.

\(^{189}\) Some Illinois exemptions, for example, exempt only the debtor's equity interest. Ill. Rev. Stat. ch. 110, §§ 12-1001(b), (d) (1983). The farmer may exempt his equity interest up to $750 in implements or trade tools.

\(^{190}\) *In re McManas*, 681 F.2d 353 (5th Cir. 1982).

\(^{191}\) Pine v. Credithrift of Am., Inc. (*In re Pine*), 717 F.2d 281 (6th Cir. 1983).

\(^{192}\) Maddox v. Southern Discount Co. (*In re Maddox*), 713 F.2d 1526 (11th Cir. 1983).

Avoiding Powers

One of the goals of bankruptcy is to make as much property as possible available to satisfy claims of creditors or to aid in an effective reorganization. Moreover, creditors are to be treated equitably, normally in light of their rights under nonbankruptcy law. Thus, it is important to ensure that the more aggressive creditors, perhaps fearing the debtor's financial instability, cannot seize the debtor's property shortly before bankruptcy to the detriment of other creditors.\footnote{Levin, \textit{An Introduction to the Trustee's Avoiding Powers}, 53 AM. BANKR. J. 173 (1979).} Nor should the debtor be permitted to pay some preferred creditors while ignoring others who may be owed similar debts. In light of these considerations, the trustee (or the debtor in possession)\footnote{The “debtor in possession,” a term used in connection with Chapter 11, is the debtor, except when a trustee is serving in the case. 11 U.S.C. § 1101(1) (1982). The debtor in possession has most of the rights, functions, and duties of the trustee. \textit{Id.} § 1107(a) (Supp. II 1984). Thus, the debtor in possession can normally exercise the trustee's avoiding powers.} enjoys a number of avoiding powers under the Code.\footnote{Strictly speaking, the avoiding powers are those granted in Code sections 544-549. But other Code sections are also relevant.} These permit the trustee to recover certain property of the debtor that has been transferred to other entities or individuals before the bankruptcy. When a transfer is avoidable, the trustee can recover the property transferred or its value for the benefit of the estate.\footnote{11 U.S.C. § 550(a) (1982 & Supp. II 1984).} Any interest in the property then becomes property of the estate.\footnote{\textit{Id.} § 541(a)(3) (Supp II 1984).}

Avoiding powers involve a number of complexities that are beyond the scope of this article.\footnote{A number of articles have provided comprehensive discussions of avoiding powers. \textit{See}, e.g., Jackson, \textit{Avoiding Powers in Bankruptcy}, 36 STAN. L. REV. 725 (1984), and the references cited therein.} Nonetheless, it is important to provide an overview of these powers and their relevance in a farm bankruptcy. They can play a significant role in the trustee's efforts to maximize the property available for the farmer's creditors. In addition, avoiding powers may help the farmer reorganizing under Chapter 11 or Chapter 13 to recover property that will make successful reorganization possible.\footnote{See Landers, \textit{Reorganizing a Farm Business Under Chapter 11}, 5 J. AGRIC. TAX'N & L. 11, 27 (1983), for the suggestion that Chapter 11 debtors, who will need cooperation from creditors to ensure a successful reorganization, may be reluctant to challenge voidable transfers.}

Section 544(a)—The Strong-Arm Clause

Section 544(a) of the Code is the so-called "strong-arm clause." It permits the trustee to avoid liens that are "secret" because they have not been perfected properly. Section 544(a)(1) gives the bankruptcy trustee the status of a hypothetical judicial lienholder who extends credit to the debtor and obtains a judicial lien on the debtor's property at the time of the bankruptcy petition.\footnote{11 U.S.C. § 544(a)(1) (Supp. II 1984). Section 544(a)(2) gives the trustee the power of a creditor who has an execution against the debtor that is returned unsatisfied.} The trustee enjoys this power, regardless of whether such a creditor
actually exists (that is, he has the status of a "hypothetical" creditor); and regardless of any knowledge of the trustee or of any creditor. The trustee's status under section 544(a) depends in part on the effect of applicable state law.

As a practical matter, the most significant effect of section 544(a) is to allow the trustee to defeat valid security interests that have not been perfected as of the date of the bankruptcy petition. Thus the trustee will be able to defeat an unperfected security interest under article 9 of the Uniform Commercial Code (UCC), as well as other interests over which a judicial lien creditor would prevail. For example, a farmer might borrow $25,000 from a machinery dealer to buy a tractor under a contract of purchase that gives the machinery dealer a security interest in the tractor. If the dealer fails to perfect that interest prior to the farmer's bankruptcy petition (or within the ten-day grace period for purchase money security interests), the trustee can defeat that dealer's security interest pursuant to the strong-arm clause, even though the security interest on the tractor was valid as between the dealer and the farmer. This result can be justified because the machinery dealer's failure to record and thus give notoriety to the "secret lien" may have prejudiced other creditors who extended credit to the farmer on the basis of his ownership of the tractor.

A recent decision involving a farm debtor illustrates the application of section 544(a). In re Pirsig Farms, Inc. was a Chapter 11 case filed by a Minnesota family farm operation doing business in corporate form. During a three-year period prior to the bankruptcy, the debtor had purchased farm equipment from John Deere dealers. The dealers took purchase money security interests in the equipment and later assigned the security agreements to the John Deere Company. The debtors had signed twenty-two financing statements, which Deere filed. At the time of the filing, Minnesota law provided that financing statements on farm equipment of a corporation had to be filed with the Secretary of State. Deere, however, filed only three of the statements with the Secretary of State and filed the other nineteen with the county recorder.

After filing a Chapter 11 petition, the debtor filed a motion under section 363 of the Code to use cash collateral in which two banks had security in-

202. Id. § 544(a)(1)(2).
203. Id. § 544(a).
204. See U.C.C. §§ 9-301(1)(b), 9-301(3) (1978), which state that an unperfected security interest is subordinate to the rights of someone who becomes a lien creditor (defined to include a trustee in bankruptcy) before perfection of the security interest. See also U.C.C. § 9-301(2), which gives the holder of a purchase money security interest ten days in which to perfect and retain priority.
206. Even if the machinery dealer in the example did record his lien before the filing of the petition, it still might be avoided as a preference. See infra text accompanying notes 250-287.
207. 46 Bankr. 237 (D. Minn. 1985).
The banks and the debtor entered a stipulation for the use of cash collateral. The court-approved stipulation required the debtor to seek to avoid Deere’s liens on the farm equipment so that the debtor could then grant liens on the equipment to the banks. As agreed, the debtor then sought to have Deere’s liens avoided under section 544(a). The bankruptcy court approved the lien avoidance; the liens were unperfected because they were filed improperly. Deere appealed from this decision to the district court.

The district court affirmed the bankruptcy court’s decision. The debtor in possession, using the powers of the trustee, had asserted section 544(a), the strong-arm clause, for the benefit of the estate. Deere’s liens, improperly filed under Minnesota law, were not perfected and thus fit under the literal interpretation of section 544(a). Deere asserted that equitable considerations should block application of section 544(a). It argued that the court should have treated the debtor as an individual because the debtor was “actually just a family farm, with family members owning all the outstanding stock.” Yet Deere could make no showing that the debtor failed to observe corporate formalities. Deere also argued that it did not know it was dealing with a corporation when it sold the farm equipment. This argument, however, was unrealistic in light of the evidence, including corporate signatures on the financing documents. Deere also argued that the lien avoidance was not necessary for the debtor to continue operating its farm. But, as the court noted, section 544(a) does not require any showing that the lien avoidance is necessary for continued operation. Indeed, section 544(a) is intended to benefit the debtor’s entire estate. As fiduciary of the estate, the debtor in possession has an obligation to seek lien avoidance.

Deere also argued that the banks, which would benefit from lien avoidance, had knowledge of the Deere liens. But, as the court emphasized, the debtor, rather than the banks, was using section 544(a), a section which prescribes statutorily that the debtor did not have notice.

Although Deere would lose more than $500,000 through the section 544(a) lien avoidance, the district court refused to use its equitable powers to prevent that result. The equities did not justify contravention of clear statutory provisions. Deere’s own failure to perfect its security interests properly caused it to lose its liens under section 544(a).

An analogous strong-arm provision focuses on real property. Section 544(a)(3) gives the trustee the status of a bona fide purchaser of real property from the debtor, who has perfected the transfer at the time of bankruptcy filing. Again, the status is that of a hypothetical buyer; no actual purchaser need exist. This status permits the trustee to avoid transfers of the debtor’s

209. On section 363, see infra text accompanying notes 393-457.
211. Id. at 241. The court believed it irrelevant that the bankruptcy cases of the individual Pirsig debtors were consolidated with the corporate bankruptcy.
212. Id. at 241.
213. Id. at 242.
214. Id. at 244. Deere also raised a fifth amendment taking issue, which the court rejected.
real property that have not been perfected pursuant to state recording statutes. Under section 544(a)(3), the trustee can defeat the interest of a lender who extends credit secured by a farmer’s land, but who fails to record the mortgage pursuant to the state recording statute.216 The trustee can defeat the creditor’s mortgage in bankruptcy, even though the mortgage on the farm was valid as between the farmer and the lender.

The strong-arm provision allows the trustee to avoid unperfected consensual liens on both real estate and personal property. In addition, the trustee can exercise other powers, discussed in the following sections, that enhance the estate in bankruptcy.

**Section 545—Avoiding Statutory Liens**

Section 545 of the Code permits the trustee to avoid the fixing of a number of types of statutory liens on property of the debtor. The trustee can avoid liens that first become effective against the debtor upon bankruptcy, insolvency, or failure to meet certain financial standards.217 State statutory liens that become effective only at bankruptcy or other financial exigency are little more than state attempts to reorder federal priorities set forth in the Bankruptcy Code. Thus the Code negates these attempts.218 In addition, the Code gives the trustee power to avoid other statutory liens on property of the debtor when those liens are not perfected as against a hypothetical bona fide purchaser who purchases the property at the commencement of the case.219 This power to affect statutory liens is analogous to the strong-arm power to avoid consensual liens.

In addition, the trustee may avoid the fixing of statutory liens on the debtor’s property that are liens for rent, or liens of distress for rent.220 This avoiding power assumes special significance in the farm bankruptcy context because it acts to invalidate the landlord’s lien when a farm tenant files bankruptcy. This is particularly important in light of the fact that a substantial percentage of the farmland in the United States is rented.221

Many states protect the landlord’s interest in a farm lease with a lien on the crop for rent222 and advances.223 The Illinois lien on crops is typical:

216. See, e.g., Leonard v. Lyens (In re Hastings), 4 Bankr. 292 (Bankr. D. Minn. 1980), in which the court allowed the trustee to avoid the creditor’s mortgage because it had not been filed at the county record office.
220. *Id.* §§ 545(3), (4).
221. According to the 1978 Census of Agriculture, approximately 40 percent of the land in farms in the United States is rented. U.S. DEP’T OF COMMERCE, 1978 CENSUS OF AGRICULTURE pt. 51, at 124 (1981). In some states, the percentage is even higher; for example, in Illinois more than 55 percent of land in farms is rented. *Id.*
223. E.g., ARK. STAT. ANN. § 51-203 (1971); MO. ANN. STAT. § 441.290 (Vernon 1952); WASH.
Every landlord shall have a lien upon the crops grown or growing upon the demised premises for the rent thereof, whether the same is payable wholly or in part in money or specific articles of property or products of the premises, or labor, and also for the faithful performance of the terms of the lease.224

The Illinois lien attaches at the time the crops begin to grow and continues for six months after expiration of the lease term. It must be enforced in an action of replevin, distress for rent, or foreclosure.

Though the high priority given the landlord's lien normally ensures that the landlord can collect rent for the premises,225 this lien will not protect the landlord when the tenant enters bankruptcy. Sections 545(3) and (4) of the Code apply to empower the trustee to avoid the statutory lien. The definition of "statutory lien" in section 101(45)224 makes it clear that the trustee can avoid both statutory and nonstatutory liens of distress for rent.226 Therefore, when a farm tenant enters bankruptcy, the trustee (or the tenant, as debtor in possession) will use section 545 to avoid the statutory lien for rent and any liens of distress for rent in the crops. The trustee can avoid the lien, even if it has been perfected prior to the bankruptcy.227 Moreover, merely filing the lease in the county office for real estate records will not negate the trustee's avoiding power.228

Although the trustee can avoid these statutory liens for rent under section 545, landlords can be protected by obtaining consensual liens in the crops growing on their land.229 Section 101(45) of the Code specifically excludes security interests from the definition of statutory lien.230 Using a security interest to ensure the landlord's receipt of rent does not contravene section 545.

227. 227. Relevant House and Senate committee reports indicate that the trustee can avoid the lien even if it has been enforced by sale prior to the bankruptcy petition. H.R. REP. No. 595, supra note 17, at 371, reprinted in 1978 U.S. CODE CONG. & AD. NEWS, at 6327; S. REP. No. 989, supra note 39, at 85, reprinted in 1978 U.S. CODE CONG. & AD. NEWS, at 5871.
228. 228. See 4 COLLIER ON BANKRUPTCY ¶ 67.23[2], at 290-91 (J. Moore 14th ed. 1978). See In re Harrell, 55 Bankr. 203 (Bankr. E.D.N.C. 1985) (landlord lien defeated by section 545(3), although statute vested all crops in lessor until rent was paid; section 545(3) applies to postpetition leases).
229. 229. Neither the Code nor its legislative history indicates that the trustee's power to avoid statutory liens for rent is conditioned on the lack of perfection or the failure to file the lease in the county real estate record office. See Grossman & Fischer, supra note 116, at 611-12.
The rationale of that section is that a preference given to a particular class of creditors by state statute is unfair to general creditors. Nonetheless, creditors who act within the law to protect themselves should not lose that protection in bankruptcy. Of course, the security interest must be properly perfected to withstand the trustee's strong-arm power under section 544(a).²³²

Sections 548 and 544(b)—Fraudulent Conveyances

A farmer who is considering bankruptcy may want to transfer unencumbered property to family members to protect that property from the reach of creditors. If an insolvent farmer, for example, gives an unencumbered tract of land to a family member or sells that land at a substantial discount from its fair market value, the transfer can probably be characterized as a fraudulent conveyance. Fraudulent conveyances deprive creditors of rights to property that might otherwise be available to satisfy their claims. Normally, creditors who are defrauded by such transfers can set aside or void fraudulent conveyances under the Uniform Fraudulent Conveyance Act²³³ or other applicable provisions of state laws.²³⁴

Like certain creditors under state law, the trustee in bankruptcy has the power to avoid fraudulent conveyances. The trustee's power is governed by the Bankruptcy Code and differs in some respects from the rights of a creditor under state law. Both section 548 and section 544(b) give the trustee the power to avoid fraudulent conveyances,²³⁵ but the sections govern somewhat different situations.

Section 548 gives the trustee broadly applicable power to avoid fraudulent transfers. This power does not depend on the actual existence of an unpaid creditor who was defrauded by the conveyance.²³⁶ Conveyances that can be

²³². See supra text accompanying notes 201-206.
²³³. See UNIFORM FRAUDULENT CONVEYANCE ACT §§ 4, 7 (1918). "Every conveyance made and every obligation incurred by a person who is or will be thereby rendered insolvent is fraudulent as to creditors without regard to his actual intent if the conveyance is made or the obligation is incurred without a fair consideration." Id. § 4, 7A U.L.A. 474 (1985). "Every conveyance made and every obligation incurred with actual intent, as distinguished from intent presumed in law, to hinder, delay, or defraud either present or future creditors, is fraudulent as to both present and future creditors." Id. § 7, 7A U.L.A. 509 (1985). Fraudulent conveyances can be set aside or ignored by creditors." Id. §§ 9, 10, at 577, 630. A new law, the Uniform Fraudulent Transfer Act, was approved by the National Conference of Commissioners on Uniform State Laws in 1984. 7A U.L.A. 639 (1985). For discussion, see Alices & Dorr, A Critical Analysis of the New Uniform Fraudulent Transfer Act, 1985 U. ILL. L. REV. 527.
²³⁴. Many state fraudulent conveyance laws are based on the Statute of 13 Elizabeth (1570). An example of a modern state fraudulent conveyance statute is ILL. REV. STAT. ch. 59, § 4 (1983): "Every gift, grant, conveyance, assignment or transfer of, or charge upon any estate, real or personal, ... made with the intent to disturb, delay, hinder or defraud creditors or other persons, ... shall be void as against such creditors, purchasers and other persons." Under id., § 5, the title of a good faith purchaser for valuable consideration is not affected.
²³⁵. A fraudulent conveyance may result in denial of discharge to an individual debtor under 11 U.S.C. § 727(a)(2)(A) (1982), when that conveyance is made within a year before filing of the bankruptcy petition.
avoided under section 548(a) are those made voluntarily or involuntarily, within one year of the date of the filing of the bankruptcy petition. The trustee can avoid transfers made (or obligations incurred) with actual intent to hinder, delay, or defraud any creditor to whom the debtor was or became indebted. In addition, the trustee can avoid transfers for which the debtor received less than a reasonably equivalent value, if the debtor was insolvent on the date of the transfer or became insolvent because of the transfer. Under this provision, the insolvent farmer's sale of land at a discounted price would constitute a voidable fraudulent conveyance under section 548 if the transfer occurred within one year of bankruptcy. If the transferee of the farm paid value and took the property in good faith (unlikely, in the case of a family member), he would have a lien on (or retain) any interest transferred to the extent that the transferee gave value. The Code, as amended in 1984, defines "transfer" broadly to include every method of disposing of property, "including . . . foreclosure of the debtor's equity of redemption." Under this definition, a foreclosure sale of real estate at less than a "reasonably equivalent value" may be thought to fall within the definition of fraudulent conveyance. Indeed, a number of decisions have so held. Courts have disagreed on this

237. 11 U.S.C. § 548(a) (1982 & Supp. II 1984). This section refers to "any transfer of an interest of the debtor in property." This evidently includes exempt as well as nonexempt property. See id. § 548(d)(1), on when a transfer is made.

238. Id. § 548(a)(1). One court has held that absent actual intent, a finding of constructive intent is sufficient to permit the trustee to void a transfer pursuant to this section. In re Castillo, 7 Bankr. 135, 137 (Bankr. S.D.N.Y. 1980). Another court has held that while actual intent to defraud cannot usually be found solely because a transfer was between insiders, the circumstances and actions of the parties involved may show intent to effect a fraudulent transfer. Loftis v. Minar (In re Montanino), 15 Bankr. 307, 312 (Bankr. D.N.J. 1981).

239. Under 11 U.S.C. § 548(d)(2)(A) (Supp. II 1984), value is defined as "property, or satisfaction or securing of a present or antecedent debt of the debtor, but does not include an unperformed promise to furnish support to the debtor or to a relative of the debtor." Thus, value need not be present value but can include satisfaction of an antecedent debt. But such a transfer may constitute a preference under section 547.

240. Id. §§ 548(a)(2)(A) and (B)(i) (Supp. II 1984). The trustee can also avoid transfers when the debtor received less than a reasonably equivalent value, id. § 548(a)(2)(A); and the debtor was engaged in business or a transaction for which remaining property was unreasonably small capital, id. § 548(a)(2)(B)(i); or the debtor intended to incur debts beyond the ability to pay as the debts matured, id. § 548(a)(2)(B)(ii) (1982).

241. Id. § 548(c) (Supp. II 1984).


243. Id. § 548(a)(2)(A). The leading case is Durrett v. Washington Nat'l Ins. Co., 621 F.2d 201 (5th Cir. 1980), decided under the Act, but reaffirmed under the code in Abramson v. Lakewood Bank & Trust Co., 647 F.2d 547 (5th Cir. 1981), cert. denied, 454 U.S. 1164 (1982). Durrett held that a sale commanding less than 70 percent of the fair market value of the property has been made for less than a reasonably equivalent value and may be avoided as a fraudulent transfer. Although the 70 percent rule has been abandoned in favor of a case-by-case analysis, Ruebeck v. Atteboro Sav. Bank (In re Ruebeck), 55 Bankr. 163 (Bankr. D. Mass. 1985), a number of decisions have followed the reasoning of Durrett. E.g., In re Garrison, 48 Bankr. 837 (Bankr. D. Colo. 1985).

For discussion of the issues raised by Durrett, see Henning, Analysis of Durrett and Its Impact on Real and Personal Property Foreclosure: Some Proposed Modifications, 63 N.C. L. Rev.

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issue, however, and some decisions have suggested that the consideration received at a noncollusive and regularly conducted foreclosure sale will satisfy the "reasonably equivalent value" standard.244

In section 544(b), the Code gives the trustee a complementary power to avoid fraudulent conveyances. That section gives the trustee the status of an unsecured creditor holding an allowed claim in bankruptcy.245 The trustee may avoid any transfer of a property interest or any obligation incurred if the transfer or obligation could be avoided by the creditor under applicable law.246 Thus section 544(b) incorporates state fraudulent conveyance law into the Code. Under section 544(b), unlike section 548, however, the trustee takes the status of an actual creditor. But under section 544(b), the trustee is not limited by the one-year requirement of section 548. Instead, any time period that applies under state law (even if it is longer than one year) will apply. Moreover, once the trustee assumes the standing of the actual creditor to avoid the transfer, the trustee can avoid the conveyance completely, even if the conveyance was fraudulent as to the creditor only in part.247 Thus the trustee has more power than the actual creditor, who normally can void a transfer only to the extent of its claim. When the trustee avoids a fraudulent conveyance under section 544(b), the entire amount recovered will be available for the benefit of creditors of the estate.248

Section 544(b) might be used, for example, to avoid a farmer's transfer of farmland to a family member at less than fair market value. If the transfer had occurred more than one year before the farmer filed the bankruptcy petition, section 548 would not apply. But if there were a creditor in bankruptcy who held an unsecured claim at the time of the conveyance, section 544(b) becomes relevant. The trustee can avoid the conveyance by assuming the status of the unsecured creditor and that creditor's rights under state fraudulent conveyance law. Even if the creditor could have avoided the conveyance only


244. See Madrid v. Lawyers Title Ins. Corp. (In re Madrid), 21 Bankr. 424 (Bankr. 9th Cir. 1982), aff'd, 725 F.2d 1197 (9th Cir.), cert. denied, 105 S. Ct. 125 (1984). The bankruptcy appellate panel held that the consideration received at a noncollusive, regularly conducted foreclosure sale is reasonably equivalent value under section 548(a)(2). In affirming, the Ninth Circuit held that the transfer effectuated by a foreclosure sale took place when the deed of trust was perfected under state law, not at the time of the sale itself. The Ninth Circuit used reasoning similar to that in Alsop v. Alaska (In re Alsop), 14 Bankr. 982 (Bankr. Alaska 1981), aff'd, 22 Bankr. 1017 (D. Alaska 1982). The 1984 Code amendments, making the definition of transfer under section 101(48) include the foreclosure of the debtor's equity of redemption, may have invalidated the Ninth Circuit's reasoning in Madrid. See also In re Winshall Settlor's Trust, 758 F.2d 1136 (6th Cir. 1985); In re Strauser, 40 Bankr. 868 (Bankr. N.D. Ohio 1984).

245. The creditor's claim must be allowed under section 502 (or not allowable only under section 502(e)). 11 U.S.C. § 544(b) (1982).

246. Id. § 544(b).

in part, the trustee can avoid it completely. So, for example, if the creditor had an unsecured claim for only $20,000 and the discount to the family member amounted to $100,000, the trustee would recover the whole $100,000 for the benefit of the estate.249

Section 547—Preferences

Fraudulent conveyance law is intended in part to regulate the relationship between the debtor and his creditors, especially by discouraging debtor misbehavior. Other law, for example, the law governing preferences, deals with the relationship among the several creditors who may have interests in the debtor’s property.250 A farmer who has a number of creditors might have some reason for wanting to make a payment to one of those creditors, rather than to the others. The payment is not fraudulent because the creditor has given consideration.251 Nonetheless, when the farmer does not have enough property to pay every creditor, the transfer does benefit one creditor at the expense of the others. Outside of bankruptcy, such payments, called preferences, are normally permissible. But in bankruptcy, one of the policies is to ensure that creditors who are situated similarly receive similar treatment. Permitting creditors who are particularly aggressive in pressing their claims or who are especially favored by the debtor to receive superior treatment contravenes this policy. Thus, the Code includes section 547, which gives the trustee authority to avoid certain preferential transfers made before bankruptcy.252

A preference is simply a statutorily defined transfer of property that prefers one creditor over another. The purpose of section 547 is “to prevent a creditor from changing, alone or with the debtor’s help, his existing position vis-à-vis other creditors in anticipation of a bankruptcy proceeding.”253 If a creditor has improved his position in relation to other creditors, the trustee can avoid the transfer that made the improvement if the transfer fits within the requirements of section 547. “Transfer” is defined quite broadly to include every mode of parting with an interest in property.254 Section 547 establishes rather technical criteria by which voidable preferences can be identified.

249. Under state fraudulent conveyance law, the result as to the family member will depend on his or her good faith. If the family member purchased in good faith, then he would have a lien on the property as security for repayment. See, e.g., Uniform Fraudulent Conveyance Act § 9 (1918), 7A U.L.A. 665 (1985).
250. See Jackson, supra note 199, at 756-58, 777 (distinguishing between the purposes of preference and fraudulent conveyance law).
251. Even if the payment is on account of an earlier debt, the creditor has given consideration—the extension of credit in the past. The Uniform Fraudulent Conveyance Act, for example, defines fair consideration to include satisfaction of an antecedent debt. Uniform Fraudulent Conveyance Act § 3(a) (1918), 7A U.L.A. 448 (1985).
253. Jackson, supra note 199, at 759.
254. 11 U.S.C. § 101(48) (Supp. II 1984). “Transfer” means every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property, including retention of title as a security interest and foreclosure of the debtor’s equity of redemption.”
When a farmer who files bankruptcy has made a prebankruptcy transfer of an interest in property that prefers some creditor, the trustee (or the debtor in possession) may avoid the transfer if it meets five specific requirements. First, the transfer must be to or for the benefit of a creditor. Second, the transfer must be for or on account of an antecedent debt owed by the debtor before the transfer was made. Third, the transfer must have been made while the debtor was insolvent. The debtor is presumed to have been insolvent on and during the ninety days immediately preceding the date of the bankruptcy petition.

The fourth requirement focuses on the timing of the transfer. To constitute a preference, the transfer must have been made on or within ninety days of the date of the bankruptcy petition. This period is extended to a year, however, if the creditor to whom the payment was made was an “insider” at the time of the transfer. The Code defines insider in section 101(28). Essentially, an insider is one with such a relationship with the debtor that their dealings cannot be considered arm’s-length transactions. In the farm situation, a lending institution that is heavily involved in advising, and perhaps even directing, the financially troubled farmer’s operation may face characterization as an insider and become subject to the one-year preference avoidance period.

The fifth, and final, criterion in the characterization of a transfer as a preference is its effect on the status of the creditor. To constitute a voidable

255. Id. § 547(b)(1)-(5) (1982 & Supp. II 1984). The trustee bears the burden of proving the existence of the five factors. Id. § 547(g) (Supp. II 1984).
256. Id. § 547(b)(1) (1982). Transfers to noncreditors are either unobjectionable sales for value or they are gifts or sales for less than adequate consideration, to which fraudulent conveyance law applies.
257. Id. § 547(b)(2). Transfers of the debtor’s property in exchange for new value normally do not prejudice other creditors. In those instances, the debtor transfers property but also gains something of equal or greater value.
258. Id. § 547(b)(3). When the debtor is solvent (see id. § 101(29) (Supp. II 1984)), payment to a given creditor does not normally harm other creditors.
259. Id. § 547(f).
260. Id. § 547(b)(4)(A) (Supp. II 1984).
261. Id. § 547(b)(4)(B). Under the Code, as applicable before the 1984 amendments, the insider also had to have reasonable cause to believe the debtor was insolvent at the time of the transfer. (Id. § 547(b)(4)(B)(ii) (1982), before 1984 amendments). The 1984 amendments eliminated this requirement.
262. Id. § 101(28) (Supp. II 1984). If the debtor is an individual, the definition of insider includes a relative of the debtor or a general partner of the debtor; a partnership in which the debtor is a general partner; a general partner of the debtor; or a corporation of which the debtor is a director, officer, or person in control. Id. § 101(28)(A). Subsections (B) and (C) define insider for corporate and partnership debtors. A managing agent of the debtor is also an insider. Id. § 101(28)(F).
preference, the transfer must have enabled the creditor to receive more than that creditor would have received if the transfer had not been made, the debtor’s estate were liquidated under Chapter 7, and the creditor received payment of the debt under the provisions of the Code.\textsuperscript{265} A creditor who receives no more than he would have received in Chapter 7 has not been favored at the expense of the other creditors. Thus it is unnecessary for the trustee to avoid the transfer to protect other creditors and the estate.

Having set forth the criteria for avoidable preferences, the Code then lists transfers that cannot be avoided as preferences under section 547.\textsuperscript{266} The first exception is not an exception at all but merely restates the rule. Transfers for new value are not voidable.\textsuperscript{267} Such exchanges for new value do not decrease the value of the estate, nor do they injure other creditors. The second exception is intended to permit the debtor to carry on normal business activities. Ordinary credit transactions, such as purchases of fuel and feed, are treated as if they were exchanges for new value. Payment of these debts incurred in the ordinary course of business or financial affairs is not voidable if made according to ordinary business terms.\textsuperscript{268}

The third exception is for a security interest granted in exchange for an enabling loan (that is, a purchase money security interest). The loan must be given at or after the signing of the security agreement and must in fact be used by the debtor to acquire the collateral. The security interest must be perfected no more than ten days after the debtor receives possession of the property.\textsuperscript{269} The fourth exception is for a transfer to a creditor, but only to the extent that the creditor thereafter replenishes the estate. Such a creditor normally receives a preference and then extends credit (new value) to the debtor. The new value given must not be secured by an otherwise unavoidable security interest. The amount of the unsecured new value is offset against the preference amount, and the trustee can avoid only the difference.\textsuperscript{270}

\begin{itemize}
\item 267. Id. § 547(c)(1) (1982). The transfer must be part of a substantially contemporaneous exchange. Id. § 547(c)(1)(b). One court has held that an exchange is not substantially contemporaneous when there is a two-month gap between the extension of credit and perfection of the security interest that secures the loan. Independence Land Title Corp. v. National Bank & Trust Co. (\textit{In re} Independence Land Title Corp.), 9 Bankr. 394 (Bankr. N.D. Ill. 1981).
\item 268. 11 U.S.C. § 547(c)(2) (Supp. II 1984). Prior to the 1984 Code amendments, these payments had to be made not later than forty-five days after the debt was incurred. The 45-day requirement no longer applies. Payment must be made “according to ordinary business terms.” Id. § 547(c)(2)(C).
\item 269. Id. § 547(c)(3). For example, suppose that on April 1, farmer borrows $30,000 from creditor to buy a new tractor and signs a valid security agreement describing the tractor. Soon after, creditor files a financing statement to perfect the security interest. On April 20, farmer buys the tractor with the $30,000. On May 1, farmer files a bankruptcy petition. This transaction meets the requirements for an enabling loan under section 547(c)(3), and the trustee cannot avoid creditor’s security interest, even though it was perfected within ninety days of bankruptcy.
\item 270. Id. § 547(c)(4) (1982). For example, assume that on July 1, creditor advances debtor $25,000. On July 20, debtor becomes insolvent. On August 1, debtor repays the $25,000 to creditor. On September 1, creditor makes another advance of $15,000, which is totally unsecured. On
\end{itemize}
The fifth exception protects secured creditors with a "floating lien" in inventory or a receivable, or their proceeds. Under a floating lien, individual units of collateral are substituted on an ongoing basis. This exception protects secured creditors whose security interests in inventory or accounts includes after-acquired property pursuant to section 9-204 of the Uniform Commercial Code. As used in section 547, inventory includes "farm products such as crops or livestock, held for sale or lease." Without this exception, the substitution of inventory or accounts could be characterized as a preferential transfer. This exception applies to secured creditors with floating liens in inventory or accounts who do not improve their position within the ninety days preceding bankruptcy. To determine if the creditor has improved his position, it is necessary to analyze the creditor's position at two points: ninety days before the date of the filing of the bankruptcy petition and on the date of bankruptcy. If the creditor improves his position, a voidable preference has occurred to the extent that the deficiency of the collateral to pay the outstanding loan is less at bankruptcy than it was ninety days before the bankruptcy. In addition, the decrease in the deficiency must be prejudicial to unsecured creditors.

Section 547(c) includes two further transfers that are not avoidable preferences. The fixing of a statutory lien that is not avoidable under section 545 is not considered a preference. In addition, the 1984 Code amendments added a new exception. When an individual debtor with primarily consumer debts files bankruptcy, a transfer is not an avoidable preference when "the aggregate value of all property that constitutes or is affected by such transfer is less than $600."
The "floating lien" exception in section 547 may raise some issues when a creditor has a security interest in the farmer's crops or livestock.\(^{278}\) The nature of such agricultural collateral makes it entirely possible that the value of the collateral will increase between the ninetieth day before bankruptcy and the date of bankruptcy, thereby reducing the creditor's deficiency.\(^{279}\) These changes arise from two related situations: increases in market value of the agricultural commodity and natural increases in the commodities themselves.

The question of an increase in value may arise when crops subject to a perfected security interest are harvested within the ninety-day period preceding bankruptcy, or when market fluctuations increase the value of those crops. Agricultural lenders hesitate to assign specific value to crops still in the field. Thus the dramatic increase in value at harvest, it might be argued, improves the secured creditor's position and is a voidable preference. At least one commentator has argued vigorously against this interpretation.\(^{280}\) Although the creditor's position has been improved, there has been no "transfer" as required by section 547(a) because the debtor has made no disposition of the property.\(^{281}\) Moreover, no prejudice to general creditors has occurred,\(^{282}\) and no bankruptcy policies have been contravened. It is difficult to imagine that the increase in crop value that occurs at harvest is the type of improvement in position that Congress intended the trustee to recover for the benefit of general creditors.

This analysis was supported by a recent decision, \textit{In re Nivens},\(^{283}\) in which the trustee had alleged that the increase in value of crops constituted a preferential transfer. The bankruptcy court rejected this argument and recognized the unique nature of crops as inventory. Although the crops normally increase in value between their embryonic stages and maturity, a security interest represents the same lien on the same crop.\(^{284}\) The court noted that "if there is only an increase in value of the inventory due to market fluctuations, without an accompanying increase in volume of inventory, there is no avoidable preference."\(^{285}\)

The question of a natural increase in the collateral may also be relevant in a farm bankruptcy. For example, livestock subject to a security interest may continue to breed without regard for the bankruptcy preference period. The increase in number of animals will result in enhanced value and support

\(^{278}\) These constitute inventory under \textit{id.} \$ 547(a)(1) (1982).

\(^{279}\) \textit{id.} \$ 547(c)(5) (Supp. II 1984).


\(^{282}\) This presumption, of course, ignores the cost of harvest. On the formula for ascertaining whether general creditors have suffered prejudice, see Professor Kripke's remarks quoted in 1 \textit{REPORT OF THE COMM'N ON THE BANKRUPTCY LAWS OF THE UNITED STATES}, H.R. Doc. No. 137, 93d Cong., 1st Sess. 210 (1973).

\(^{283}\) (First State Bank v. Holder), 22 Bankr. 287 (Bankr. N.D. Tex. 1982).

\(^{284}\) \textit{id.} at 293.

\(^{285}\) \textit{id.}
the argument that the secured creditor's position has improved. In re Fairchild,286 which involved a creditor's security interest in hogs, addressed this issue. Pigs were born during the bankruptcy preference period, enhancing the value of the lender's collateral. In addition, the hogs' value increased as they continued to eat and grew closer to market weight. In this situation, the court recognized, no transfer resulted. It was "the very nature of the collateral to increase in value."287 Indeed, the terms of the credit arrangement are likely to anticipate this natural increase in value, for example, by including progeny as collateral.

Section 549—Postpetition Transfers

The above discussion of avoiding powers has focused on transfers made prior to bankruptcy. In some instances, however, the debtor's property may have been transferred, by the debtor or another entity, after the initiation of bankruptcy. The Code gives the trustee the power to avoid certain of these postpetition transfers. Section 549 permits the trustee to avoid transfers of property of the estate that occur after the commencement of the case, if those transfers are not authorized by the Code.288 In addition, the trustee can avoid postpetition transfers of estate property that are authorized only by section 303(f) or section 542(c) of the Code.289 But special protection is granted to section 303(f) creditors.

Section 303(f), which applies in involuntary cases, could be of special relevance to a farmer. If creditors file an involuntary petition against a farm debtor, who must establish his status as a farmer to defeat the involuntary petition, the debtor will be concerned with his ability to control his operation until the order for relief is granted or denied. Section 303(f) gives a debtor in this situation the authority needed to continue to control his operation free of any restrictions.290 Creditors would refuse to deal with such a farmer, if any transactions authorized by section 303(f) could be avoided by section 549(a). Thus section 549(b) provides for protection of section 303(f) transactions that occur after the case is filed but before any order for relief, to the extent they are made for fair postpetition value.291 Without section 549(b) protection for creditors, the capacity of the farmer to challenge an involuntary petition would be severely reduced.

The trustee can also avoid postpetition transfers authorized by section 542(c). Section 542(c) allows an entity with no actual knowledge or notice of the com-

290. "Notwithstanding section 363 [dealing with use, sale, or lease of property], ... the debtor may continue to use, acquire, or dispose of property as if an involuntary case concerning the debtor had not been commenced." Id. § 303(f) (1982).
291. "To the extent any value, including services, but not including satisfaction or securing of a debt that arose before the commencement of the case, is given ... in exchange for such transfer." Id. § 549(b) (1982).

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mencement of a case involving the debtor to transfer property of the estate or pay a debt owed to the debtor to another entity besides the trustee without incurring any liability to the estate. Although under section 542(c) the transferor is not liable, section 549(a) permits the trustee to hold the transferee liable for what he has received.

The Code also places limits on the trustee's power under section 549(a) to avoid postpetition transfers of real property. The trustee may not avoid a transfer of real estate to a good faith purchaser without knowledge of the commencement of the case and for present fair equivalent value, or to a purchaser at a judicial sale of real property located outside the county in which the case is commenced. These transfers may be avoided, however, if a copy of the bankruptcy petition is filed in the recording office of the county where the real property is located before the transfer is perfected as against a bona fide purchaser. In addition, if the trustee avoids a transfer simply because the transfer was for less than present fair equivalent value, the good faith purchaser without knowledge of the commencement of the case has a lien on the property to the extent of any present value given, unless a copy of the petition was filed before the transfer was perfected.

Section 553—Setoffs

As a general rule, the Code does not affect any right of a creditor to offset a mutual debt as long as both the debt and the credit arose before the commencement of the case. Of course, the right of the creditor to use the setoff is stayed under section 362 when a bankruptcy petition is filed. Although the trustee normally cannot recover or avoid a setoff, some requirements qualify the right to setoff. First, the creditor's claim must be allowable. Second, the claim must not have been transferred to the creditor (by someone other than the debtor) after the commencement of the case, or within ninety days before the date of the filing of the petition while the debtor was insolvent. Finally, the debt owed to the debtor must not have been incurred by the creditor within ninety days before the date of the filing of the petition, while the debtor was insolvent, and for the purpose of obtaining a right of setoff against the debtor. These requirements prevent the creditor, who off-

294. Id.
295. Id. § 553(a) (Supp. II 1984). In Framingham Winery, Inc. v. J.A.G., Inc. (In re J.A.G., Inc.), 7 Bankr. 624 (Bankr. D. Mass. 1980), the court held that when the creditor's liability to pay rent to the debtor did not accrue until after the bankruptcy petition was filed, the mutuality of obligation at the time of filing necessary for setoff did not exist.
296. 11 U.S.C. § 362(a)(7) (Supp. II 1984). See id. § 506(a), regarding the creditor's secured claim to the extent of the amount subject to setoff.
297. Id. § 553(a) (Supp. II 1984).
298. Id. § 553(a)(1).
299. Id. § 553(a)(2) (1982).
300. Id. § 553(a)(3).
sets a debt from eluding preference law. A debtor is presumed to be insolvent during the ninety days preceding bankruptcy.301

The trustee has the power to avoid a setoff that occurred on or within ninety days before bankruptcy, to the extent that the creditor improved his position because of the setoff.302 The two relevant dates for the analysis of the creditor’s position are the ninetieth day before bankruptcy and the date of the setoff.303 This power to recover from the creditor is similar to the trustee’s power to avoid a floating lien preference under section 547(c)(5).

Section 546(c)—The Seller’s Right of Reclamation

In section 546, the Code places some limits on the trustee’s avoiding powers. One limitation relevant in a farm bankruptcy is found in section 546(c). Pursuant to section 2-702 of the Uniform Commercial Code, the seller has the right to reclaim goods sold to an insolvent debtor within 10 days of the debtor’s receipt of the goods.304 Under section 546(c) this statutory right of reclamation enjoys some protection from the trustee’s avoiding powers.305 Generally, the trustee cannot avoid any transfer made under the seller’s right of reclamation by using powers under section 544(a) (the strong-arm clause), section 545 (statutory liens), section 547 (preferential transfers), or section 549 (postpetition transfers).306 For a seller to exercise the right of reclamation, however, the sale must be in the ordinary course of the seller’s business, and the seller must demand reclamation in writing within ten days after the debtor’s receipt of the goods.307 The court may deny actual reclamation of the goods, but must grant the seller an administrative expense priority or secure the seller’s claim with a lien.308

Section 550—Liability of Transferees of Avoided Transfers

As the above discussion has indicated, the trustee (or the debtor in possession) has broad authority to avoid many types of prebankruptcy and postpetition transfers of property of the debtor or the estate. Section 550 of the Code is essential to the successful application of the avoiding powers because it authorizes the trustee to recover property for the benefit of the estate from

301. Id. § 553(c).
302. Id. § 553(b)(1) (Supp. II 1984).
303. Id.
307. Id.
308. Id. § 546(c)(2). See id. § 503(b) (1982 & Supp. II 1984). Section 546(c) does not alter a trustee’s power under section 544(b) to avoid a transfer made through a seller’s reclamation. Thus the trustee could still avoid a reclamation voidable under state law by a general unsecured creditor.
transferees. The trustee may recover the property transferred (or on court order, the value of the property) from the initial transferee or from the entity for whose benefit the transfer was made. Alternatively, the trustee may recover from any immediate or successive transferee of the initial transferee, but not if that transferee takes for value (including satisfaction or securing of a present or antecedent debt), in good faith, and without knowledge of the voidability of the transfer avoided. If the trustee recovers from a good faith transferee, that transferee receives a lien on the property. The lien secures the lesser of the cost of any improvements made after transfer decreased by the amount of any profit realized from the property, and any increases in value of the transferred property as a result of the improvement. The trustee who recovers transferred property is only entitled to a single satisfaction.

Section 550 and an interrelated provision, in section 522(g), could be crucial if the debtor is to receive all the exemptions to which he is entitled. For example, a trustee in a Chapter 7 liquidation case might want to include all the property recovered through the avoiding powers in the assets to be distributed to creditors, even though some of the property may also qualify for an exemption. But section 522(g) allows a debtor to exempt property that the trustee has recovered under various sections, including property recovered under section 550, if the debtor did not voluntarily transfer the property and if the debtor did not conceal the transfer. Because section 550 includes property recovered under most of the trustee’s avoiding powers, the debtor has power to claim as exempt the property recovered for the estate from avoided transfers.

In addition, if the trustee does not attempt to avoid a transfer recoverable under sections 544, 545, 547, 548, 549, or 553 regarding setoffs, the debtor himself can avoid the transfer to the extent that he could exempt that property. In some instances, a trustee might be reluctant to exercise the power to recover an avoidable transfer if the transfer involved exempt property that would not augment the estate. Under section 522(h), the debtor has the power to avoid the transfer and recover the exempt property.

III. Chapter 7: Liquidation

A farmer whose financial condition leaves no choice other than liquidation

309. Id. § 550(a) (1982 & Supp. II 1984). The power applies to transfers avoided under sections 544, 545, 547, 548, 549, 553(b), or 724(a).
310. Id. § 550(a)(1).
311. Id. §§ 550(a)(2) and 550(b)(1). Under section 550(b)(2), the trustee cannot recover from an immediate or mediate good faith transferee of the subsection (a)(2) transferee.
313. Id. § 550(d)(1) (Supp. II 1984).
314. Id. § 550(c) (1982).
315. Id. § 522(g). Also included is property recovered under sections 510(c)(2), 542, 543, 551, and 553.
316. Id. § 522(h).
of the farm business will use Chapter 7 of the Bankruptcy Code. This Chapter is appropriate for the farmer who can negotiate no further with creditors and who faces personal property repossessions, mortgage foreclosures, and judicial actions seeking judgments on debts. Ultimately, these often lengthy and complex proceedings may liquidate the farmer's operation. But even after his property is gone, the farmer may remain liable on judgments that he does not have the assets to satisfy. Thus the farmer may look at Chapter 7 because most debts remaining after the proceeds of the estate are distributed will be discharged.\textsuperscript{317}

Chapter 7 proceedings are relatively quick and efficient, because the various claims against the debtor are resolved in a single forum. Moreover, despite their adverse interests, creditors generally benefit from the orderly procedure of bankruptcy, which frees creditors from the need to act hastily and aggressively to foreclose or collect ahead of other creditors. A Chapter 7 bankruptcy may benefit the secured creditor in particular because it offers protection from self-help measures taken by unsecured creditors or by secured creditors with conflicting liens. In addition, the bankruptcy proceeding may offer a more efficient and less expensive forum in which to pursue a secured claim.

\textit{The Farm Debtor's Role in Chapter 7}

A farmer commences a case under Chapter 7 by filing a voluntary petition\textsuperscript{318} and paying a filing fee of $60.\textsuperscript{319} A farmer who has initiated a case under Chapter 7 is not bound to liquidate. Instead, the debtor maintains the right to convert the case to a Chapter 11 or Chapter 13 proceeding at any time.\textsuperscript{320}

The debtor's role in a Chapter 7 liquidation is rather limited. Section 521 of the Code lists five duties of Chapter 7 debtors. First, the debtor must file a list of creditors; unless otherwise ordered, there must also be a schedule of assets and liabilities, a schedule of current income and expenses, and a statement of financial affairs.\textsuperscript{321} Second, the debtor who has consumer debts secured by property of the estate has special responsibilities to indicate his intentions regarding retention or surrender of the property, exemption and redemption, or reaffirmation of the debts secured by the property. The debtor must indicate these intentions within thirty days of the bankruptcy petition, or by the date of the meeting of creditors, whichever is earlier, and perform

\textsuperscript{317} See \textit{supra} text accompanying notes 44-54.

\textsuperscript{318} 11 U.S.C. § 301 (1982).


\textsuperscript{320} 11 U.S.C. § 706(a) (1982). A debtor who discovers that discharge is not available under Chapter 7 may want to convert to Chapter 11 or Chapter 13. See \textit{infra} text accompanying notes 381-628 and 629-676 on Chapters 11 and 13. But the debtor has only one chance to convert the case. A case already converted to Chapter 7 under sections 1112 or 1307 cannot be reconverted. \textit{Id.} § 706(a).

the intentions within forty-five days after the notice of intent.\textsuperscript{322} Third, the
debtor must cooperate with the trustee as necessary to enable the trustee to
perform his duties.\textsuperscript{323} Fourth, the debtor must surrender to the trustee all
property of his estate and any recorded information (books, documents,
records, and papers) relating to property of the estate.\textsuperscript{324} Fifth, the debtor
must appear at the discharge hearing required under section 524(d).\textsuperscript{325}

In addition, pursuant to section 343, the debtor must appear and be
examined under oath at the meeting of creditors prescribed by section 341(a).\textsuperscript{326}
Attendance at this meeting is restricted. The bankruptcy judge is not per-
mitted to preside over, or even attend, the meeting of creditors.\textsuperscript{327} This provi-
sion ensures the impartiality of the judge, who may later be asked to resolve
objections to discharge that arose at the meeting.\textsuperscript{328} The scope of the examina-
tion at the meeting of creditors includes all questions relating to the financial
affairs of the debtor.\textsuperscript{329} The debtor who invokes the privilege against self-
incrimination at the meeting can receive use immunity.\textsuperscript{330}

Assuming that no objections to discharge are sustained, the debtor will
receive a discharge sixty days after the section 341 meeting.\textsuperscript{331} For most pur-
poses, this is the end of the case for the debtor. The debtor will have sur-
rrendered his property to the trustee, exempt property will have been set apart
for the debtor, and the property of the estate will be available for distribu-

\textsuperscript{323} Id. § 521(3).
\textsuperscript{324} Id. § 521(4). The debtor must surrender the property regardless of whether he receives
use immunity under section 344 of the Code.
\textsuperscript{325} Id. § 521(5).
\textsuperscript{326} Id. § 343 (Supp. II 1984). The meeting of creditors must be held a reasonable time after
an order for relief in a case. Id. § 341 (1982). In a voluntary bankruptcy, the order for relief
is automatic upon the commencement of the case. The section 341(a) requirement of a meeting
of creditors also applies to cases filed under Chapters 11 and 13.
The bankruptcy court may also order a meeting of all equity security holders. Id. § 341(b).
Section 101(15) (1982) defines an equity security as:

(A) share in a corporation, whether or not transferable or denominated "stock,"
or similar security;
(B) interest of a limited partner in a limited partnership; or
(C) warrant or right, other than a right to convert, to purchase, sell, or subscribe
to a share, security, or interest of a kind specified in subparagraph (A) or (B) of
this paragraph; . . .
An "equity security holder" is the "holder of an equity security of the debtor." Id. § 101(16).
\textsuperscript{327} Id. § 341(c).
\textsuperscript{328} Aaron, supra note 32, at 226.
\textsuperscript{329} Id.
The issue of use immunity arises most frequently in bankruptcy because of the debtor's refusal
to file the required schedules. 2 COLLIER ON BANKRUPTCY ¶ 344.03[1] (L. King, 15th ed. 1979).
The debtor, for example, may have refused to file the required schedules because he fraudulently
concealed property prior to bankruptcy. The bankruptcy court must decide whether the debtor
has reasonable grounds to believe that his answer may incriminate him. Id. ¶ 344.03[1].
\textsuperscript{331} Bankr. Rule 4004(a) and (c). On discharge, see supra text accompanying notes 44-46.
tion to creditors. The debtor may receive a discharge even before property is distributed to the creditors.

Although a discharge is generally available to the individual debtor, a debtor may not desire the discharge of a debt. The farmer who believes that a particular creditor will be essential to his fresh start after bankruptcy may want to cultivate the good will of that creditor. In addition, the farmer may not want the discharge of a debt to a relative or a debt on which a friend or relative is a cosigner. To accommodate these situations, the Code permits debtors to reaffirm their debts under certain circumstances. Any agreement to reaffirm a debt must be entered before the discharge is granted. Furthermore, the debtor may rescind the reaffirmation agreement within sixty days or any time before discharge. The attorney representing the debtor must declare that the debtor's agreement was voluntary, based on full disclosure, and that it does not impose undue hardship on the debtor or a dependent.

When the debtor is an individual, the Code offers special protection against hasty reaffirmation. The court must hold a hearing regarding the discharge, and the debtor must appear. At this hearing, the court informs the debtor why the discharge has been granted or denied. If the debtor wants to enter into a reaffirmation agreement, the judge must inform the debtor that reaffirmation agreements are not required under bankruptcy or nonbankruptcy law, and must explain the legal effect and consequences of both the agreement and default. If the individual debtor was not represented by an attorney during negotiation of a reaffirmation agreement and the debt being reaffirmed is not secured by real property, additional protection is mandated. The court must approve the agreement as being in the best interest of the debtor and not imposing undue hardship on the debtor or a dependent.

The Creditors and the Trustee in Chapter 7

Immediately after the farmer has filed a Chapter 7 petition, the court appoints an interim trustee, who serves until election of the permanent trustee. The creditors have the authority to elect a permanent trustee at the meeting held pursuant to section 341 of the Code. The creditors may elect any individual to serve as trustee in the farmer's case, as long as the

332. See infra text accompanying notes 360-379.
334. Id. § 524(c)(2).
335. Id. § 524(c)(3).
337. Id.
338. Id. § 524(d)(1).
339. Id. §§ 524(c)(6), (d)(2). The 1984 Bankruptcy Code amendments made it somewhat easier for creditors to get reaffirmation agreements from consumers. See id. §§ 524(c) and (d) (1982) (preamendment).
340. Id. §§ 701(a), (b) (1982).
elected individual is qualified and bonded. If the creditors fail to elect a trustee, the interim trustee appointed by the court will serve for the duration of the case.

The trustee plays an extremely important part in a Chapter 7 liquidation. The trustee is the official representative of the debtor’s estate. As such, the trustee collects and reduces to money the assets of the estate; he must close the estate expeditiously, but with consideration for the best interests of the parties. The trustee must account for all property received and investigate the financial affairs of the debtor. Additional duties may include examining proof of claims and, if any purpose would be served, objecting to the allowance of any improper claim. The trustee may also oppose the discharge of the debtor. Ultimately, the trustee must make a final report and file a final account of the administration of the debtor’s estate with the court.

As the nature of these duties suggests, the trustee’s major responsibility focuses on maximizing the property of the estate for creditors. The interests of the creditors will not always coincide with the best interests of the debtor. Accordingly, the farm debtor must ensure that his interests are represented by his own attorney.

In Chapter 7 cases, the creditors may choose to assume an additional role. At their section 341 meeting the creditors may elect a creditors’ committee, consisting of three to eleven creditors, each holding an allowable unsecured claim of a kind entitled to distribution. This elected committee may consult with the trustee in connection with the administration of the case, make recommendations to the trustee about the performance of his duties, and submit to the court any question that affects administration of the estate.

Naturally, creditors also hope to participate in the ultimate distribution of the Chapter 7 estate. When the Chapter 7 petition is filed, the “automatic stay” prevents secured creditors from proceeding against property subject to liens and unsecured creditors from collecting on their claims. After the debtor

342. Id. § 321. A person who has also served as an examiner in the case is disqualified from serving as trustee. Id. § 321(b) (Supp. II 1984).

A natural person or a corporation may act as trustee. A corporation must be authorized to act as trustee in its charter or bylaws, and must have an office in or adjacent to the district where the case is pending. Id. § 321(a) (1982).

343. Id. § 322 (1982 & Supp. II 1984). The court determines the original amount of bond. A proceeding on a trustee's bond must be commenced within two years after the trustee was discharged.

344. Id. § 702(d) (Supp. II 1984).

345. Id. § 323(a) (1982).

346. Id. § 704(1) (Supp. II 1984).

347. Id. §§ 704(2), (4).

348. Id. § 704(5).

349. Id. § 704(6).

350. Id. § 704(9). See also subsections (3), (7), and (8) for additional duties.


353. See supra text accompanying notes 67-105 for an explanation of the automatic stay.
files a list of creditors pursuant to section 521, notice is sent to those creditors who are listed. An unsecured creditor who wants to participate in the ultimate distribution of the estate must file a proof of claim. Distribution of the assets of the estate is made only to creditors whose claims are allowed. Unless an objection is entered, a claim for which proof has been filed is allowed. If an objection is made, then the court must determine the allowable amount of such claim as of the date of the filing of the petition.

Distribution of the Estate

The heart of a Chapter 7 liquidation is the process by which the trustee distributes proceeds from the sale of the farm debtor’s property (that is, the property of the estate) to creditors with allowed claims. This distribution follows strict statutory guidelines. Moreover, not all property of the estate is available for distribution to creditors. Some property will have been set aside to the debtor as exempt property, and some proceeds of the estate will be used to satisfy administrative expenses of the bankruptcy proceeding.

Creditors who have allowed secured claims are assured of receiving the full value of their claims. Secured claimants are satisfied before the trustee distributes property of the estate to general creditors. A secured claim exists if the creditor has a lien on property of the estate. But a creditor’s claim is secured only to the extent of the value of the creditor’s interest in the property. A creditor may be partially secured if the value of the creditor’s claim exceeds the value of the collateral. In such a case, the creditor has a secured claim to the extent of the value of the collateral and an unsecured claim for the balance. A creditor who has loaned money on farmland at inflated values

356. Id. § 501(a) (1982). The debtor or trustee may file proof of the creditor’s claim, if the creditor does not file it on time. Id. § 501(c).
357. Id. § 726(a)(2).
358. Id. § 502(a) (Supp. II 1984).
359. Id. § 502(b) (Supp. II 1984). Section 502(b)(1)-(8) lists some limitations on allowable claims. Subsection (b)(6) may be particularly relevant in some farm bankruptcies. It limits the size of an allowable claim of a lessor for damages from termination of a lease of real property. Damages are limited to rent reserved for the greater of one year, or 15 percent of the lease term (not exceeding three years). These periods follow the earlier of the filing of the bankruptcy petition or the date on which the lessor repossessed (or the lessee surrendered) the property. In addition, damages may include unpaid rent due under the lease. Id. §§ 502(b)(6)(A), (B).
360. See supra text accompanying notes 130-93.
361. See infra text accompanying note 367.
362. 11 U.S.C. § 506(b) (Supp. II 1984). Moreover, if the value of the collateral exceeds the amount of the claim, the claimant may receive interest, plus reasonable fees, costs, or charges provided for in the loan agreement. Id.
363. Id. § 725.
364. Id. § 506(a) (1982). Under section 506(c), the trustee may recover from the collateral the reasonable, necessary expenses of preserving or disposing of the property, to the extent of the benefit to the holder of the claim. Id. § 506(c).
may be in this situation when the farmer goes bankrupt, particularly if declining farmland values have reduced the value of the collateral below the outstanding balance of the debt owed to that lender.

After setting aside property subject to liens, the trustee distributes the proceeds of the estate in the order prescribed by the Code. In section 726(a), the Code specifies six classes of claimants, including the debtor as the last class. Under this statutory scheme, each class must be paid in full before members of the next class receive any distribution. Moreover, if the property of the estate is insufficient to satisfy an entire class, creditors within the class share in the available property on a pro-rata basis.

The section 726 scheme gives first place to claims specified in section 507. Section 507 establishes the bankruptcy priorities that must be paid before any other unsecured claimants receive proceeds of the estate. Under section 507, first priority is assigned to administrative expenses and fees and charges against the estate. Second priority applies in involuntary cases and has limited relevance in farm bankruptcies. It covers unsecured claims arising in the ordinary course of the debtor’s business after commencement of the case but before the appointment of a trustee or the order for relief, whichever is earlier. Third and fourth priorities focus on the claims of employees. Allowed unsecured claims for wages, salaries, or commissions earned by an individual within ninety days of the filing of the petition (or the cessation of the debtor’s business, if that occurred first) receive priority, up to $2,000 for each

365. Id. § 725 (Supp. II 1984). Under section 552(a) of the Code, property acquired by the estate or the debtor after commencement of the case is not subject to prepetition security interests. Section 552(b) provides an exception to this general rule for security interests extending to proceeds, products, and offspring of prepetition property. On the effect of section 552(b) on milk produced after filing, see Pigeon v. Prod. Credit Ass’n of Minot (In re Pigeon), 49 Bankr. 657 (Bankr. D.N.D. 1985) (milk was newly acquired property). Contra, In re Nielsen, 48 Bankr. 274 (D.N.D. 1984). Pigeon noted that the district court deciding Nielsen did not consider the legislative history of section 552(b).

366. Id. § 726(b) (Supp. II 1984).

367. Subordination may change the order of priorities and may also affect liens. The Code requires enforcement of subordination agreements that are enforceable under nonbankruptcy law. Id. § 510(a) (1982). Moreover, after notice and a hearing, the court may order equitable subordination. The court may subordinate all or part of an allowed claim to all or part of another allowed claim, or may transfer a lien securing a subordinated claim to the estate. Id. § 510(c).

Generally, a showing of fraud or inequitable conduct is required before the court can order equitable subordination. Katz v. Department of Justice (In re Bellucci), 29 Bankr. 814, 815 (Bankr. 1st Cir. 1983). A farm lender that manipulates the farmer’s financial status to its own advantage and to the detriment of other creditors may be vulnerable to a decision subordinating its claims. See In re Osborne, 42 Bankr. 988 (W.D. Wis. 1984), in which a PCA that was an operating lender of a Chapter 7 farm debtor was subordinated to a feed supplier because of its inequitable conduct toward the supplier.


369. See supra text accompanying notes 21-34.

370. 11 U.S.C. §§ 507(a)(2), 502(f) (1982). See also section 502(d), which disallows certain claims from a postpetition transferee subject to sections 549 and 550, unless the transferee has turned over property for which it is liable to the trustee. See supra note 126 and accompanying text.
individual. In addition, allowed unsecured claims for contributions to an employee benefit plan, for services within 180 days of the petition or cessation of business, receive limited priority. The fifth priority under section 507(a) is new, having been added in 1984. It applies when the debtor owns or operates a grain storage facility. Each individual with an allowed unsecured claim for grain or grain proceeds against the debtor has a priority, but only to the extent of $2,000. Sixth priority applies to individuals who have made deposits, of up to $900, for purchase of property or services for personal, family, or household use. The seventh priority focuses on unsecured tax claims of governmental units.

When a farm debtor's property is liquidated under Chapter 7, these priority claims will be paid first under section 726. After the priority claimants are paid in full, general creditors without priority receive payment. Creditors holding allowed unsecured claims that were filed on time receive payment after the section 507(a) priorities. These creditors are followed by the creditors with allowed unsecured claims that were filed late. Next, claims representing fines, penalties, forfeitures, or punitive damages (that is, claims not representing actual pecuniary loss to the creditor) are paid. Next, the trustee may pay postpetition interest on prepetition claims. Finally, if any property remains after all claimants have been paid, the debtor receives the property.

IV. Chapter 11: Reorganization

Every farmer who faces financial difficulty may not view liquidation under Chapter 7 as the only possible option. Those farmers who believe that their operation could survive, given some restructuring of debt and perhaps new management strategies, may prefer to reorganize the farm business using Chapter 11 of the Bankruptcy Code. Chapter 11 involves a number of the concepts already discussed, such as the automatic stay and the power to avoid prebankruptcy transfers. But under Chapter 11, the farmer will generally continue to operate the business as the “debtor in possession.” The Code gives the farmer special opportunities to continue to use the farm property and

372. Id. § 507(a)(4). The priority for each employee benefit plan is limited to the number of employees multiplied by $2,000, less the aggregate amount paid to such employees under section 507(a)(3) and the aggregate amount paid by the estate to any other benefit plan.
373. Id. § 507(a)(5)(A) (Supp. II 1984). Other provisions for grain storage facility bankruptcy have also been added. See id. §§ 546(d), 557.
374. Id. § 507(a)(6).
375. Id. § 507(a)(7).
376. Id. § 726(a)(2) (1982).
377. Id. § 726(a)(3). Bankr. Rule 3002(c) establishes the time limit for proofs of claim in Chapter 7.
378. Id. § 726(a)(4).
379. Id. § 726(a)(5).
380. Id. § 726(a)(6).
381. Id. § 1101(1).
to obtain credit. Ultimately, the goal for the Chapter 11 farm debtor is to devise a workable plan of reorganization that will be confirmed by the creditors and that will allow continued operation of the farm business.\(^{382}\)

The Chapter 11 debtor initiates the bankruptcy proceeding by filing a petition.\(^{383}\) Chapter 11 requires a filing fee of $200.\(^{384}\) The farmer who has filed under Chapter 11 has specific duties to perform. These, which have already been discussed in connection with Chapter 7,\(^{385}\) are listed in section 521 of the Code. In addition, the farmer must attend the meeting of creditors prescribed by section 341. The significant role of the creditors in a Chapter 11 case will be discussed below in connection with the reorganization plan.\(^{386}\)

Normally, the debtor remains in control and possession of his farming operation throughout the Chapter 11 proceeding. A trustee need not be appointed. Indeed, the debtor in possession exercises most of the powers of the trustee.\(^{387}\) Nonetheless, at the request of a party in interest, the court may appoint a trustee who can operate the debtor's farm.\(^{388}\) Fraud, dishonesty, incompetence, or gross mismanagement of the debtor's affairs will justify appointment.\(^{389}\) In addition, the court can appoint a trustee if appointment is in the interest of creditors, equity security holders, or other interests of the estate.\(^{390}\) If a trustee is not appointed, the court also has the authority to appoint an examiner to investigate the debtor.\(^{391}\) The appointment of a trustee does not signal the debtor's permanent loss of control of his operation. At any time before confirmation of a plan, the court may terminate the trustee's appointment and restore the debtor to possession and management of the estate property and operation of the farm business.\(^{392}\)

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\(^{385}\) See supra text accompanying notes 321-326.

\(^{386}\) See infra text accompanying notes 567-584.


\(^{388}\) Id. § 1108.


\(^{392}\) Id. § 1105 (Supp. II 1984). In the case of In re Curlew Valley Assocs., 14 Bankr. 506 (Bankr. D. Utah 1981), the court refused to use its powers under sections 1105 and 1108 to interfere with the trustee's operation of the debtor's farm. The debtor, an agribusiness, owned a 24,000-acre farm in northern Utah and southern Idaho. The farm's principal crops were alfalfa, hay, alfalfa seed, barley, and wheat. The trustee decided to substitute hay baling for hay cubing. The debtor objected, arguing that baling was an agronomically unsound method that would result in a $500,000 loss of crop proceeds, and would defeat the debtor's opportunity to confirm a
The Interim Period

Although the ultimate goal of Chapter 11 is the confirmation and successful completion of a reorganization plan, the debtor will normally continue to operate the farm business during the time after the petition is filed and before the plan is negotiated and confirmed. During this interim period, the debtor needs protection from aggressive creditors, authority to use property of the estate, and aid in obtaining the credit necessary to continue farming.

Section 363—Use, Sale, or Lease of Property of the Estate

Use of Estate Property

When the debtor files a bankruptcy petition, section 362 operates to impose an automatic stay on creditors' efforts to collect on their claims. But that section does no more than stay creditors; it does not authorize the debtor to continue to use the encumbered property that makes up the estate. The debtor in possession does, however, have authority to continue to operate the farm business. Moreover, section 363(c)(1) gives the debtor in possession the power to use the property of the estate in the ordinary course of business without notice or a hearing. In addition, the debtor in possession has the power to sell or lease property of the estate, in the ordinary course of business, without notice or a hearing.

Thus, under section 363(c), the farmer in Chapter 11 will be able to use his tractor for spring planting, even though the tractor is subject to a perfected security interest and despite the fact that each hour of use will reduce the value of the tractor as collateral. The Code, however, provides two different mechanisms by which the creditor can protect himself in this situation. The plan based on cubing. The debtor sought an injunction under section 1108 against the trustee's substitution of hay baling for hay cubing; in the alternative, the debtor requested under section 1105 that the court terminate the trustee's appointment and restore the debtor to operation of the farm.

The court denied relief. First, the court held that under section 1108, "[T]he court will not entertain objections to a trustee's conduct of the estate where that conduct involves a business judgment made in good faith, upon a reasonable basis, and within the scope of his authority under the Code." 14 Bankr. at 513-14. The court went on to hold that it would not terminate the trustee's appointment under section 1105 because the debtor did not allege either that the appointment of the trustee was improvident in light of evidence that was unavailable earlier, or that a change in circumstances (such as fraud or mismanagement) required the trustee's termination.

Farm debtors who want to control the operation of their farms should make every effort to manage their farms carefully so as to avoid the appointment of a trustee. As this case demonstrates, even on appointed, the trustee has extremely wide latitude in the operation of the farm.

393. See supra text accompanying notes 67-105.
395. Id. § 363(c)(1) (1982).
396. Id.
protection is not automatic; the creditor must take affirmative steps to receive protection.

Section 363(d) states that the right to use, sell, or lease property of the estate exists only to the extent that it is not inconsistent with any relief that the court gives from the automatic stay.\(^{398}\) Thus, a creditor can seek relief from the automatic stay under section 362.\(^{399}\) As earlier discussion has indicated,\(^{400}\) a creditor may obtain relief from the stay if the creditor lacks adequate protection of his position, as defined in section 361.\(^{401}\) If the court lifts the stay, the creditor can foreclose against the collateral (in the example above, the tractor), removing it from the use of the debtor in possession.

The creditor can also invoke section 363(e), which provides that the court can prohibit or condition the use, sale, or lease or property of the estate as necessary to provide adequate protection of the creditor's interest.\(^{402}\) The trustee (or debtor in possession) has the burden of proving that the creditor's interest is adequately protected.\(^{403}\) The creditor's interest in the collateral, rather than the collateral itself, must be adequately protected. If the court denies the creditor's request to prohibit or condition the use of the collateral, and the protection offered proves to be inadequate, the creditor may receive special priority for his claim.\(^{404}\)

**Cash Collateral**

An exception to the trustee's power to use, sell, or lease property in the ordinary course of business is made for "cash collateral." This is defined broadly to include cash, as well as proceeds, products, or offspring of property subject to a security interest.\(^{405}\) The debtor in possession (or the trustee) may not use, sell, or lease cash collateral in the ordinary course of business unless each entity with an interest in the cash collateral consents. Alternatively, cash collateral can be used if the court, after notice and a hearing, authorizes the use, sale, or lease in accordance with the adequate protection provisions of section 363(e).\(^{406}\) Until the debtor in possession (or the trustee) receives consent or authorization, he must segregate and account for any cash collateral in his possession, custody, or control.\(^{407}\) Accordingly, a farm debtor

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398. **Id.** § 363(d) (1982). This section refers to relief granted under sections 362(c), (d), (e), or (f).
400. Adequate protection is discussed more fully **supra** in text accompanying notes 94-105.
402. **Id.** § 363(e) (Supp. II 1984).
403. **Id.** § 363(g)(1).
404. **Id.** § 507(b) (1982). This priority, although not as advantageous to a creditor as being secured, at least places the objecting creditor ahead of all other unsecured claims. Upon liquidation, there may not be anything to distribute to unsecured creditors of any type, in which case the creditor would have completely lost his collateral.
405. Cash collateral means "cash, negotiable instruments, documents of title, securities, deposit accounts, or other cash equivalents whenever acquired in which the estate and an entity other than the estate have an interest and includes the proceeds, products, offspring, rents, or profits of property subject to a security interest." **Id.** § 363(a) (Supp. II 1984).
406. **Id.** § 363(c)(2) (1982).
407. **Id.** § 363(c)(4).
in possession must be extremely careful to identify property that is cash collateral. Cash collateral in the hands of the farmer might include proceeds of milk, eggs, or livestock for slaughter sold in the ordinary course of business, warehouse receipts for stored grain, or grain stored on the farm but subject to a security interest. The farm debtor’s use of cash collateral without either the secured creditor’s consent or court authorization may constitute grounds for court appointment of a trustee.408

Nonetheless, farmers who file bankruptcy in the middle of a crop year usually face bleak prospects of financing future crops. Such a farmer must often secure either the crop lender’s consent or court authorization to retain proceeds derived from present crops for use in financing future crops.409 To satisfy the section 363(e) requirement of adequate protection, a farmer might want to offer the crop creditors a lien on crops produced in future years, until the original crop loan is paid in full.410 In this case, the debtor will assert that the crop lender will receive adequate protection in the form of a lien on any crops produced from the use of the cash collateral. In addressing applications for the use of cash collateral, the court must balance two often “irreconcilable and conflicting interests.”411 The crop lender wants to be paid back, or at the very least, to receive adequate protection of his interest in the crop proceeds. But the purpose of Chapter 11 is to rehabilitate debtors.412

Often access to cash collateral is essential for the continued operation of the farm business. Therefore, the court must implement a “policy of balancing the competing interests of a debtor who proposes to use secured property to contribute to the reorganization plan on the one hand, and the creditor who wishes to retain the value and safety of its security interest on the other.”413

408. See id. § 1104(a).
409. Anderson & Rainach, supra note 382, at 476.
410. See, e.g., In re Thompson, 5 Bankr. 667 (Bankr. D.S.D. 1980). The debtor was a beekeeper, and the creditor had a perfected security interest in the debtor’s honey crop. By agreement of the parties, the debtor sold the honey and placed the money in escrow. The court had allowed the debtor, under section 363(c)(2)(B), to use the cash to purchase bees and beehives, determining that the transfer of the creditor’s security interest to the property purchased by the debtor and the debtor’s 1980 and 1981 honey crops provided the debtor with adequate protection.

The creditor then sought a stay of the court’s order, pending appeal. The court denied the creditor’s request, again finding that the transfer of collateral provided the creditor with adequate protection. It reasoned that:

Debtor’s sole business is as a beekeeper. Debtor has no realistic chance of rehabilitation without being allowed to purchase more bees and beehives. If this Court stayed execution of its Order until the completion of the appeal, the effect on the Debtor would probably result in Debtor having to convert to a liquidation bankruptcy. Debtor cannot economically survive while litigation on this matter continues for several months or years.

5 Bankr. at 668.
Recent cases suggest that it may be difficult for the debtor in possession to provide adequate protection for the creditor, particularly when the debtor proposes to use a lien on future crops to provide the protection. Although section 361 defines adequate protection for purposes of both section 363 and section 362, reported decisions reflect an important difference.414 Under section 363, collateral is being consumed or used up, whereas in the context of section 362 the creditor's use of the collateral is merely delayed. Therefore, the standard for adequate protection under section 363 is strict.415 In some instances, replacement liens in land or other minimally depreciable assets would be acceptable.416 The creditor must be protected against depreciation in the value of farmland and farm equipment used as collateral.417 A number of decisions indicate that "a lien in future crops is not in and of itself adequate protection."418 A replacement lien in livestock to be purchased is slightly more acceptable, but will not always suffice.419

The issue as to adequate protection is a different one in a § 362 motion to lift the automatic stay. If the stay is not lifted, the creditor still has a security interest in the bargained for and existing collateral. If the automatic stay is lifted, the creditor receives the collateral itself. In a cash collateral hearing under § 363, if the Debtor is allowed to use the cash collateral, the creditor's security—the collateral—is gone. No longer does the secured party have the asset it originally bargained for as collateral available to it. If the use of cash collateral is denied, the secured party has the collateral, or its cash equivalent, in hand or being held for its benefit. In other words, in an automatic stay situation, the creditor does not lose its collateral; its possession of the collateral is merely delayed. In an 11 U.S.C. § 363 Motion, the collateral is actually used up.


417. In re Polzin, 49 Bankr. 370 (Bankr. D. Minn. 1985). Polzin also suggests that adequate protection includes providing for the direct costs of foreclosure.

418. In re Serbus, 48 Bankr. 5, 9 (Bankr. D. Minn. 1984); In re Schaller, 27 Bankr. 959 (W.D. Wis. 1983). See also First Bank of Miller v. Wieseler (In re Wieseler), 45 Bankr. 871, 876 (D.S.D. 1985): "The uncertainties of the weather, crop prices, and all the other uncertainties inherent in farming increase the insecurity of a replacement lien solely in crops to be grown."

In Wieseler, the lack of irrigation made the replacement lien in future crops even less acceptable. 45 Bankr. at 877 n.5. But see In re Sheehan, 38 Bankr. 859, 866 (Bankr. D.S.D. 1984) (the irrigation system was a proven system that had been operating at least three years).

419. In re Serbus, 48 Bankr. 5, 6, 9 (Bankr. D. Minn. 1984), involved the offer of a replacement lien in cattle, which did provide adequate protection. The bank had an interest in the debtor's dairy herd (as well as in some cash resulting from the sale of cows), and crops growing on the debtor's home farm. The debtor wanted to use the cash and to sell some other cows; as adequate protection, he offered the bank a replacement lien in the cows he would purchase. The value of the cows ($24,000) plus the 1984 crop ($10,500) exceeded the debt owed to the bank ($22,230.19). The bank had an equity cushion and was adequately protected by the existing crop and the replacement lien. But the court refused to permit the sale of the 1984 crop because a replacement lien in the future crop would not constitute adequate protection because it is too speculative.

See also First Bank of Miller v. Wieseler (In re Wieseler), 45 Bankr. 871, 878 (D.S.D. 1985), in which the court recognized that a lien on livestock might, in some circumstances, provide better protection than a lien on anticipated crops. Nonetheless, the court did not accept Wieseler's
The question of a replacement lien in future crops was addressed recently by the U.S. District Court for the District of North Dakota, in a group of cases that were then appealed to the Eighth Circuit. In In re Berg, the debtors proposed to sell grain stored on their farm and under loan to the Commodity Credit Corporation (CCC) to obtain cash for planting their 1984 crop. They proposed to give the CCC a first lien on the 1984 crop, as well as an assignment of Federal Crop Insurance proceeds. The bankruptcy court had granted the debtor's motion to sell the grain and use the cash collateral. The CCC appealed to the district court, which stayed the bankruptcy court's order. On appeal to the district court, the CCC argued that it would not be adequately protected by "a lien on crops not yet in existence and that are purely speculative in nature as well as being subject to the uncertainties of weather and other natural phenomena." In contrast, the debtors argued that adequate protection was not designed to be a guaranty but merely protection against unreasonable risks.

The district court reviewed the statutory language and the legislative history and concluded that, throughout the case, the court must protect the value of a creditor's secured position as it existed at the beginning of the case. Accordingly, the court concluded that a lien on crops to be grown in the future and an assignment of crop insurance proceeds would not constitute adequate protection. The debtors provided "a promise of collateral which may exist in the future. This is, in effect, an offer of no collateral at all." The debtors' offer did not assure the CCC the indubitable equivalent of the CCC's interest in the cash collateral.

On further appeal of the group of consolidated cases now titled In re Martin, the Eighth Circuit provided a valuable analysis of the question of adequate protection for purposes of section 363(e). The Eighth Circuit first reviewed legislative history of the Bankruptcy Code and concluded that adequate protection is a question of fact, to be determined on a case-by-case basis. Normally the bankruptcy court's findings of fact should not be overturned unless clearly erroneous. An appellate court, however, does have the power to correct findings of fact based on misunderstanding of the ap-

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offer of livestock as adequate protection because it was too speculative and thus insufficient. The Wieseler court, however, did not hold that a replacement lien in nonexistent property could never constitute adequate or partial protection.

420. 42 Bankr. 335 (D.N.D. 1984), remanded sub nom In re Martin, 761 F.2d 472 (8th Cir. 1985).
422. 42 Bankr. at 337.
423. Id. at 338.
424. Id.
425. 761 F.2d 472 (8th Cir. 1985).
426. Ultimately, the Eighth Circuit remanded the cases to the district court, with instructions to remand to the bankruptcy court, which would correct its misunderstanding of applicable law and decide the case in light of the Eighth Circuit's opinion. Id. at 478.
427. Id. at 474. See also In re American Mariner Indus., Inc., 734 F.2d 426, 435 (9th Cir. 1984).
428. 761 F.2d at 474. See also In re Comer, 723 F.2d 737, 739 (9th Cir. 1984).
The Eighth Circuit believed that the bankruptcy court's error in deciding that the CCC's security interest would be adequately protected was based on a misunderstanding of the law. In making this judgment, the court relied on statutory language and legislative history.

Reviewing the language of sections 363 and 361, the court focused on section 361(3), which provides that adequate protection can consist of relief that lets the creditor get the "indubitable equivalent" of its interest. This concept, the court noted, originated in an early bankruptcy case and exists in the present Code as a result of legislative compromise. But its inclusion in the language of section 361(3) led the court to conclude that the debtor must attempt to give the creditor "the value of his bargained for rights." The existence of indubitable equivalence, however, depends on the type of collateral and the debtor's proposed use of that collateral.

The flexibility inherent in such a standard cannot be distorted to harm the creditor's interest. Accordingly, the Eighth Circuit listed three steps that the bankruptcy court must follow in making an adequate protection determination. The court must:

1. establish the value of the secured creditor's interest,
2. identify the risks to the secured creditor's value resulting from the debtor's request for use of cash collateral,
3. determine whether the debtor's adequate protection proposal protects value as nearly as possible against risks to that value consistent with the concept of indubitable equivalence.

The bankruptcy court, in the cases appealed as In re Martin, had failed to establish the value of the CCC's interest through evidence of yields or market price. Moreover, the bankruptcy court did not identify the risks associated with "the planting and harvesting of a crop not yet in existence." In this regard, the Eighth Circuit noted that crop failure could leave CCC's interest unprotected despite the insurance policy.

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429. 761 F.2d at 475. See also Bose Corp. v. Consumer Union, 461 U.S. 904 (1984).
430. 761 F.2d at 475. Because of its remand, the Eighth Circuit did not decide whether the bankruptcy court's finding was "clearly erroneous." Id. at 475.
432. In re Murel Holding Corp., 75 F.2d 941 (2d Cir. 1935). Judge Learned Hand explained adequate protection as being "completely compensatory; and . . . a substitute of the most indubitable equivalence." Id. at 942.
433. 761 F.2d at 476.
434. Id. at 476, quoting In re American Mariner Indus., Inc., 734 F.2d 426, 435 (9th Cir. 1984).
435. 761 F.2d at 477. On the requirement of a finding as to the value of the creditor's interest, see also First Bank of Miller v. Wieseler (In re Wieseler), 45 Bankr. 871, 875 (D.S.D. 1985).
436. 761 F.2d at 477.
437. As the Eighth Circuit noted, Federal Crop Insurance covers only crop failures due to certain "unavoidable consequences" within the meaning of the policy. The policy does not cover, for example, failure that results from the farmer's neglect or poor husbandry. 761 F.2d at 477. The court listed a number of factors to be considered in evaluating the value of a lien on crops to be grown. Id.
The Eighth Circuit’s discussion provides guidance for the bankruptcy court’s evaluation of the value of the creditor’s security interest and the risks of the farm debtor’s proposal for adequate protection. The bankruptcy court must decide whether the debtor’s adequate protection proposal provides protection to the creditor consistent with the concept of indubitable equivalence. The opinion in In re Martin should provide considerable assistance to courts facing the issue of whether a replacement lien in future crops constitutes adequate protection for the debtor’s use of cash collateral.

Other Considerations Concerning Sale of Estate Property

During the interim period after the bankruptcy petition is filed and before the reorganization plan is confirmed, the debtor in possession has the power to use, lease, or sell property of the estate (with the exception of cash collateral) without notice or court order, as long as the transaction is in the ordinary course of business. Section 363(b) also gives the power to use, sell, or lease property of the estate, other than in the ordinary course of business. Such use, however, requires notice and a hearing. The requirement ensures that the creditor will have notice of the debtor in possession’s intention to carry out a transaction involving the property of the estate that is outside the ordinary course of the debtor’s business. The creditor then will have an opportunity to make any objections known at the required hearing.

The requirements of section 363(b) apply, however, only before confirmation of the reorganization plan. In re Wood involved a dairy farmer who had filed a Chapter 11 case. After confirmation of his plan, which did not explicitly prohibit the sale of his dairy cattle, Wood arranged for a purported sale of the cows to obtain cash to redeem some real estate. The cows were later resold at auction. Creditors claimed that section 363(b) required notice and hearing of the sales in the bankruptcy court. But the court stated that section 363 did not apply to either sale because the plan had been confirmed prior to the sales.

Sales of property of the estate made under section 363, whether in or out-

438. Id. at 475. The CCC also argued that the debtor’s sale of grain and use of the cash collateral would be inconsistent with statutes and regulations governing the price support programs. The court rejected this argument. Id. at 478.


440. According to the rules of construction in section 102, “after notice and a hearing” actually means notice after an opportunity for a hearing as is appropriate. But an act may occur without any hearing if notice is given properly and either a party in interest does not make a timely request for a hearing or there is insufficient time for a hearing before the act must be done. Id. § 102(1)(A), (B) (1982).

441. 47 Bankr. 774 (Bankr. W.D. Wis. 1985).

442. Id. at 776. Nonetheless, the court characterized the purported sale as merely a loan. Wood did not relinquish possession or risk of loss of the animals, nor was there sufficient consideration for a sale. Id. at 778-79. The buyer had only an unperfected security interest, which had priority over general creditors. Id. at 780.
side of the ordinary course of the debtor’s business, are free and clear of any other interest in the property if one of five statutory conditions is met.\textsuperscript{443} The trustee may sell property free and clear only if applicable nonbankruptcy law permits sale of the property free and clear of the interest;\textsuperscript{444} the entity with an interest in the property consents;\textsuperscript{445} the interest is a lien, and the sale price for the property is greater than the value of all liens on the property;\textsuperscript{446} the interest is in dispute;\textsuperscript{447} or the entity with an interest could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of the interest.\textsuperscript{448}

The Code also provides that under certain conditions the trustee (or the debtor in possession) may sell both the estate’s interest and the interest of any co-owner of property. This provision may apply, for example, in the sale of jointly owned farm property. Section 363(h) applies to property in which, immediately before the commencement of the case, the debtor had an undivided interest as a tenant in common, joint tenant, or tenant by the entirety.\textsuperscript{449} For the trustee to sell under section 363(h), partition in kind of the property among the estate and the co-owners must be impracticable.\textsuperscript{450}

In addition, sale of the estate’s undivided interest in the property would have to realize significantly less for the estate than sale of the property free of the interest of the co-owners.\textsuperscript{451} Further, the benefit to the estate of a sale of the property free of the interest of co-owners must outweigh any detriment to those co-owners.\textsuperscript{452} In a related provision, section 363(g) provides that property of the estate remains free and clear of any vested or contingent right of dower or curtesy.\textsuperscript{453}

If farm property is to be sold under sections 363(g) or 363(h), the co-owner receives some protection, either before or after consummation of the sale. First, if the property is jointly owned, subject to dower or curtesy, or community property, the debtor’s spouse or any other co-owner has the right to purchase the property at the price at which the property is to be sold.\textsuperscript{454} Second, if the co-owner does not exercise this right, after the sale of the property the trustee must distribute the proceeds of the sale, less costs and expenses, according to the interests of the spouse or other co-owners, and of the estate.\textsuperscript{455} The Code does not describe how the value of interests in the property sold

\textsuperscript{444} \textit{Id.} § 363(f)(1).
\textsuperscript{445} \textit{Id.} § 363(f)(2).
\textsuperscript{446} \textit{Id.} § 363(f)(3).
\textsuperscript{447} \textit{Id.} § 363(f)(4).
\textsuperscript{448} \textit{Id.} § 363(f)(5).
\textsuperscript{449} \textit{Id.} § 363(h).
\textsuperscript{450} \textit{Id.} § 363(h)(1).
\textsuperscript{451} \textit{Id.} § 363(h)(2).
\textsuperscript{452} \textit{Id.} § 363(h)(3).
\textsuperscript{453} \textit{Id.} § 363(g).
\textsuperscript{454} \textit{Id.} § 363(l).
\textsuperscript{455} \textit{Id.} § 363(j). Costs and expenses do not include compensation for the trustee.
is to be computed. One commentator has suggested that courts are likely to apply state presumptions that operate in nondeath terminations of joint interests.\(^{456}\)

Finally, the validity of a sale is not affected if the authorization under section 363 is revised or modified on appeal, as long as the purchase was in good faith. Whether the purchaser knew of the pendency of the appeal from the authorization of the trustee to sell is not relevant to the validity of the purchase, unless the authorization and the sale were stayed pending the appeal.\(^{457}\)

**Section 364—Obtaining Credit**

A farmer who has filed a Chapter 11 bankruptcy case wants the opportunity to reorganize the business and continue with the farming operation. In most instances, the farmer's continued ability to obtain credit to finance that operation will be crucial to the success of the reorganization. Even if cash collateral is available under section 363, the farmer may need to borrow additional money for production costs and other expenses. But that farmer may encounter reluctance from creditors who are not eager to extend new credit to farmers in bankruptcy.

To accommodate reluctant creditors and to make it possible for reorganizing debtors to obtain credit, the Code includes section 364. Under certain circumstances, this section gives special assurance of repayment to lenders who provide money to Chapter 11 debtors.\(^{458}\)

First, section 364(a) permits the debtor in possession (or the trustee) who is authorized to operate the business to obtain unsecured credit and incur unsecured debt in the ordinary course of business, unless the court orders otherwise. This unsecured credit will then be allowed under section 503(b)(1) as an administrative expense, payable before other priorities and before other unsecured creditors.\(^{459}\) Thus the farm debtor in possession can incur ordinary business expenses, like the cost of seed and fertilizer, and can assure creditors that their debt will receive priority. In addition, the court can authorize unsecured credit or debt other than under subsection (a)—that is, not in the ordinary course of business—but only after notice and a hearing.\(^{460}\) This credit, too, is allowable as an administrative expense.\(^{461}\)

In some instances, the mere assurance of administrative expense priority will not satisfy the farm debtor's suppliers and other creditors. If the debtor cannot obtain unsecured credit using the administrative expense priority, the court, after notice and a hearing, may authorize one of three stronger assurances to the creditor. The new credit authorized by the court may enjoy

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458. *Id.* § 364. This section applies to trustees authorized to operate the business under sections 721, 1108 or 1304. Thus it has broader application than merely in Chapter 11. *Id.* § 364(a).
459. *Id.* § 364(a).
460. See *supra* note 440 on the meaning of notice and hearing.
priority over any or all administrative expenses.\textsuperscript{462} Alternatively, the credit can be secured by a lien on unencumbered property of the estate,\textsuperscript{463} or it can be secured by a junior lien on property of the estate that is already subject to a lien.\textsuperscript{464}

To postpetition creditors, these provisions of section 364 are significant because they have the effect of putting the new creditors ahead of prepetition unsecured creditors in the rank of priority. Despite the fact that this postpetition credit is obtained at the expense of the unsecured prepetition creditor, the Code does not protect prepetition general creditors through the right to demand adequate protection. Unsecured creditors have no rights in specific property of the debtor. Therefore, it appears that there are no constitutional objections to this statutory scheme.\textsuperscript{465} Of course, the debtor must receive value for the security interest granted to postpetition lenders.

Although creditors who extend postpetition credit are likely to accept a lien on previously unencumbered property under section 364(c), such property may not always be available. Moreover, creditors may not be willing to extend credit on the basis of a junior lien\textsuperscript{466} or an administrative expense priority. Recognizing these difficulties, the Code authorizes another method of obtaining postpetition credit, available only if the trustee or debtor in possession is unable to obtain credit otherwise.\textsuperscript{467} This method involves a "superpriority" or "priming lien." After notice and hearing, the court may authorize credit that is secured by a senior or equal lien on property that is already subject to a lien.\textsuperscript{468} This superpriority is authorized, however, only when the debtor can offer adequate protection to the holder of the prepetition lien.\textsuperscript{469} Adequate protection, for purposes of section 364, is defined in section 361, and has already been discussed.\textsuperscript{470}

\textsuperscript{462} Id. § 364(c)(1). This includes priorities under sections 503(b) and 507(b).
\textsuperscript{463} Id. § 364(c)(2).
\textsuperscript{464} Id. § 364(c)(3).
\textsuperscript{467} See Landers, supra note 200, at 25.
\textsuperscript{469} 11 U.S.C. § 364(d)(1)(B). The trustee (or debtor in possession) has the burden of proof on the issue of adequate protection.
\textsuperscript{470} See supra text accompanying notes 94-105, 410-438. In In re Stratbucker, 4 Bankr. 251, 251-53 (Bankr. D. Neb. 1980), the debtor in possession was a farmer without the necessary working capital to plant his spring crops. To plant the crops, the debtor needed to incur debt in the following amounts: fuel, $2,500; seed corn, $1,200; herbicide and pesticide, $1,800; tractor overhaul and repair, $2,000 or more; fertilizer, $4.000. The debtor had debts of $286,456 and property, chiefly 270 acres of land, valued at $357,447. Most of the debt was for two real estate mortgages that reserved security interests in rents and profits. The debtor wanted credit to purchase the necessary supplies to plant crops and proposed to repay the debts ahead of all others out of the proceeds from the crops.

The court gave the creditor priority under two alternative holdings. First, the mortgagees' security interests in the crops would not continue, pursuant to section 552(b), to the extent necessary to grant the new creditors a section 364(c) priority. Second, the new creditors could be granted
To illustrate with a simplified example, a farm debtor might have a tract of land worth $150,000, but subject to a $50,000 mortgage. The court, using section 364(d), could authorize the trustee to incur another $50,000 of debt to be secured by the granting of a senior lien on that land. The prepetition lienholder would receive adequate protection because the debtor’s equity was $100,000. Even after the new security interest, a $50,000 cushion would be available to absorb any fluctuations in the real estate market.

The superpriority provisions of section 364 may allow a lender better security in bankruptcy than would be possible outside of bankruptcy. With the section 364 lender incentives available, Chapter 11 farm debtors may be able to overcome the initial reluctance of creditors and thus obtain the credit that is needed to reorganize successfully.

Section 365—Executory Contracts and Unexpired Leases

In many instances, the financial difficulties of a farmer who has entered bankruptcy are due in part to that farmer’s obligations under disadvantageous contracts or leases. In other instances, the farm debtor may be operating under leases, or may be committed to contracts, that are essential to the successful continuation of the farm business. For example, a farm debtor may have an unexpired lease on farm real estate, an installment land contract, unexpired farm equipment leases, and executory contracts for services or for the sale or purchase of farm products and supplies. Section 365 of the Code is designed to give the debtor considerable flexibility in dealing with these executory contracts and unexpired leases.

Section 365 gives the trustee (or the debtor in possession, pursuant to section 1107) the power, subject to court approval, to assume or reject any executory contract or unexpired lease of the debtor.4 Although the Code

a senior lien under section 364(d) because the mortgagees’ interests in the crops were adequately protected. The court explained:

After consideration of the equities of this matter, I have concluded that the priority should be granted subject to certain limitations. Short of liquidation, the sole chance for rehabilitation of the debtor lies in carrying on his farming operation. Creditors who supply the wherewithal to grow the crops should logically receive the first proceeds, as without such credit no proceeds at all would exist. Moreover, a substantial cushion remains in the estate, so that it is unlikely that existing creditors, secured or unsecured, will be injured by allowing the debtor to borrow funds for one more growing season.

4 Bankr. at 253.

In addition, the court noted that adequate protection existed because, unless the crops were planted, the mortgagees would have no interest requiring protection. The court concluded that: “Thus, even if the proceeds from the crops are sufficient only to cover the costs of planting, the lienholders are in as good a position as they would be if the crops were not planted at all.” Id.

471. 11 U.S.C. § 365 (1982 & Supp. II 1984). Of course, section 365 is available to debtors other than farmers. Thus, when a party with whom a farmer has business agreements (for example, a landlord or a purchaser of farm products) enters bankruptcy, that party will have the rights under section 365 that are discussed below. For example, as illustrated by a controversial Missouri grain warehouse bankruptcy, the trustee of a bankrupt grain warehouse may assume executory contracts with farmers for the purchase of grain, pursuant to section 365. In re Cox Cotton Co., 8 Bankr. 682, 683 (Bankr. E.D. Ark. 1981).
itself provides no definition of executory contract or unexpired lease, legislative history explains: "Though there is no precise definition of what contracts are executory, it generally includes contracts on which performance remains due to some extent on both sides." 472 Moreover, a number of courts have adopted the definition articulated by Professor Vern Countryman. 473 According to this definition, an executory contract is "a contract under which the obligations of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other." 474

In most instances, it will be clear which of the farm debtor's agreements fit within section 365. Analysis will focus on whether both parties to an agreement must still fulfill substantial and material obligations. 475 Normally in the case of a long-term lease of farm equipment or a contract to sell grain or livestock in the future, both parties will have unfulfilled obligations. In some instances, it will be necessary to distinguish a true lease from a lease that is merely a disguised sale in which the seller retains an interest as security. 476 Moreover, the lease cannot have expired; if the debtor's interest in the lease expired by the lease terms, there will be no lease for the debtor to assume or reject. 477 In the cases of leases for the use of farmland, the crop share lease should be considered unexpired until the crops are harvested; a cash lease should expire only after the lease term has ended. 478 Installment land


476. The lease intended as security can often be distinguished from the true lease by a provision that allows the lessee to purchase the leased property for a nominal sum at the conclusion of the lease term. See the U.C.C. definition of "security interest" at § 1-201(37). If a lease is intended as a security interest (to be determined by the facts of each case), U.C.C. article 9 applies. U.C.C. § 9-102 and comment 1. This type of arrangement should be treated as a sale secured by collateral, rather than as an executory contract. See Kunkel, supra note 174, at 319-20. See also In re Booth, 19 Bankr. 53, 59 n.10 (Bankr. D. Utah 1982). See generally Jones, Lease or Secured Transaction—The Saga Continues Under the Bankruptcy Act, 90 CON. L.J. 281 (1985).

477. See In re Crabb, 48 Bankr. 165 (Bankr. D. Mass. 1985). The court refused to revive a terminated lease merely because it was essential to reorganization. Id. at 168. The Crabb lease included an option to extend. The debtor tried to exercise that option a month after the lease itself had expired, and seven months after the option deadline. The debtor had entered bankruptcy before the option and lease expired, but the automatic stay did not stop the running of these contractual deadlines. Id. at 166-68. See also 11 U.C.C. § 365(c)(3) (Supp. II 1984): "The trustee may not assume . . . if—(3) such lease of nonresidential property has been terminated under applicable nonbankruptcy law prior to the order for relief." This section was added in 1984. See supra note 71.

contracts are often considered executory contracts for purposes of section 365, but may raise other issues, to be discussed below.479

General Provisions

Time Limits. When the debtor is party to an unexpired lease or an executory contract, the trustee normally has the right to assume or reject that agreement.480 Some time limitations govern this right. In a Chapter 7 case in which an executory contract or an unexpired lease of residential real estate or personalty is at issue, the time limit is sixty days from the order for relief. If the trustee does not assume or reject within the sixty days (or within additional time that the court grants for cause), then the lease or contract is considered rejected.481 In many instances, the trustee in Chapter 7 will have little incentive to assume a contract or lease because the purpose of the proceeding is to liquidate the debtor's estate, rather than to reorganize. In some instances, however, section 365 will prove helpful to a trustee who plans to assume a particularly advantageous contract or lease and make it profitable to the estate by assigning it to another individual or entity.482

When the debtor is in Chapter 11 or Chapter 13, the trustee or debtor in possession may assume or reject an executory contract, or an unexpired lease of residential real estate or personalty, at any time before confirmation of the plan. The time period from initiation of the bankruptcy may be 120 days, 180 days, or even longer.483 If a party to that contract or lease requests, however, the court can impose a specific time limit for assumption or rejection.484

Section 365 includes a special rule for unexpired leases of nonresidential real property in which the debtor is the lessee. This rule was added by the 1984 Code amendments, in part to protect lessors of shopping centers, but it also applies in the case of leases of farmland when the tenant is the debtor. Under this rule, if the lease is not assumed or rejected within sixty days after the order for relief (or within additional time that the court grants for cause), the lease is considered rejected, and the trustee must surrender the property to the lessor.485 Another new provision requires the trustee to perform obliga-

479. See infra text accompanying notes 521-552.
480. 11 U.S.C. § 365(a) (Supp. II 1984). The trustee's decision is subject to court approval. The Code does not provide standards for court approval of the trustee's decision to assume or reject these contracts. The rule most commonly used is the business judgment rule: "[T]he question whether a lease should be rejected and, if not, on what terms it should be assumed is one of business judgment." Group of Inst. Inv. v. Chicago, Mil., St. P. & Pac. R.R., 318 U.S. 523, 550 (1943). See also Control Data Corp. v. Zelman (In re Minges), 602 F.2d 38, 43 (2d Cir. 1979) (approving the business judgment rule). See 2 Collier on Bankruptcy, supra note 330, § 365.03.
482. On assignment, see infra text accompanying notes 500-514.
483. On time limits for submission of the plan, see infra text accompanying notes 554-558 (Chapter 11) and 641-642 (Chapter 13).
485. Id. § 365(d)(4).
tions under unexpired leases of nonresidential real estate (that is, to pay rent, among other obligations) until the lease is assumed or rejected.486

**Adequate Assurance.** When the debtor has not defaulted on an unexpired lease or executory contract, the trustee is free to assume that obligation without giving the other party any particular guarantees of continued performance.487 But if the debtor has defaulted, either before or after the commencement of bankruptcy,488 the requirements of section 365(b) apply and trigger the obligation of “adequate assurance.”489 Before the lease or contract may be assumed, the trustee must cure the default or provide adequate assurance that cure will occur. The trustee must also compensate the other party to the agreement for any monetary loss caused by the default. In addition, the trustee must provide “adequate assurance of future performance” under the contract or lease.490 The trustee need not cure or provide adequate assurance if the only default results from an ipso facto clause stating that a default occurs if the debtor becomes insolvent, enters bankruptcy, or has a trustee or custodian appointed.491

The term “adequate assurance of future performance” is not a term of art in section 365. Instead, it has pragmatic significance; what constitutes adequate assurance is to be determined by the facts of each case.492 In evaluating adequate assurance, a court must be sensitive to the rights of the nondebtor party in these agreements. As the legislative history of section 365 indicates: “If the trustee is to assume a contract or lease, the courts will have to insure that the trustee’s performance under the contract or lease gives the other contracting party the full benefit of his bargain.”493 Accordingly, a court is likely to consider both whether the farm debtor will be able to meet his obligations under the contract or lease,494 and whether the other party to the agreement will receive the benefit of the bargain.495 Adequate assurance may involve a cash payment,496 or merely the cure of default and the continued payment of obligations on the contract after bankruptcy.497

486. *Id.* § 365(d)(3).
488. See 2 Collier on Bankruptcy, *supra* note 332, ¶ 365.04[1].
490. *Id.* §§ 365(b)(1)(A)-(C).
491. *Id.* §§ 365(b)(2)(A)-(C).
495. E.g., *In re* Evelyn Byrnes, Inc., 32 Bankr. 825 (Bankr. S.D.N.Y. 1983) (adequate assurance gives the landlord the “full benefit of his bargain,” but eventual assignee may not be required to comply literally with every lease term, *id.* at 829).

One court has held that the assumption of a contract should not be permitted when adequate assurance of future performance would require the complete reworking of procedures set forth in the contract. *In re* Luce Indus., Inc., 8 Bankr. 100 (Bankr. S.D.N.Y. 1981).

**Ipso facto Clauses.** A number of contracts include ipso facto or bankruptcy clauses, which purport to terminate the contract should a party enter bankruptcy or otherwise demonstrate insolvency. By making a potentially valuable contract unavailable to a debtor trying to reorganize, these clauses would contravene the purposes of bankruptcy law. Thus section 365(e) invalidates ipso facto clauses. After commencement of a bankruptcy case, an executory contract or unexpired lease may not be terminated or modified solely because of a provision conditioned on the insolvency or financial condition of the debtor, the commencement of a bankruptcy proceeding, or the appointment of a trustee or custodian.498 Section 365(e) does not invalidate an ipso facto clause in a contract entirely, but only during the case. The clause could again apply, for example, in a new insolvency after the bankruptcy case is closed.499

**Assignment.** When the trustee or debtor in possession assumes any executory contract or unexpired lease, he will either retain possession of rights under the contract or lease, or assign those rights to some other entity. In a Chapter 11 or Chapter 13 case, the farm debtor in possession is likely to want to retain possession of the contract or lease after assumption; in a Chapter 7 liquidation, the trustee who has assumed a contract or lease can be expected to assign the debtor's rights under the agreement.

The Code facilitates the assignment of executory contracts and unexpired leases through section 365(f). Under this section, the trustee or debtor in possession may assign the contract or lease, under certain circumstances, regardless of whether a provision in the agreement itself or in applicable state law prohibits, restricts, or conditions that assignment.500 Moreover, any provision of the agreement or of applicable law that would terminate or modify the contract or lease because of assignment is invalidated in bankruptcy.501 The trustee or debtor in possession must assign the agreement in accordance with the provisions of section 365.502 The assignee must provide adequate assurance of future performance, regardless of whether the debtor has defaulted on the agreement.503

Despite this fairly broad power to assign executory contracts and unexpired leases, not all such agreements can be assigned in bankruptcy. Contracts to make a loan, extend financial accommodations, or issue a security of the debtor

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498. 11 U.S.C. § 365(e)(1) (1982). Section 365(e)(2) states instances in which subparagraph (1) does not apply: when applicable law excuses the nondebtor party from accepting performance from the trustee or an assignee and the party does not consent to assignment; or when the contract is an agreement to make a loan, to extend financial accommodations, or to issue a security. Id. § 365(e)(2). Thus, a personal service contract can be terminated at bankruptcy through an ipso facto clause. This result is consonant with section 365(c)(1), discussed infra.


501. Id. § 365(f)(3).

502. Id. § 365(f)(2)(A).

503. Id. § 365(f)(2)(B). Compare section 365(b)(1), regarding assumption, which requires adequate assurance only if the debtor has defaulted.
cannot be assumed or assigned.504 In addition, the trustee cannot assume or assign a lease of nonresidential real property that terminated under nonbankruptcy law prior to the order for relief (that is, prior to the commencement of the case).505

More significantly, personal service contracts are excepted from the general right to assign contracts and leases. Pursuant to section 365(c), the trustee may not assume or assign an agreement if applicable law would excuse the nondebtor party from accepting performance from, or rendering performance to, the trustee or an assignee.506 Of course, the trustee may assume and assign such a personal service contract if the nondebtor party consents.507 Though the trustee could not assume such a contract without the consent of the nondebtor party, the debtor in possession could assume the contract; he is the party with whom the nondebtor originally contracted. But neither the trustee nor the debtor in possession could assign the contract or lease involving personal service to another party.508

Farm debtors are likely to be involved in several different agreements that may be characterized as personal service contracts. Employment contracts fall within this category and cannot be assigned without consent of the nondebtor party. In addition, farm debtors who are party to a farm lease must ask whether the lease is a personal service contract. A landlord will usually choose a crop-share tenant for his land on the basis of personal characteristics because the landlord’s share of the rent will depend in part on the tenant’s knowledge and diligence. Almost every state court that has faced the issue directly has held that a crop-share lease is a nonassignable personal service contract.509 Not all courts have addressed the issue, however, and the characterization of a particular tenancy will depend on a number of factors, including the nature of the relationship and the party who is debtor.510 If the farm lease is characterized under state law as a nonassignable personal service contract, it comes within the provisions of section 365(c) and may not be assigned in bankruptcy without consent of the nondebtor party.

One issue that may arise when the trustee or debtor in possession wants to assume and assign an executory contract or an unexpired lease pursuant

504. Id. § 365(c)(2) (Supp. II 1984).
505. Id. § 365(c)(3). This provision, quoted supra in note 477, was added in 1984.
506. Id. § 365(c)(1)(A).
507. Id. § 365(c)(1)(B).
510. For more comprehensive discussion of this issue, see Grossman & Fischer, supra note 116, at 640-45.
to section 365 is whether the agreement must be assumed and assigned strictly according to its terms, or whether the court may allow modification of the agreement. 511 It is clear from both the Code requirement of adequate assurance and the legislative history that the nondebtor party must receive the full benefit of his bargain. 512 In some respects, the requirement of adequate assurance may be viewed as a substitute for strict compliance with all the terms of the agreement. Courts that have addressed this issue have not been consistent. For example, in situations involving unexpired leases, some courts have refused to permit the trustee to modify a lease. 513 Others, however, have concluded that adequate assurance does not require the assignee to comply literally with every term of the lease as long as the nondebtor party would not suffer actual and substantial detriment. 514 A farm debtor who wants to assume, or assume and assign, an executory contract or unexpired lease must ensure that any proposed change in the literal requirements of the agreement treats the nondebtor party fairly. Of course, the court approval required under section 365(a) will protect the nondebtor.

Rejection. When an executory contract or unexpired lease is disadvantageous or otherwise not useful for the estate, it will normally be rejected pursuant to section 365. 515 When such an agreement is rejected, the rejection constitutes a breach of the lease or contract. If the agreement is rejected without having been assumed, either under section 365 or under a confirmed plan, the date of breach is immediately before the date of the filing of the petition. 516 The nondebtor party to the agreement will then usually have an unsecured, non-priority claim for damages, allowable under section 502(g). 517

Leases

Section 365 includes special rules to accommodate the rejection of leases of real property. Section 365(h) protects the tenant if the trustee rejects an unexpired lease of real property under which the debtor is the lessor. Thus, if the landlord under a farm lease enters bankruptcy and rejects the unex-

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511. See generally Simpson, Leases and the Bankruptcy Code, 38 Bus. Law. 61, 75 (1982) for a discussion of this issue. See also 2 Collier on Bankruptcy, supra note 330, ¶ 365.04[1].
512. See supra text accompanying notes 492-493.
516. Id. § 365(g)(1). Subsection (g)(2) provides alternative dates of breach for situations in which the executory contract or unexpired lease has been assumed. The date varies, depending on whether the debtor's case has been converted to Chapter 7.
517. 11 U.S.C. § 502(g) (1982) states:

A claim arising from the rejection, under section 365 of this title or under a plan under chapter 9, 11, or 13 of this title, of an executory contract or unexpired lease of the debtor that has not been assumed shall be determined, and shall be allowed under subsection (a), (b), or (c) of this section or disallowed under subsection (d) or (e) of this section, the same as if such claim had arisen before the date of the filing of the petition.
pired farm lease, the tenant has a choice. He can decide to treat the lease as terminated, yield possession of the property, and claim damages.\textsuperscript{518} Alternatively, the tenant may decide to remain in possession of the property for the remainder of the lease term and any renewals or extensions that are enforceable under nonbankruptcy law.\textsuperscript{519} The tenant may offset against the rent any damages occurring after the rejection because of the landlord-debtor’s nonperformance of any obligations (for example, providing a share of the production inputs) under the lease. Offset is the tenant’s only remedy; he does not have a claim for damages for the landlord’s failure to perform.\textsuperscript{520}

\textit{Installment Contracts}

Section 365 also includes a special provision to accommodate situations in which the seller of real property is a debtor, and the trustee rejects the executory contract for the sale of the property.\textsuperscript{521} Because the installment land contract (or contract for a deed) is often used as a method of financing the sale of farmland, this provision may have particular relevance in farm bankruptcies. Consistent with the Countryman definition of an executory contract,\textsuperscript{522} the installment land sale contract is often characterized as an executory contract. Under the typical arrangement, the buyer has the duty to make payments, and the seller has the duty to deliver title to the land after the buyer’s last payment.\textsuperscript{523}

If the trustee rejects the executory installment contract and the buyer is in possession of the property, that buyer has an alternative under section 365(i).\textsuperscript{524} First, he may treat the contract as terminated.\textsuperscript{525} If he does so, then under section 365(j) he has a lien on the debtor’s interest in the property for the recovery of any portion of the purchase price that the buyer has paid.\textsuperscript{526}

\textsuperscript{518} No limit is placed on the tenant’s claim for damages. Compare section 502(b)(6) (Supp. II 1984), which limits the allowable claim, when the lessor is claiming damages resulting from the termination of a lease on real property. See \textit{supra} note 361. On the issue of ascertaining damages from breach of farm leases, see Grossman & Fischer, \textit{supra} note 116, at 657-63.


\textsuperscript{520} \textit{Id.} § 365(h)(2).


\textsuperscript{522} For the Countryman definition, see \textit{supra} text accompanying note 474.

\textsuperscript{523} The installment land contract is more than a note. “A note is not usually an executory contract if the only performance that remains is repayment.” S. Rep. No. 989, \textit{supra} note 39, at 58, \textit{reprinted in} 1978 U.S. CODE CONG. & AD. NEWS, at 5844.

Despite the fact that the seller must still perform by transferring title after the buyer makes his last payment, the buyer enjoys most of the incidents of ownership. The seller has retained title for security in much the same way that a lender might hold a mortgage. Indeed, “[t]he installment land contract and the purchase money mortgage fulfill the identical economic function—the financing by the seller of the unpaid portion of the real estate purchase price.” G. Osborne, G. Nelson & D. Whitman, \textit{Real Estate Finance Law} 79 (3d ed. 1979).

\textsuperscript{524} At least one decision has stated that sections 365(i) and (j) are exclusive remedies for parties to executory contracts for the sale of real property. See \textit{In re} Fisher, 13 Bankr. 286, 287 (Bankr. E.D. Pa. 1981).


\textsuperscript{526} \textit{Id.} § 365(j) (1982).
Alternatively, the buyer may decide to remain in possession of the property. The buyer who remains in possession must continue to make payments due under the contract, but may offset any damages caused by the seller's nonperformance after the date of rejection. The seller's trustee must deliver title to the buyer according to the land sale contract, but need not perform other obligations under the contract.

This choice is available only to the buyer who is in possession of the farmland. The Code does not define "in possession." Although that term has assumed meaning in state law contexts, a recent bankruptcy court case suggests that it is inappropriate to construe the term in an abstract way. Instead, the term should be construed in light of the language of section 365 and its legislative history. These reflect a congressional concern for buyers, including farm buyers, with a permanent connection with the land who would face dislocation through rejection of an installment sale contract. Under this analysis, if the buyer of farmland under an installment land sale contract actually farmed the land, and perhaps lived on the property, that buyer would be in possession as required by section 365(i).

The installment purchaser who is not in possession of the property does not have the option of continuing to purchase the land after the seller rejects the executory contract. Instead, that buyer will receive a lien on the interest of the seller-debtor in the property for the recovery of the portion of the purchase price the buyer paid.

In dealing explicitly with the rights of the nondebtor-buyer under an installment land contract rejected by the trustee, section 365 recognizes the contract as executory. But the protection offered to the buyer in possession under section 365(i) treats the contract as if it were not executory, but similar to a purchase money mortgage. Section 365(i) is silent, however, as to the treatment of installment land contracts in bankruptcy when the buyer of the land is the debtor.

In cases in which the debtor is the purchaser, a threshold issue is whether the contract is executory at all within the provisions of section 365. Because an installment land contract is treated as executory if the debtor is a seller, it might follow that the same contract should also be executory when the debtor is a buyer. If the installment land contract is viewed as executory, even when the debtor is a buyer, then it may be assumed or rejected as any executory contract. If the contract is assumed, it must be taken cum onere, that is,

527. Id. § 365(i)(1) (Supp. II 1984).
528. Id. § 365(i)(2)(A) (9182). The buyer has no claim for damages arising after the rejection, other than the offset.
529. Id. § 365(i)(2)(B).
531. Id. at 318. See also Lacy, Land Sale Contracts in Bankruptcy, 21 U.C.L.A. L. Rev. 477, 484 (1973).
533. Id. § 365(i) (1982).
534. Id. § 365(i)(1) (Supp. II 1984).
as written, with its benefits and burdens. The bankrupt buyer who rejects an installment land contract would be deemed to have breached, and the seller would be entitled to forfeiture. This treatment of installment contracts as executory when the debtor is a buyer, however, would lead to situations in which the debtor is treated less favorably in bankruptcy than under state law. Some states treat the installment land contract as a nonexecutory purchase money mortgage, with the seller as mortgagee and the buyer as mortgagor. In these states, if the buyer defaults, the seller's remedy is foreclosure instead of forfeiture.

Reflecting this analysis, several recent bankruptcy court cases have treated

537. Some states view forfeiture as a penalty. In certain cases, therefore, even though the installment land contract is treated as an executory contract, the seller still cannot demand forfeiture as a remedy for a debtor-buyer's breach when the result would be unconscionable. See Note, Recent Utah Developments on Forfeitures in Real Estate Contracts, 7 Utah L. Rev. 95 (1960).
538. E.g., Chapman v. Britton (In re Britton), 43 Bankr. 605 (Bankr. E.D. Mich. 1984); In re Patch Graphics, 32 Bankr. 373 (Bankr. W.D. Wis. 1983). See generally Jackson, Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain, 91 Yale L.J. 857 (1982). To avoid a situation in which the debtor-buyer may be treated less favorably in bankruptcy than under state law, a bankruptcy court could adopt the law of the state where it sits as the rule of decision in the case. Where a federal statute like the Code refers to executory contracts, but does not say whether an installment land contract is executory when the debtor is a buyer, it is beyond question that the issue is one of federal law. This, however, does not eliminate the possibility that a federal court might adopt state law as the appropriate authority for the federal rule of decision in the case. See, e.g., the concurring opinion of Justice Jackson in D'Oench, Duhme & Co. v. Federal Deposit Ins. Corp., 315 U.S. 447, 468 (1942).

When an issue is not controlled by any formal expression of the will of Congress, then in addition to concluding that federal common law must fill the statutory interstice, a court must also decide what the federal rule should be. In short, Congress acts against the background of the total corpus juris of the states in much the same way that a state legislature acts against the background of the common law, assumed to govern unless changed by legislation. A. HART & H. WECHSLER, THE FEDERAL COURTS AND THE FEDERAL SYSTEM 471 (2d ed. 1973). Because of concerns of federalism, a court should not displace a state rule if there is no overriding interest in nationwide uniformity on the issue. In other words, federal common law should reflect state rules of decision in the absence of a showing that some federal interest or regulatory policy requires a nationwide uniform rule. There is no inflexible rule that federal law governs all questions in federal government litigation, even in cases involving federal government litigation. See United States v. Yazell, 382 U.S. 341 (1966), finding that state law supplied the rule of decision because "there is no overriding interest in nationwide uniformity on the issue." See also Board of Commrs v. United States, 308 U.S. 343, 351 (1939), also holding that state law supplied the rule of decision: "Nothing seems to us more appropriate than due regard for local interests and local interests."

In the present context, then, the issue at the debtor-buyer's breach becomes why a seller should have the benefit of a uniform federal rule that dictates the forfeiture of the debtor's equity in the contract for the sale of real estate when the spirit of the Code, particularly Chapter 11, is to encourage the rehabilitation of debtors. See H.R. REP. No. 595, supra note 17, at 348; reprinted in 1978 U.S. Code Cong. & Ad. News, at 6304. No overriding federal interest seems to justify the rejection of state law for the adoption of a uniform federal rule that could result in less favorable treatment for debtors in bankruptcy than they might receive in a state court. But see infra note 546.
installment land contracts involving a debtor-buyer as mortgages.\footnote{539} The leading case in this area is In re Booth,\footnote{540} which involved a Chapter 11 debtor who was buyer under a contract for a deed. Sellers had moved for an order under section 365(d)(2), directing debtor to assume or reject the contract. The debtor, however, argued that the contract was not executory, and therefore section 365 did not apply.\footnote{541}

The bankruptcy court analyzed the Countryman test, which it viewed as “an index to when assumption or rejection of a contract will ‘benefit the estate’ and therefore when a contract is executory.”\footnote{542} But the court was not convinced that the test always defined the benefit to the estate or spoke to the protection of creditors. Analyzing the purposes of sections 365(i) and (j), the court recognized that these were intended to mitigate the harsh results of cases decided under the Bankruptcy Act, when buyers under installment contracts often lost their land and were relegated to the status of unsecured creditors when their sellers entered bankruptcy.\footnote{543} These sections now give the debtor-seller some flexibility in designing an effective reorganization, but not at the expense of the debtor-buyer under a land sale contract.

The Booth court believed that when the debtor is purchaser under a contract for a deed, the contract benefits the estate more when viewed as a lien rather than as an executory contract. Treatment of the contract as a lien enhances the value of the estate, furthers the rehabilitation of the debtor, and makes adequate protection available to creditors.\footnote{544} Treatment of the contract as a lien treats the seller like other lienors and prevents forfeiture and loss of the value of equity to the estate.\footnote{545} This treatment is similar to the approach adopted by a number of states, which now treat installment land contracts almost like mortgages.\footnote{546} In addition, if the contract is treated as a lien, the costs of assumption are avoided and the lien can be “dealt with” in a plan, thus giving the debtor more latitude in reorganization.\footnote{547} Moreover, the seller can receive adequate protection for the value of the lien.\footnote{548}

The court recognized that sections 365(i) and (j) were enacted to give non-debtor buyers the protection of mortgagors. Therefore, treating the contract

\footnotetext{540}{ 19 Bankr. 53 (Bankr. D. Utah 1982).}
\footnotetext{541}{ Id. at 54.}
\footnotetext{542}{ Id. at 55.}
\footnotetext{543}{ Id., citing Gulf Pet., S.A. v. Collazo, 316 F.2d 257 (1st Cir. 1963); In re Philadelphia Penn Worsted Co., 278 F.2d 661 (3d Cir. 1960); In re New York Inv. Mut. Group, 143 F. Supp. 51 (S.D.N.Y. 1956).}
\footnotetext{544}{ 19 Bankr. at 58.}
\footnotetext{545}{ Id. at 58-59.}
\footnotetext{546}{ Id. at 58 n.9. The result in Booth did not depend on state law treatment of the executory contract. Instead, the court focused on policy implementation.}
\footnotetext{547}{ Id. at 60-61.}
\footnotetext{548}{ Id. at 61.}
for a deed as a lien when the buyer is the debtor is consonant with the spirit of those sections. Any other treatment would give nondebtor buyers more favorable treatment in bankruptcy than debtor-buyers and debtor-sellers better treatment than debtor-buyers. 549 Although the court hesitated to depart from the Countryman test, it believed the strict application of that rule to be inconsistent with the rationale of sections 365(i) and (j). Thus, to implement the underlying bankruptcy policy it treated the debtor’s contract for a deed as a lien and denied the seller’s motion to require assumption or rejection of the contract.

Although not all courts have agreed with the rationale of Booth, 550 other courts have followed the decision. 551 Moreover, the result has been extended to installment sales contracts that involve personal property. 552 Thus the debtor who is party to an installment sale contract involving farmland must consider the possibility that the contract will be treated as a lien, rather than as an executory contract to which the provisions of section 365 apply.

The Plan of Reorganization

The debtor in possession in a Chapter 11 bankruptcy does not operate his farm indefinitely on the authority of the interim provisions prescribed in sections 363, 364, and 365. These provisions merely facilitate the continued operation of the debtor’s business during the interim period between filing of the petition and confirmation of a plan. The reorganization plan will establish provisions for paying both secured and unsecured creditors. In addition, it will include the debtor’s plans for continuing the operation of the farm business.

The Debtor’s Role

A debtor may file a plan with the petition commencing a voluntary case. 553 Although some debtors may have already negotiated parts of a plan with lenders, most Chapter 11 debtors do not enter bankruptcy with a plan already designed. 554 Indeed, many file the bankruptcy petition to alleviate pressure from creditors and gain time to formulate a plan. The farm debtor has the exclusive right to file a plan for the first 120 days after the order for relief, 555

549. Id. at 63.
551. E.g., In re Adolphsen, 38 Bankr. 776 (D. Minn.), aff’d 38 Bankr. 780 (D. Minn. 1983); In re Flores, 32 Bankr. 455 (Bankr. S.D. Tex. 1983); In re Patch Graphics, 32 Bankr. 373 (Bankr. W.D. Wis. 1983); In re Cox, 28 Bankr. 588 (Bankr. D. Idaho 1983). Some courts have used the policy approach espoused by Booth, while others have followed state law treatment of the installment land contract. Other rationales also apply. Cox used the doctrine of equitable conversion, and Adolphsen analogized to the promissory note. See Kunkel, supra note 174, at 321.
554. Landers, supra note 200, at 14.
if a trustee has not been appointed.\textsuperscript{556} If the debtor does file a plan within the 120-day period, then other parties in interest are precluded from submitting a plan of their own for another sixty days.\textsuperscript{557} But if the debtor fails to file a plan in the first 120-day period, or if he fails to gain acceptance of his plan within 180 days, then any other party in interest may also file a plan.\textsuperscript{558} Most individual creditors, however, lack the economic incentive and knowledge of the farmer's operation needed to file a meaningful plan, so the farm debtor himself has substantial power to influence the plan even after the 120- to 180-day exclusivity period has expired.\textsuperscript{559}

It is essential both for the Chapter 11 farm debtor to submit a reorganization plan in a timely manner and for that plan to be feasible. If the plan is not timely and feasible, the court can dismiss the case for cause pursuant to section 1112(b). \textit{In re Becker} involved a creditor's motion to dismiss for cause.\textsuperscript{560} The debtors had filed a voluntary Chapter 11 petition in March 1983. Thereafter, they made no payments to a number of creditors, including Farmers Home Administration and the seller under an installment land contract. They also failed to pay delinquent property taxes. They owed an unscheduled debt to the Commodity Credit Corporation and had secured that debt by 1981 and 1982 corn stored at the debtors' farm and at an elevator. The corn had deteriorated after the petition was filed.\textsuperscript{561} In the months since their petition was filed, the debtors sustained operating losses of $107,000. The equipment and machinery that served as collateral for several creditors was depreciating through continued use, and the debtors made no payments to the creditors to protect their interests. The corn was spoiling, and the farmland, used as collateral for several creditors, was declining in value. Thus, the estate in bankruptcy suffered a continuing loss.\textsuperscript{562}

The court concluded that there was no reasonable likelihood of rehabilitation. The debtors' operation could not "cash flow itself."\textsuperscript{563} Moreover, the debtors had not filed a plan or disclosure statement in the year since they filed their petition. Many of their creditors were entitled to relief from the automatic stay under section 362(d)(1), and the debtors would then be left with little property. These facts led the court to the conclusion that the creditors were entitled to dismissal for cause under section 1112(b)(2). In addition, the court believed that debtors who have proceeded under Chapter 11 for a year without a plan, particularly with debts of nearly a million dollars, caused unreasonable delay. Section 1112(b)(3) allows dismissal for "unreasonable delay

\textsuperscript{556} Id. § 1121(c)(3) (Supp. II 1984).
\textsuperscript{557} Id.
\textsuperscript{558} Id. § 1121(c)(2), (3) (1982 & Supp. II 1984). The court may lengthen or reduce these time periods on request of a party in interest, and after notice and a hearing. Id. at 1121(d) (Supp. II 1984).
\textsuperscript{559} Landers, supra note 200, at 18.
\textsuperscript{560} 38 Bankr. 913 (Bankr. D. Minn. 1984).
\textsuperscript{561} Id. at 915.
\textsuperscript{562} Id. at 915-16.
\textsuperscript{563} Id. at 916.
by the debtor that is prejudicial to creditors.\textsuperscript{564} The Beckers’ delay, in light of declining land values, spoiling corn, and deteriorating equipment, had prejudiced creditors and justified dismissal under section 1112(b)(3).\textsuperscript{565}

Infeasibility of a Chapter 11 plan submitted by a farm debtor can also result in dismissal of the case. A plan that is infeasible and inequitable may be rejected, and a bankruptcy court finding that the debtor cannot effectuate a plan that will be confirmable is also a basis for dismissal under section 1112(b)(2).\textsuperscript{566}

\textit{The Creditors’ Role}

Although the debtor will have best access to the information needed to formulate a feasible plan, creditors as a group play a significant role in the formulation of most plans. After the order for relief, the court appoints a creditors’ committee,\textsuperscript{567} which normally consists of the holders of the seven largest unsecured claims.\textsuperscript{568} Once selected, the committee has a number of duties. The committee consults with the trustee or debtor in possession concerning administration of the case.\textsuperscript{569} It also investigates the debtor’s financial affairs, the operation of the business and desirability of its continuance, and any other matter relevant to the case or formulation of a plan.\textsuperscript{570} In addition, the committee may participate in the formulation of a plan, advise other creditors of its recommendations regarding any plan, and collect and file with the court the acceptances of a plan.\textsuperscript{571} Finally, the committee may request the appointment of a trustee or examiner\textsuperscript{572} and perform other services in the interests of the creditors.\textsuperscript{573}

Regardless of whether the plan is formulated by the farm debtor or by the creditors, that plan must be favorable enough to the creditors to encourage them to approve it. Most plans will have one or more classes of secured claims and at least one class of unsecured claims. A class of claims is a group of substantially similar claims.\textsuperscript{574} A plan must treat each claim in a particular class the same,\textsuperscript{575} but a plan may treat the various classes differently. One

\textsuperscript{565} 38 Bankr. at 917. The court would have preferred to convert the case to a Chapter 7 liquidation, but section 1112(c) prevents such conversion when the debtor is a farmer.
\textsuperscript{566} \textit{In re Fossum}, 764 F.2d 520, 521-22 (8th Cir. 1985). \textit{See also In re Anderson}, 52 Bankr. 159 (D.S.D. 1985).
\textsuperscript{567} 11 U.S.C. § 1102(a) (1982).
\textsuperscript{568} \textit{Id.} § 1102(b)(1) (Supp. II 1984). The committee can be the body organized by the creditors before commencement of the case, if fairly chosen and representative.
\textsuperscript{569} \textit{Id.} § 1103(c)(1) (1982).
\textsuperscript{570} \textit{Id.} § 1103(c)(2).
\textsuperscript{571} \textit{Id.} § 1103(e)(3) (Supp. II 1984).
\textsuperscript{572} \textit{Id.} § 1103(c)(4). \textit{In re Bel Air Assocs., Ltd.}, 4 Bankr. 168 (Bankr. W.D. Okla. 1980), the court held that mere naked allegations of misconduct or incompetence were not enough to warrant the appointment of an examiner.
\textsuperscript{574} \textit{Id.} § 1122(a).
\textsuperscript{575} \textit{Id.} § 1123(a)(4). The holder of a particular claim may consent to receive less favorable treatment than the class.
of the potential advantages to the debtor in a Chapter 11 case is that the plan may incorporate provisions that extend payment time and scale down debts. In practice, most plans filed will include one or more impaired classes, in which creditors will be asked to accept less than their full claims. Creditors will cooperate with impairment because they will ordinarily receive more under the reorganization plan than in a Chapter 7 liquidation.

The court does not actually approve a plan before the debtor in possession submits the plan to the creditors. Instead, the Code provides that the creditors' acceptance or rejection of a plan may not be solicited until after the court agrees that the written disclosure statement to be submitted along with the plan contains adequate information. "Adequate information" is information of a kind, and in sufficient detail, that would enable a hypothetical reasonable investor to make an informed judgment about the plan. This requirement ensures that creditors will have access to enough information about the debtor's financial condition to make an informed judgment about the plan. What constitutes adequate information is determined on a case-by-case basis and may be affected in part by factors like the need for investor protection and the speed of confirmation required.

After the plan and written disclosure have been submitted to the creditors, the creditors vote to accept or reject the plan. Holders of allowed claims or interests are permitted to vote. A class not impaired under a plan is deemed to accept the plan without voting. A class that receives nothing under a plan is deemed to reject the plan without voting. A voting class of claims accepts a plan if creditors holding at least two-thirds in amount and more than one-half in number of the allowed claims in the class that actually votes agree to accept the plan.

**Confirmation and Cram Down**

Acceptance of the plan by all classes of claims does not automatically put

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576. A class is unimpaired if one of three criteria is satisfied. First, the plan may leave unaltered the legal, equitable, and contractual rights of the holders of claims or interest of a class. Second, the plan may cure defaults that occurred before or during the bankruptcy proceeding, reinstate the maturity date of the claim or interest, and compensate the holder for any damages incurred as a result of the default. Third, the plan may provide that the holders of claims receive cash equal to the allowed amount of their claims, or that the holders of interests receive cash equal to the greater of any fixed liquidation preference or any fixed price at which the debtor, under the terms of the security, may redeem the interest. *Id.* § 1124 (1982 & Supp. II 1984).

577. *Id.* § 1125(b) (1982).

578. *Id.* § 1125(a) (Supp. II 1984).


581. See supra note 576.


583. *Id.* § 1126(g).

584. *Id.* § 1126(c) (1982). For example, assume that a farm debtor establishes a class with claims totaling $100,000 and with twenty creditors. Fifteen creditors holding claims of $75,000 vote. If eight creditors holding claims of more than $52,000 approve the plan, that class has accepted the plan.
a plan into effect; the court must still confirm the plan pursuant to section
1129. A plan accepted by every class of claims and interests is generally con-

ermed. But each creditor in an accepting class with impaired claims who
has voted to reject a plan must receive at least the amount that the creditor
would have received if the debtor had been liquidated in Chapter 7. Also,
a plan must provide that holders of certain priority claims under section 507
receive the full amount of their allowed claims if other classes are to receive
anything. In addition, confirmation of the plan must not be likely to be
followed by liquidation or need for further reorganization. That is, the plan
must be feasible, with a reasonable prospect for success. Of course, the
court cannot guarantee that a plan proposed by a farm debtor, or any other
debtor, will succeed. Predicting crop yields and crop prices always leaves an
element of uncertainty.

In certain circumstances, a court may confirm a plan even though certain
classes have rejected the plan, so long as at least one impaired class approves
the plan. Confirmation of a plan over the objection of one or more classes
is called " cram down." The law dealing with cram down is quite com-
plex. The plan must not discriminate unfairly and must be fair and equitable
to each class that is impaired and has not accepted the plan. In general,
the holders of secured claims must at least get to retain their liens and receive
payments that have a present value, as of the effective date of the plan,
equal to the value of their collateral. Unsecured claimants must receive at
least the allowed amount of their claim, plus the assurance that if their
claims are not satisfied in full, creditors in junior classes will not receive or
retain any property.

In re Monnier Brothers was a recent case involving application of the cram-
down provisions in a farm reorganization. Prudential Insurance Company
appealed from the confirmation of the Monnier Brothers' plan. Prudential

586. Id. § 1129(a)(7).
587. Id. § 1129(a)(9).
588. Id. § 1129(a)(11) (1982).
589. See In re Monnier Bros., 755 F.2d 1336, 1341 (8th Cir. 1985).
592. For a thorough analysis of the Code's cram-down provisions, see Klee, All You Ever
Wanted To Know About Cram Down Under the New Bankruptcy Code, 53 AM. BANKR. L.J.
133 (1979).
593. 11 U.S.C. § 1129(b)(1) (1982). "Fair and equitable" is a term of art. See In re Monnier
Bros., 755 F.2d 1336, 1342 (8th Cir. 1985); In re King Resources Co., 651 F.2d 1326, 1340
(10th Cir. 1980). See also In re Stoffel, 41 Bankr. 390 (Bankr. D. Minn. 1984) (fair and equitable
standard not met by debtors long delinquent to Federal Land Bank; case dismissed under section
1122(b)(1)).
596. Id. § 1129(b)(2)(B)(i).
598. 755 F.2d 1336 (8th Cir. 1983).
had loaned the debtors $800,000, secured by a mortgage on the debtors' farmland. Interest was set at 13 percent (15 percent on overdue installments), with payments over a term of fifteen years. Debtors filed a Chapter 11 petition before making the first required principal payment to Prudential. Shortly after the bankruptcy, the value of the farmland was $1,356,000, and the indebtedness to Prudential was $1,012,209.599

The Monnier Brothers submitted a plan describing how and when each claim would be paid and making predictions about future crop yields, prices, and expenses. Ten classes of creditors accepted the plan, but Prudential rejected it. The plan provided for an initial payment of $75,000 to Prudential toward accrued interest and for payment of the remaining indebtedness in amortized installments over fifteen years. Interest was to accrue at 10.5 percent after the confirmation date. The bankruptcy court confirmed the plan over Prudential's objections. The district court affirmed confirmation, but fixed the interest rate at the 13 percent established in the original mortgage.600 Prudential appealed to the Eighth Circuit.

Under the cram-down provisions of the Code, the deferred cash payments due to Prudential must total "a value, as of the effective date of the plan, of at least the value of [Prudential's] interest in the estate's interest" in the collateral.601 Prudential had the right to the principal plus interest accrued up to the date of the plan. Thus the court had to determine the interest rate needed for Prudential to receive its total value in light of the fifteen-year amortization of the debt. The Eighth Circuit looked to the indubitable equivalent standard of section 1129,602 which requires that a substitute for the creditor's right to get money under a plan must compensate for present value and ensure the safety of the principal.603 Considering the market value of the farmland and the fact that Prudential was oversecured, the Eighth Circuit could find no error in the district court's imposition of the contract interest rate of 13 percent.604 The court also concluded that the treatment of Prudential under the cram-down provisions had been fair and equitable as required by section 1129(b)(1).605 Prudential retained its lien; it would receive repayment over several years; and it was treated fairly in relation to other secured and unsecured claims.606

599. Id. at 1337.
600. Id. at 1338.
603. 755 F.2d at 1339. See also supra text accompanying notes 98 & 431-434 on indubitable equivalence.
604. 755 F.2d at 1339.
605. Id. at 1342.
606. Prudential raised two additional issues: adequate protection and feasibility of the plan. On the issue of adequate protection, the Eighth Circuit noted that that standard applies to decisions to terminate the automatic stay, but not to confirmation decisions. Although the issue was probably moot, the court concluded that Prudential had been adequately protected during the pendency of the automatic stay. 755 F.2d at 1340.

Prudential also argued that the Monnier Brothers' plan was infeasible under section 1129(a)
In re Hollanger also focused on the issue of indubitable equivalence. In the Hollanger case, a farmer and his wholly owned farming corporation filed under Chapter 11. Pursuant to section 1129(b)(2)(A), the court approved the cram down of a plan over the objections of secured creditors with liens on land with a value that greatly exceeded the value of the liens. Under the plan, these creditors would retain their liens and receive annual installments providing full payment of interest, and some reduction of principal, over seven years. At the end of seven years, the balance of any principal and deferred arrearages became fully due and payable. The court held that the plan met the criteria of section 1129(b)(2)(A)(i). It also held that the plan satisfied the "indubitable equivalent" standard:

[W]here a dissenting claimant is receiving payment in full over a reasonable period of time, with an appropriate interest or discount factor being paid, that creditor is receiving all that the law requires, that is—full payment over a reasonable period of time. Such a dissenting secured claimant is not being deprived of any rights and is receiving completely compensatory treatment.

For a Chapter 11 farm debtor, the real estate mortgage is often a major debt that must be dealt with under the plan. Thus the farm mortgage deserves special consideration at this point. If the farmer has defaulted on a mortgage prior to filing, the plan may propose to cure the default and continue the payments as originally established under the mortgage. The farmer may save a mortgage loan at a favorable interest rate, despite both the lender's acceleration of the full balance of the loan prior to the petition and the initiation of proceedings. If the creditor on the mortgage is oversecured, the creditor will always receive full payment of his claim. But in this situation, the plan may extend the repayment schedule. The farmer's cash flow problems may be mitigated by the lower annual debt service required under an extended mortgage.

In some cases, the farm debtor's mortgagee may be undersecured. Because under section 506(a) the undersecured creditor is unsecured to the extent that

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and should not have been confirmed. The court rejected this argument also. The Eighth Circuit could not say that the feasibility finding was clearly erroneous. Id. at 1341.


608. Id. at 46-47. See also In re Benson, 9 Bankr. 854 (Bankr. N.D. Ill. 1981), decided under section 401(11) of the Bankruptcy Act. This case "established the proposition that farmers should have the right to retain their land, restructure their mortgage debts over a reasonable time, and pay the mortgage debts out of future earnings." Anderson & Rainach, supra note 382, at 471. See also section 1111(b) and Klee, supra note 592, at 152-54, 158-59 for discussion of the election possible to undersecured creditors.

609. See Landers, supra note 200, at 21-22.


611. See In re Hewitt, 16 Bankr. 973 (D. Alaska 1982). But see In re Madison Hotel Assocs., 749 F.2d 410 (7th Cir. 1984), for a discussion of the Chapter 11 debtor's ability to cure and reinstate a foreclosed mortgage.

the debt exceeds the value of the collateral, a scale down as well as an extension of the mortgage debt may be possible. Section 1111(b), however, gives some undersecured creditors an option to be secured to the extent their claims are allowed in exchange for giving up any deficiency judgment against the debtor. If the real estate creditor chooses to be fully secured, then, like oversecured creditors, he must receive payments whose present value is equal to his allowed claim. This would prevent a scale down, but if the reorganization plan is confirmed and the debtor ultimately fails, the creditor cannot look beyond the collateral for payment. Section 1111 is also available to undersecured machinery dealers, but it is less likely that the machinery dealer will choose to be a fully secured nonrecourse lender simply because machinery is certain to depreciate in value more quickly than real estate. The risk of a reorganized farmer failing to meet the plan payments is a great risk for a machinery dealer to assume.

If all the requirements of section 1129(a) and (b) are met, then the court will confirm the plan. The debtor and all creditors are bound, even those creditors who have not accepted the plan. The property of the estate is vested in the debtor, subject only to the rights of the creditors as set forth in the plan. Immediately upon confirmation, the debtor is discharged from prepetition debts, except those debts provided for in the plan and, if the debtor is an individual, debts excepted from discharge under section 523. The debtor then continues to operate the business according to the provisions established in the plan.

Although the procedure for having a plan accepted and confirmed under Chapter 11 is fairly straightforward, albeit not always simple, not all debtors


614. 11 U.S.C. § 1111(b)(2) (1982 & Supp. II 1984). For example, suppose that a class consisted solely of a creditor with a mortgage lien of $600,000 on real property of a farm debtor valued at $500,000. Pursuant to § 506(a), the creditor would have an allowed secured claim of $500,000 and an allowed unsecured claim of $100,000. For a court to cram down a plan over the creditor’s rejection, the creditor would have to retain his lien and to receive payments at least equal as of the effective date of the plan to $500,000. If the creditor made the section 1111(b)(2) election, however, it would have an allowed secured claim of $600,000 and no unsecured claim. For a court to cram down a plan over the creditor’s rejection now, the creditor would have to retain his lien and receive payments equal to $600,000.

615. Id. § 1111(b)(1) (1982). If the claim holder did not have recourse originally, then the election to be secured notwithstanding section 506(a) is unavailable. Id.

616. Landers, supra note 200, at 23 n.43. Professor Landers suggests that Chapter 11 offers one other advantage to the farm-debtor mortgagor. If a farmer wishes to sell a mortgaged parcel under a reorganization plan, the due-on-sale clause will not prevent transfer in Chapter 11. 11 U.S.C. § 541(c)(1)(A) (Supp. II 1984). Even if interest rates have risen, the lender cannot terminate a low-interest loan. The debtor may use the agreement to benefit all the creditors. Landers, supra, at 22.


618. Id. § 1141(b)(1982).

619. Id. § 1141(d). Regarding the individual debtor, see section 1141(d)(2). On discharge, see supra text accompanying notes 44-66.
succeed in having a plan accepted. Some Chapter 11 farm debtors do not submit a plan within the requisite 120 days, nor do they apply to the court for an extension. In some of these cases, litigation has focused on the creditors’ right to propose a liquidating plan for the farm debtor under Chapter 11. In such cases, the debtors have argued that the Code implicitly exempts farmers from Chapter 11 liquidations.

In re Button Hook Cattle Co. involved this issue. The debtor, a family corporation engaged in the business of raising crops and cattle, filed a Chapter 11 petition. It did not file a reorganization plan within 120 days of its petition, nor did it apply for an extension. Button Hook’s principal creditor then filed a plan calling for the sale of all the debtor’s assets. Button Hook objected, arguing that it was exempt from involuntary liquidation and relying on three statutory sections: section 303(a), which precludes an involuntary bankruptcy petition against a farmer; section 1112(c), which prohibits involuntary conversion of a farmer’s Chapter 11 case to Chapter 7; and section 1112(e), which prohibits converting a case to a different chapter, unless the debtor could be a debtor under that chapter.

Relying in part on a case decided by the Fifth Circuit, the Eighth Circuit rejected the debtor’s argument. The court recognized that Congress had drafted section 1121(c) of the Code, which allows creditors to file a plan after the debtor’s 120-day period of exclusivity, to eliminate the debtor’s ability to exert undue bargaining leverage through delay. Congress envisioned the possibility of liquidating plans proposed by creditors, but did not exempt farmers from those plans. Farmers receive defensive protection in bankruptcy when they are protected from both involuntary petitions and involuntary conversions. But Congress indicated no intent to give them offensive protection through the “capability to initiate a Chapter 11 proceeding which both stays collection by creditors and allows [the farmer], by refusing to file, to block the submission of a plan of liquidation.” Thus the court held that after the 120-day period, any party in interest may file a plan, including a liquidation plan, which can be confirmed even over the objection of the farm debtor.

Although all courts have not agreed, a number of decisions have concluded that creditors can file a liquidating plan over the objection of the

620. 747 F.2d 483 (8th Cir. 1984).
621. Id. at 485.
622. In re Jasik, 727 F.2d 1379 (5th Cir. 1984).
624. Button Hook, 747 F.2d at 486, quoting In re Jasik, 727 F.2d at 1381.
Chapter 11 farm debtor.\textsuperscript{627} Even in this event, however, the individual farm debtor will be able to retain assets exempt under section 522.\textsuperscript{628}

V. Chapter 13: Adjustment of Debts of an Individual With Regular Income

It is unrealistic to believe that, without significant amendment, Chapter 13 will be a viable bankruptcy alternative for most farmers. The present debt limitations for that chapter\textsuperscript{629} are considerably lower than the amount of debt that burdens the usual farmer who contemplates bankruptcy.\textsuperscript{630} Nonetheless, because some small farmers may qualify as Chapter 13 debtors, a brief overview follows. Moreover, proposed amendments to the provisions of the Code to make Chapter 13 available to family farmers may make that chapter more relevant in the future.\textsuperscript{631}

Roles of Debtor, Creditor, and Trustee

Chapter 13, like Chapter 11, provides a means of financial reorganization that will permit the farmer to continue the farm operation and pay creditors over a somewhat extended period of time. Chapter 13 is less expensive and less complex, however, and gives the debtor more control over the structure of the reorganization.

The individual farmer who is eligible for Chapter 13 initiates the case by filing a petition and paying a fee of $60.\textsuperscript{632} As in Chapter 11, the farmer-debtor must perform the four basic duties of the debtor specified in section

\begin{itemize}
  \item \textsuperscript{627} In addition to Jaski and Button Hook, cases include: \textit{In re Cassidy Land & Cattle Co.}, 747 F.2d 487 (8th Cir. 1984); \textit{In re J.F. Toner & Son, Inc.}, 40 Bankr. 461 (Bankr. W.D. Va. 1984); \textit{In re Tinsley}, 36 Bankr. 807 (Bankr. W.D. Ky. 1984).
  \item \textsuperscript{629} See supra text accompanying notes 19-20. On Chapter 13 and the farmer, see generally Dole, \textit{supra} note 9.
  \item \textsuperscript{630} The following statement from a Bankruptcy Judge from the Middle District of Tennessee indicates the extent of indebtedness of farm debtors:
    Since . . . October of 1981, this district has handled approximately 34 Chapter 11 cases involving family farmers. Of these cases, 19 are still pending, eight have been converted to Chapter 7 and seven have been dismissed. In approximate figures, the total statistics are as follows: Secured debt, $29,985,850; Unsecured debt, $5,642,650; and 10,410 acres of farmland valued at $19,354,300. Our average family farmer would therefore have approximately $881,935 in secured debt; $170,990 in unsecured debt; 336 acres of farmland valued at $645,145.
    The following statement from a Bankruptcy Judge from the Middle District of Tennessee indicates the extent of indebtedness of farm debtors:
    \begin{itemize}
      \item See H.R. 1397, 99th Cong., 1st Sess. (1985); H.R. 1399, 99th Cong., 1st Sess. (1985). H.R. 1399, for example, would amend section 101 of the Code to define "family farmer" as an individual (or a family-owned corporation) who received more than 50 percent of his gross income from farming. In addition, it would raise the Chapter 13 debt limitations, for cases involving family farmers, to $1 million of noncontingent, liquidated, secured, and unsecured debt. The family farmer's plan could extend ten years.
      \item 28 U.S.C. \S 1930 (1982).
    \end{itemize}
\end{itemize}
521, as well as attend the meeting of creditors prescribed by section 341.\textsuperscript{633} Also, subject to any limitations imposed by the court, the Chapter 13 debtor who is engaged in business may continue the operations after filing the petition.\textsuperscript{634} A "debtor engaged in business" is a debtor who is self-employed and who incurs trade credit in the production of income from his self-employment.\textsuperscript{635} Most farm debtors, if otherwise eligible for Chapter 13, should be able to continue to operate their farms during the bankruptcy proceedings.

Under Chapter 13, the debtor's estate is defined expansively. It includes prepetition property normally considered part of the bankrupt estate under section 541.\textsuperscript{636} In addition, it includes property that the debtor acquires after he files the bankruptcy petition and before the case is closed, dismissed, or converted to Chapter 7 or 11.\textsuperscript{637} The debtor's postpetition earnings are also part of the estate.\textsuperscript{638} Unless the plan or a court order specifies otherwise, the debtor will retain possession of property of the estate.\textsuperscript{639}

The Chapter 13 farm debtor, like other Chapter 13 debtors, has the advantage of two special protective provisions. First, in Chapter 13, only the debtor may file a plan. Unlike in Chapter 11, the creditors have no right to file a plan.\textsuperscript{640} The debtor has the exclusive right and must file the plan either with the petition or within the time prescribed by bankruptcy rules.\textsuperscript{641} Unless the court grants an extension for cause, the plan must be filed within fifteen days.\textsuperscript{642} Although this time limit is short, the debtor, rather than creditors, will control the development of the reorganization.

Second, Chapter 13 includes a provision that stays any actions of creditors to collect any part of a consumer debt of the debtor from a codebtor.\textsuperscript{643} This stay against codebtors does not apply if the codebtor secured or became liable on the debt in the ordinary course of his business, or if the case is dismissed, closed, or converted to a Chapter 7 or a Chapter 11 case. The court may grant relief from the stay if the codebtor actually received consideration, if the plan proposes not to pay the claim, or if the stay would irreparably harm the creditor.\textsuperscript{644} Although the stay is only temporary and the codebtor may

\textsuperscript{633} See supra text accompanying notes 326-330.
\textsuperscript{634} 11 U.S.C. § 1304(b) (Supp. II 1984).
\textsuperscript{635} Id. § 1304(a) (1982).
\textsuperscript{636} Id. §§ 1306(a), 541. See supra text accompanying notes 106-117.
\textsuperscript{638} Id. § 1306(a)(2). Earnings from services are included until the case is closed, dismissed, or converted to Chapter 7 or 11.
\textsuperscript{639} Id. § 1306(b).
\textsuperscript{640} Id. § 1321.
\textsuperscript{642} Bankr. Rule 3015.
eventually be required to pay the debt,\textsuperscript{645} the stay may be useful to the farm debtor, especially when members of the family or friends are codebtors. It protects the debtor from pressure exerted from those who may have cosigned on a consumer debt.

In part because creditors cannot file a plan, they play a less important role in Chapter 13 cases than under Chapter 11. The trustee’s role in Chapter 13 is also unique. Normally, the trustee does not take possession of the debtor’s property.\textsuperscript{646} Instead, the trustee acts as a financial counselor and as a disbursing agent. The trustee performs many of the normal trustee’s duties specified in section 704.\textsuperscript{647} He participates in hearings concerning the debtor’s plan, gives the debtor nonlegal advice and assistance, and ensures that the debtor begins to make timely payments under the plan.\textsuperscript{648} In addition, under the debtor’s plan, the trustee must supervise and control that part of the debtor’s future income needed to carry out the plan.\textsuperscript{649} Unless the plan or a court order provides otherwise, the trustee will also make payments to creditors under the plan.\textsuperscript{650}

\textit{The Plan}

Although only the debtor may submit a plan, the debtor’s plan must conform to the requirements of Chapter 13. Three requirements are paramount.\textsuperscript{651} The plan must provide for submission of all or part of the debtor’s future earnings or income to the trustee as needed to execute the plan. It must provide for full payment of all claims with priority under section 507, unless the holder agrees otherwise. In addition, if the plan classifies claims, it must provide the same treatment for each claim within a particular class.\textsuperscript{652}

Beyond these three requirements, the plan may include any appropriate provision that is not inconsistent with the Code.\textsuperscript{653} The Code lists a number of


\textsuperscript{646} 11 U.S.C. § 1306(b) (1982).

\textsuperscript{647} Id. § 1302(b)(1) (Supp. II 1984).

\textsuperscript{648} Id. § 1302(b)(2), (4), (5).

\textsuperscript{649} Id. § 1322(a)(1).

\textsuperscript{650} Id. § 1326(c).

\textsuperscript{651} Id. § 1322(a).

\textsuperscript{652} Courts have generally held that a Chapter 13 plan cannot classify claims according to whether the underlying debt is guaranteed by a codebtor. \textit{In re} McKenzie, 4 Bankr. 88 (Bankr. W.D.N.Y. 1980); \textit{In re} Utter, 3 Bankr. 369 (Bankr. W.D.N.Y. 1980). But see section 1322(b)(1) (concerning consumer debts when an individual is liable with the debtor). A plan can classify a claim separately when the underlying debt is a child support obligation. \textit{In re} Haag, 3 Bankr. 649 (Bankr. D. Or. 1980); \textit{In re} Curtis, 2 Bankr. 43 (Bankr. W.D. Mo. 1979). One court has warned that definitions in and interpretations of section 1122 are irrelevant to classification problems in a Chapter 13 plan because of the different contexts of Chapter 11 and Chapter 13 cases. \textit{In re} Hill, 4 Bankr. 694 (D. Kan. 1980).

\textsuperscript{653} 11 U.S.C. § 1322(b)(10) (1982). For example, in \textit{In re} Simmons, 23 Bankr. 364 (Bankr. N.D. Ill. 1982), the court confirmed a plan that reinstated a foreclosed mortgage and provided for payment of mortgage arrearages within twenty-four months. The issue was whether a foreclosed mortgage could be reinstated in a Chapter 13 plan, and if so, whether the payment of a sum.
provisions that may be included in the plan. The debtor may classify unsecured claims, but may not discriminate unfairly against any class. The debtor may modify the rights of holders of unsecured and secured claims, but cannot modify claims secured only by a mortgage on the debtor's principal residence. Under a plan the debtor may cure or waive any default, and he may assume or reject executory contracts or unexpired leases under section 365. The Chapter 13 plan is subject to fewer requirements than a Chapter 11 plan; thus it offers more flexibility to the debtor. One important restriction in Chapter 13, however, is the time limitation. The plan usually may not provide for payments over a period longer than three years, although the court may approve a period not to exceed five years.

After the debtor files the plan under Chapter 13, secured creditors have an opportunity to accept the plan. Pursuant to sections 1324 and 1325, the court must evaluate and confirm the plan. The court will hold a confirmation hearing, at which parties in interest may object to the confirmation of the plan. Generally, the court will confirm the plan if it meets the requirements of section 1325. Under that section, the debtor must be able to carry out the plan, which must comply with the provisions of the Code, and the

less than the judgment amount resulted in lack of adequate protection and was cause for lifting the stay under section 362(d). The court concluded that:

Chapter 13 debtors may reinstate their mortgages and arrange for repayment of arrearages over a reasonable period of time and keep current on payments due under the terms of the reinstated mortgage. Whether the entire judgment amount must be paid to provide adequate protection to creditor need only be addressed where the creditor has met his burden of proof on the issue of equity. Once the creditor has met this burden, it is then, and only then, incumbent upon the debtor to establish that the creditor is adequately protected, the property is necessary to an effective reorganization and that there is a reasonable possibility of a successful reorganization.

23 Bankr. at 366 (citations omitted). The court found that the debtors had equity in the property and thus that cause for lifting the stay did not exist. See also In re Fulks, 48 Bankr. 20 (Bankr. N.D. Ga. 1984) (foreclosure sale not stayed by debtor's Chapter 13 petition because debtor did not have record title).

655. Id. § 1322(b)(1) (Supp. II 1984).
656. Id. § 1322(b)(2). Several courts have indicated, however, that the Chapter 13 debtor may cure a default on a mortgage secured by a principal residence. Clark v. Federal Land Bank, 738 F.2d 869 (7th Cir. 1984) (petition filed after foreclosure; debtor can cure in part because title did not pass under Wisconsin law until foreclosure sale); Grubbs v. Houston First Am. Sav. Ass'n, 730 F.2d 236 (5th Cir. 1984) (en banc) (default may be cured; past due amounts may be paid during term of the plan); Di PIERRO v. Taddeo (In re Taddeo), 685 F.2d 24 (2d Cir. 1982).

658. Id. § 1322(c) (1982).
659. Id. § 1324 (Supp. II 1984). No objection need be made, however, for a court to deny confirmation of a plan that does not meet the criteria set forth in section 1325(a) (1982 & Supp. II 1984). In re Williams, 3 Bankr. 728 (Bankr. N.D. Ill. 1980).
660. 11 U.S.C. § 1325(a)(6) (1982). See General Motors Accep. Corp. v. Ryals (In re Ryals), 3 Bankr. 522 (Bankr. E.D. Tenn. 1980), for an example of the factors a court may consider in determining whether the debtor will be able to carry out the plan. See also Goeb v. Heid
plan must have been proposed in good faith.\textsuperscript{662} Unsecured creditors should receive at least the amount they would have been paid in a Chapter 7 liquidation case.\textsuperscript{663} For secured claimants, there are three possibilities. Holders of allowed secured claims may accept the plan.\textsuperscript{664} Alternatively, the secured claimants will retain their liens and receive property under the plan with a present value of at least the allowed amount of such claims.\textsuperscript{665} Or the debtor could surrender the property securing the claims to the claimholders.\textsuperscript{666} Once the plan is confirmed, it binds the debtor and each creditor, regardless of whether the creditor’s claim is provided for by the plan.\textsuperscript{667} Unless the plan provides otherwise, confirmation vests all of the property of the estate in the debtor, free and clear of creditors’ claims or interests.\textsuperscript{668} After confirmation, the debtor will continue to run the farm business, unless the court orders otherwise, and has the same rights and powers as after the order for relief and before confirmation. Both before and after confirmation, the farmer must file periodic reports of the operation of the business, including a statement of receipts and disbursements.\textsuperscript{669} While the debtor is running the business, he normally remits payments under the plan to the trustee, who in turn distributes the payments to the creditors.\textsuperscript{670} Upon completion of payments under the plan, the court must discharge the debtor, as described above.\textsuperscript{671} Normally in Chapter 13, a creditor cannot object to discharge of a debtor, though a creditor may challenge the debtor’s good faith by objecting to confirmation of the plan.\textsuperscript{672} Chapter 13 also pro-

\textsuperscript{662} Id. § 1325(a)(3) (1982). Courts have disagreed considerably as to when a Chapter 13 plan is proposed in good faith. Some courts have required no or only minimal payments to unsecured creditors, while others have held that the plan was not proposed in good faith because the payments were too low. See 5 COLLIER ON BANKRUPTCY ¶ 1325.01 (L. King ed., 15th ed. Cum. Supp. 1980) and cases cited therein. Courts have also disagreed on whether the plan must represent the debtor’s best efforts and on the effect of fraud on the part of the debtor. Id. In addition, some courts have found that a plan was not proposed in good faith because the debtor would not be able to make all of the payments under the plan. Id.
\textsuperscript{663} 11 U.S.C. § 1325(a)(4) (1982). If unsecured creditors object to confirmation, the court cannot approve the plan unless the value of property to be distributed is not less than the amount of the claim. Alternatively, the plan must provide that all of the debtor’s disposable income to be received during the three-year plan period will be used for payments under the plan. Id. § 1325(b) (Supp. II 1984). Subsection (b) was added by the 1984 amendments.
\textsuperscript{664} Id. § 1325(a)(5)(A) (1982).
\textsuperscript{665} Id. § 1325(a)(5)(B).
\textsuperscript{666} Id. § 1325(a)(5)(C).
\textsuperscript{667} Id. § 1327(a).
\textsuperscript{668} Id. §§ 1327(b), (c).
\textsuperscript{669} 11 U.S.C. § 1304(c) (Supp. II 1984).
\textsuperscript{670} Id. § 1326.
\textsuperscript{671} See supra text accompanying notes 59-61.
vides for a hardship discharge, 673 which may be especially important to farmers because of the unpredictability of farming. Because of the vagaries of weather conditions or prices, or because of government policies, such as embargos and changes in price-support programs, 674 the Chapter 13 farm debtor may be unable to complete payments on a plan that seemed reasonable when confirmed. In most instances, however, modification of the Chapter 13 plan would be more advantageous than the hardship discharge to the farmer, if he can perform under the modified plan.

The Chapter 13 debtor who must eventually file a Chapter 7 liquidation case receives special consideration. Normally, a debtor can be discharged in bankruptcy only once every six years. The debtor who has been discharged under section 1328 within six years before the Chapter 7 petition cannot receive a discharge in the Chapter 7 case, unless payments under the Chapter 13 plan totaled at least 100 percent of the allowed unsecured claims, or 70 percent of the allowed unsecured claims and the plan was proposed by the debtor in good faith and was the debtor’s best effort. 675 No similar relaxation of the six-year rule is made for debtors who receive a discharge in a Chapter 7 or 11 case. 676

Conclusion

The nature of farming, which is subject to unpredictable weather conditions and uncontrollable commodity prices, makes the farmer particularly vulnerable to financial stress. Moreover, the recent combination of high debt loads, bad weather, low crop prices, and declining land values has led to insolvency for an increasing number of farmers. Others have managed to survive, only to face failure after another crop year.

Many of these farmers in financial crisis face the difficult prospect of bankruptcy. Once a decision to file a bankruptcy petition has been made, most often because no other option can succeed, the farmer and his attorney must comply with the often complex requirements of the Bankruptcy Code. As the above discussion has indicated, some provisions protect the farmer; most require compliance, cooperation, and financial sacrifice from the already-stressed farmer.

The nature of the farming profession raises some unique issues in bankruptcy. This article has focused on these important issues within the framework of a general discussion of farm bankruptcy. The unprecedented number of farmers entering bankruptcy, and the recent amendments to the Bankruptcy Code, have made a clear understanding of this subject crucial to attorneys with farm clients. It is hoped that this analysis of these issues will help attorneys to guide bankrupt farmers successfully through these troubled times.

673. See supra text accompanying notes 62-64.
674. 2 Juergensmeyer & Wadley, supra note 16, at 384; Looney, supra note 16, at 520.
676. Id. § 727(a)(8) (Supp. II 1984).