# In the United States Bankruptcy Court

## for the Northern District of Iowa

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| EDDIE L. BURKHART and<br>SANDRA S. BURKHART | Bankruptcy No. |
| *Debtor(s).* | Chapter 12 |

## MEMORANDUM OF DECISION AND ORDER RE: DENIAL OF CONFIRMATION

The matter before the Court is the confirmation of a Chapter 12 amended Plan of Reorganization proposed by Debtors Eddie L. Burkhart and Sandra S. Burkhart. A hearing was held April 26, 1988. Briefs were filed by Debtors and one objector, Farmers Home Administration, by June 20, 1988. This ruling shall constitute findings of facts and conclusions of law as required by Bankr. R. 7052. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(L).

I.

On January 25, 1988, Debtors Eddie L. Burkhart and Sandra S. Burkhart (Debtors) filed a Chapter 12 petition in bankruptcy. They filed their plan of reorganization on January 29, 1988. Following an objection by Farmers Home Administration (FmHA), Debtors filed an amended plan on March 29, 1988.

Debtors and FMHA have stipulated to the value of certain secured property.[(1)]

Further, the parties have agreed that FMHA has a lien on 240 acres of Debtors' property at a value of $108,800.00 and a purchase money security interest in a combine, planter, and cultivator at a value of $7,700.00. Debtors and FmHA have also agreed that FmHA has a second lien on livestock for $6,406.00 and a first lien on feed for $4,800.00.

Debtors' debt to FmHA is evidenced by six promissory notes:

| Date | Interest Rate | Type of Loan (and Action Requiring Note) | Amount |
|---|---|---|---|
| 7-15-85 | 10.75 | Economic Emergency | $91,108.76 |
| 4-2-87 | 4.5 | Operating Loan (subsequent loan) | 25,000.00 |
| 4-2-87 | 5.0 | Emergency Loan (rescheduling) | 30,765.42 |
| 4-2-87 | 4.5 | Operating Loan (consolidation; rescheduling) | 63,686.09 |
| 4-2-87 | 5.0 | Farm Ownership Loan (consolidation; reamortization) | 230,654.47 |
| 4-2-87 | 7.5 | Economic Emergency (rescheduling) | 168,232.35 |

Debtors' plan proposes to pay FmHA's secured claim of $108,800.00 in 20 annual installments of $8,730.33 at 5% interest beginning April 1, 1989 with the first three payments made through the Trustee. Debtors' plan provided that FmHA's lien on equipment would be avoided with the exception of that equipment in which FMHA has a purchase money security interest valued at $7,700.00. Debtors recognized FmHA's lien on livestock and agreed to maintain 900 head and grant FMHA a replacement lien on all livestock and feed acquired after the filing of their petition. Debtors further proposed to pay FMHA $18,906.00 over seven years on the equipment, feed, and livestock with equal annual payments beginning April 1, 1989 with the initial three payments made through the Trustee.

Debtors disputed FmHA's interest in Debtors' $7,840.00 1987 deficiency payment and 1988 conservation reserve program (CRP) payment and did not provide for them in the plan.

FmHA has raised several issues:

(1) whether FMHA has a secured interest in Debtors' 1987 farm program payments which should be recognized in Debtors' plan;

(2) whether FMHA has a secured interest in Debtor's 1988 CRP payment;

(3) whether Debtors may avoid FmHA's lien on exempt property pursuant to 11 U.S.C. § 522(f) within their plan;[(2)]

(4) whether Debtors have provided for an appropriate rate of interest on FmHA's secured claim;

(5) whether's Debtors have set forth appropriate repayment periods on FmHA's secured claim on non-breeding livestock, feed, farm program payment, and CRP payment; and

(6) whether Debtors' plan is feasible.

II.

Confirmation of a Chapter 12 plan is governed by 11 U.S.C. § 1225. It sets forth several requirements including compliance with Chapter 12 and Title 11, payment of required fees, a proposal in good faith, and an appropriate valuation and distribution of claims. 11 U.S.C. § 1225(a). Contents of a plan are governed by § 1222. This section also establishes several requirements including payment of priority claims and equal treatment of each claim within a particular class. 11 U.S.C. § 1222(a). Several optional provisions are also set forth. 11 U.S.C. § 1222(b). The debtor has the burden of showing the plan comports with Code requirements. See In re Opperman, Bankr. No. 87-00548F, slip op. at 2 & 8. (Bankr. N.D. Iowa January 12, 1988).

III.

A.

FMHA first objects to Debtors' failure to recognize FmHA's secured interest in certain farm and conservation program payments paid or to be paid to Debtors.

On March 3, 1987, Debtors contracted to participate in Commodity Credit Corporation's 1987 Price Support and Production Adjustment Programs with their corn crop. In exchange, Debtors became eligible to receive deficiency and diversion payments. FMHA claims a secured interest in Debtors' payment by virtue of its security agreement of June 25, 1987. This agreement provided for a security

interest in inter alia "[a]ll [of Debtors'] accounts, contract rights and general intangibles as follows: All Deficiency Payments and PIK Certificates."

The Court concludes that FMHA has a secured interest in Debtors' 1987 deficiency payment which should be recognized in Debtors' plan. The security agreement specifically identified the item of collateral in compliance with I.C. § § 554.9402(l) and 554.9110. Compare In re Heims, 65 B.R. 112 (Bankr. N.D. Iowa 1986). Further, Debtors have not identified any subsequent agreement between the parties nor any valid statute or regulation which defeats FmHA's secured interest in this deficiency payment. In re Arnold, Bankr. No. 87-00767W, slip op. at 8 (Bankr. N.D. Iowa July 8, 1988).

Debtors argue in their brief that FmHA's lien on the deficiency payment should be "limited to the debtors actual receipt and value at the time that payments are made" and that FmHA's interest is "so speculative that on the date of confirmation the value pursuant to 11 USC [§] 506 would be 0 and according [sic] [FMHA] would be entitled to nothing from the PIK certificate." Debtors' Brief, filed June 20, 1988 at p. 9.

No evidence was presented on the value of Debtors' 1987 deficiency payment or its speculative nature so the Court is unable to further address Debtors' concern. Any subsequent plan of reorganization proposed by Debtors should, however, properly reflect FmHA's secured status in the deficiency payment pursuant to § 506.

B.

FMHA also argues it has an enforceable lien in Debtors' 1988 CRP payment under a mortgage pledge of rents and profits. Debtors do not disagree. See Debtors' Brief, filed June 20, 1988 at p. 10. Rather, Debtors argue FMHA "cannot collect the rental payments as long as the [debtor] makes the plan payments." Id. Further, Debtors argue that the CRP payment actually serves as adequate protection for the payments under the plan to be made to FmHA. Id. at 11.

A granting clause in a mortgage which conveys rents with the land is a pledge of rent as primary security for the indebtedness. Federal Land Bank v. Lower, 421 N.W.2d 126, 128 (Iowa 1988). A primary pledge of security is not effective upon default but instead transfers rent as security as well as the land. Id. at 128 (quoting Equitable Life Insurance Co. v. Brown, 220 Iowa 585, 591-92, 262 N.W. 124, 127-28 (1935)).

The granting clause in the mortgages given by Debtors conveyed certain described real estate "together with all the rents, issues, and profits thereof . . . and all payments at any time owing to Borrower by virtue of any sale, lease, transfer, conveyance or condemnation of any part thereof or any interest therein. . . . " Thus, as a primary grant of security, FMHA had a lien on rents, which Debtors recognize to include CRP payments, that was effective from the date the mortgage was executed and which was perfected at the time the mortgage was recorded. Federal Land Bank v. Terpstra (In re Minnie Ella Porter), D.C. No. C87-0063 (D. N.D. Iowa 1988).

FMHA does have an enforceable lien in the debtors' 1988 CRP payment which is to be received in October of 1988, under a mortgage pledge of rents and profits. However, the value of this lien should be and is reflected in FmHA's allowed secured claim in the 240 acres. If the CRP payments increase the value of the property, this increase should be reflected in the value of the allowed secured claim.

This court believes the most appropriate way to value the FmHA's secured claim in the 240 acres and the CRP payments is to value the land taking into consideration any enhanced value attributed to the

CRP payments. This approach seems to be more logical than valuing the land and CRP payments separately. If the land was valued without taking into account the remaining CRP payments, it seems to this court that the land would be of less value.

The debtors will be allowed to use the annual CRP payments, including the 1988 payment, to make any payments under a subsequently filed Chapter 12 plan. However, FMHA will be entitled to retain its security interest in the annual CRP payments to provide security in the event the plan payments are not made.

C.

Debtors' plan proposes to avoid FmHA's lien on all exempt equipment pursuant to § 522. FMHA argues avoidance of a lien is required by Bankr. R. 4003(d) to be a separate proceeding by motion in accordance with Bankr. R. 9014.

FmHA's argument is correct. Debtors have not offered any statutory authority or decisions which allow the mandatory provisions of the cited rules to be mitigated. The debtors cannot merely provide for avoidance of the liens in the plan of reorganization. See In re McKay, 732 F.2d 44 (3rd Cir. 1984). The debtors should utilize the proper procedure for avoiding liens on exempt property.

D.

Under the present value provisions of § 1225(a)(5), FMHA challenges the interest rates and repayment periods proposed by Debtors on FmHA's secured claims. Debtors propose to pay FmHA's $108,800.00 claim secured by real estate over 20 years with equal annual payments at 5% interest. Debtors propose to pay FmHA's $18,906.00 claim secured by equipment, feed, and livestock over seven years at 7-3/4% interest.[(3)]

The debtors argue that the interest rate paid to FMHA under the plan should be the treasury bill rate on the date of confirmation. The debtors argue that since the Agricultural Credit Act of 1987, Pub. L. 100-233, 1987 U.S. Code Cong. & Admin. News (101 Stat.) 1568-1718, covers FMHA loans, the court should use the definition of present value contained in the new legislation. Debtors' brief filed June 20, 1988 at p. 3-4.

Alternatively, the debtors argue that if the Agricultural Credit Act of 1987 is determined inapplicable, the rate of interest should be the contract rate of the FMHA loans.

The FMHA contends that the appropriate rate of interest in a Chapter 12 reorganization is a yield on treasury bonds plus an additional risk premium of at least 2%. The FMHA argues that the debtors should not be allowed to take advantage of both the bankruptcy law and FMHA procedures which allow for lower interest rates. The FMHA contends that the allowance of the contract rate to the Chapter 12 debtor creates a competitive advantage which is contrary to Congress' intent in establishing the limited resource loan rate.

The term "present value" is defined in the Agricultural Credit Act as a discount rate of not more than the current rate on 90-day treasury bills. This present value figure is used by the Secretary of Agriculture in calculating the value of the restructured loan. The value of the restructured loan must be calculated in order to determine if an FMHA borrower is eligible for loan restructuring under the Agricultural Credit Act of 1987. An FMHA borrower is eligible for restructuring if the restructured loan results in a net recovery to the federal government that would equal or exceed the present value

of the loan. See Agricultural Credit Act of 1987, Pub. L. 100-233, 1987 U. S. Code Cong. & Admin. News (101 Stat.) 1568, 1678-79.

The court believes that the term "present value," as defined in the Agricultural Credit Act of 1987 is only applicable in those situations where the FMHA borrower is seeking a restructuring of his loans. There is no indication that the debtors have sought restructuring of their loans with the FMHA. Therefore, this court does not need to decide whether the provisions of the Agricultural Credit Act of 1987 apply if a debtor has filed bankruptcy.

Four of the debtors' six notes with the FMHA are at or below the government's cost of money. The operating loans, emergency loan, and farm ownership loan made on April 2, 1987 at rates of 41/2 to 5% were at or below the government's cost of money.

Since the court has determined the term "present value," as defined in the Agricultural Credit Act of 1987, is not applicable to this case, the debtors argue the court should follow the reasoning of In re Doud, 74 B.R. 865 (Bankr. S.D. Iowa 1987) aff'd. sub nom., slip op. U.S.D.C. 87-577-B (Dec. 7, 1987). In Doud at 871, the court concluded that the congressional policy of FMHA subsidized loan program would be thwarted if the traditional market rate approach was used. Therefore, the court held that the appropriate rate of interest should be the contract rate for those loans which were at or below the government's cost of money. The court stated in Doud at 871, "It would be incongruous indeed if a farmer who on one hand qualified for FMHA protection because of high risk characteristics but on the other hand be required to forego these protections in order to proceed under Chapter 12."

The reasoning of Doud, 74 B.R. 865 (Bankr. S.D. Iowa 1987), was adopted by this district in In re Even, slip op. Bankr. No. 86-02802W (Bankr. N.D. Iowa 1987), affirmed, slip op. U.S.D.C. No. C87-2036, May 27, 1988.

The court in Even stated "[t]hat the decision in In re Doud correctly holds that in Chapter 12 plans containing FMHA noncommercial interest rate loans as debt, the correct Chapter 12 plan rate is the underlying FMHA note rate." The court in Even held that the bankruptcy court committed no error in approving the contract rate for the FmHA's allowed secured claim in the Chapter 12 plan.

In Doud, the court relied heavily on the social welfare objective of the FMHA in concluding that it would be unfair to charge an FMHA borrower in a Chapter 12 reorganization a commercial interest rate. Farmers Home Administration is a lender of last resort and one of its major purposes is to provide low-cost credit to high risk and low equity farmers. See U. S. v. Kimbell Foods, Inc., 99 S.Ct. 1448, 440 U.S. 715, 59 L.Ed.2d 711 (1979). However, an FmHA borrower is only entitled to a low interest rate loan during those periods in which he can show that he is unable to obtain credit from other sources and that his equity position entitles him to low interest rates. FmHA loans which are made below the government's cost of money are periodically reviewed to determine if the borrower is still eligible for the subsidized loan. See 7 C.F.R. § 1951.25 (1988). Each year the FMHA borrower is required to file a Farm and Home Plan with the county supervisor. A Farm and Home Plan provides the FMHA with projections of income and expenses for the upcoming year. If a review of the Farm and Home Plan shows that the borrower has a substantial increase in income and repayment ability, either the interest rate may be increased to the current rate for farm ownership or long term operating loans or the borrower may be graduated to a different FMHA program. See 7 C.F.R. § 1951.25(b)(3) (1988).

If this court follows the reasoning of Doud, it is possible that a Chapter 12 debtor would be allowed to repay the FmHA at a subsidized rate even though circumstances may have changed that would enable

the debtor to be able to pay the market rate. However, if the court applies a market rate and increases the interest rate above the contract rate, the debtors would in effect be required to forego the low interest FMHA program in order to file a Chapter 12 reorganization.

This court agrees with the reasoning of In re Doud and In re Even in concluding that the appropriate discount rate for the FMHA noncommercial interest rate loans is the contract rate.

The appropriate discount rate to be used for the following FMHA loans is the contract rate:

| Date | Contract Interest Rate | Type of Loan (and Action Requiring Note) | Amount |
|---|---|---|---|
| 4-2-87 | 4.5 | Operating loan (subsequent loan) | $25,000.00 |
| 4-2-87 | 5.0 | Emergency loan (rescheduling) | 30,765.42 |
| 4-2-87 | 4.5 | Operating loan (consolidation; rescheduling) | 63,686.09 |
| 4-2-87 | 5.0 | Farm ownership loan (consolidation; reamortization) | 230,654.47 |

With regard to FMHA loans made above the government's cost of money, the court in In re Doud at 871 concluded that the appropriate discount rate is the yield on a treasury bond with a remaining maturity matched to the average amount outstanding during the term of the allowed claim plus an additional risk factor of 2%.

The economic emergency loan made by FMHA on July 15, 1985 at an interest rate of 10.75% was made on the basis of the current market rate. Additionally, the economic emergency loan made to the debtors on April 2, 1987 at an interest rate of 7.5% was also made at the market rate. With regard to these loans, the appropriate discount rate should be the yield on a treasury bond with the remaining maturity matched to the average amount outstanding during the term of the allowed claim plus an additional risk factor of 2%. See In re Doud, 74 B.R. 865, 867 (Bankr. S.D. Iowa 1987).

E.

Finally, FMHA contends that the projected death loss on pigs as well as the estimated annual hog production in Debtors' plan do not accurately reflect past years' figures. Consequently, FMHA argues Debtors' plan is not feasible.

At the confirmation hearing, both parties presented some evidence that death loss in Debtors' pigs in past years exceeded the 2% loss recognized in Debtors' plan. Debtors, however, also presented evidence that past years' losses due to disease have now been reduced by purchasing feeders from one source and that only a problem with a nervous disorder remains.

Debtors have not demonstrated a reasonable probability that the plan will be successful. Opperman, slip op. at 2. Debtors did not present sufficient evidence to establish that higher production as well as lower death loss rates on pigs can be reasonably expected in contrast to historical averages. See In re Konzak, 78 B.R. 990, 994 (Bankr. D. N.D. 1987). Any subsequent plan proposed by Debtors should appropriately reflect historical production, death loss, and veterinary expenses or more clearly demonstrate what variances from past years can be reasonably expected.[(4)]

**ORDER**

Confirmation of the amended Plan of Reorganization proposed by Debtors Eddie L. Burkhart and Sandra S. Burkhart is hereby denied. Debtors shall have 30 days to file a new or amended plan.

SO ORDERED THIS 23rd DAY OF AUGUST, 1988.

William L. Edmonds
Chief Bankruptcy Judge

Filed Stamped Sept. 23, 1988

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1. See Order Re: Initial Confirmation Hearing, filed March 24, 1988, p. 3.

2. FMHA initially contended that Debtors could not avoid FmHA's lien on post-petition crops within their plan instead of by motion. FMHA states in its brief that the offensive language has been removed from Debtors' plan. FmHA's Brief, filed May 27, 1988, at p. 22.

3. If the Court found FmHA had a secured interest in Debtors' CRP and deficiency payments, Debtors proposed to pay a total of $12,715.00 over seven years at 7-3/4% interest.

4. Changes made in Debtors' Cash Flow [Exhibit 8] at the confirmation hearing should also be incorporated in any subsequent plan.