

# **In the United States Bankruptcy Court**

## **for the Northern District of Iowa**

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PAUL KOPPE  
SANDRA KOPPE  
*Debtor(s).*

Bankruptcy No. 99-01748-D

Chapter 12

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### **ORDER RE ELIGIBILITY UNDER CHAPTER 12 AND VALUATION HEARING**

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This matter came before the undersigned on December 6, 1999 pursuant to assignment. Peter Riley represented Debtors Paul and Sandra Koppes. Matt McQuillen represented Security State Bank. Carol Dunbar appeared as Chapter 12 Trustee. After the presentation of evidence and argument, the Court took the matter under advisement. The time for filing briefs has now passed and this matter is ready for resolution. This is a core proceeding pursuant to 28 U.S.C. §157(b)(2)(A) and (B).

#### **STATEMENT OF THE CASE**

In its objection to confirmation of Debtors' Plan, Security State Bank argues that Debtors do not qualify for Chapter 12 relief. The Bank also objects to Debtors' valuation of its collateral. This matter was set for hearing on valuation issues, and to determine Debtors' eligibility for Chapter 12 relief under §109(f) and §101(18)(A).

#### **FINDINGS OF FACT**

Debtors have been farmers for 35 years, raising hogs and beef cattle. They sold their entire sow herd in 1992. They retained their stock cow herd until 1998. On February 14, 1998, to avoid a foreclosure by the Bank, Debtors sold all their cattle with the Bank's authorization. Debtors felt this liquidation would satisfy their loans with the Bank and they would be able to keep their home free and clear. Mrs. Koppes testified that the Bank told them that if there was an orderly liquidation they should be able to keep their home. Mr. Koppes testified that, after the sale of the cattle herd, he still intended to raise cattle. However, it would be on rented ground on a limited basis. The sale eliminated Debtors' equity, however, and they had no cash flow to start a new herd. The Bank foreclosed on Debtors' real estate and received a judgment in Iowa District Court on March 11, 1999. Debtors filed their Chapter 12 petition on June 30, 1999.

When Debtors filed their initial Chapter 12 plan, they proposed keeping 60 acres of their farm real estate, including the building site where their residence is located. Their plan was based in part on conducting a cow operation on the property. Debtors now indicate, however, that they intend to amend their plan and keep only a 7-acre parcel of land including the building site. They testified that they intend to lease 55 acres from a neighbor, at \$30 per acre, for a stock cow herd of between 30 and

35 cattle. Debtors currently have no funds with which to restock a cattle herd. Mr. Koppes testified that he has talked to Tri-County Bank about financing.

Mr. Koppes has farm machinery, including a combine and tractor. In 1999, he did some custom combining for his brother. This was done without compensation. He works full-time at Cascade Manufacturing as a fork lift operator. Prior to selling the cow herd, he worked off the farm on a part-time basis. Mrs. Koppes has a full-time job off the farm as receptionist at the Maquoketa Veterinary Clinic.

Debtors leased their tillable acres to tenants in 1998 and 1999. They did not have any interest in the crops in either year. Debtors have their farmland bid in to a CRP program. If the bid is accepted, there will be no crop production on the land for 10 years. The last season Debtors cultivated a crop was in 1997. Debtors have had no cattle since they sold their herd in February 1998.

In 1998, Debtors earned wages of \$25,341. Gross income from farming shown on Schedule F of their 1998 federal tax return was \$7,212. They also reported "other income" of \$49,911 which is capital gains from the liquidation of their cattle and some equipment. The gains from the sale of cattle and equipment, plus the gross farming income, equal more than 50% of their 1998 gross income. Excluding the gains from the sale, Debtors' 1998 gross income from farming as shown on Schedule F is less than 50% of their total gross income.

The Bank previously objected to Debtors' valuation of hay, machinery and real estate. The parties agreed, at the time of hearing, to the following values: \$100 for the hay, \$5,200 for the combine, and \$800 for the corn head. The value of the real estate remains in dispute and the parties offered testimony from their appraisers. The Bank's Proof of Claim states it has a claim for \$401,101.78 plus fees and interest secured by real estate, a motor vehicle, farm personalty and proceeds.

Appraiser Ted Deacon prepared a report and testified for Debtors. He concluded that the 7-acre building site has a value of \$68,000 and, separately, the 60 acres of timber and pasture is valued at \$41,000. This totals \$109,000 for the 60 acres and the building site combined. The assessed value of the building site alone is \$74,290. Mr. Deacon admitted that he misidentified the age and value of the machine shed on the building site. He also failed to account for a difference in square feet between Debtors' house and a comparable property he used in his sale comparison approach. The Bank argues that by correcting these errors, Mr. Deacon's appraisal would increase to a combined value of \$150,000 for the two properties together. Debtors did not offer evidence of the value of their remaining farm real estate of 200 acres. The Bank asserts that Mr. Deacon is not familiar with Jackson County real estate values.

Appraiser Dennis Starling testified for the Bank and prepared two reports. He values the 200 acres of farmland at \$258,000. He separately values the 60-acre agricultural land including the building site at \$190,000. He did not separate out the 7-acre building site for final appraisal purposes. On page 52 of Exhibit A, however, Mr. Starling does estimate the value of the 7-acre building site at \$25,200 or \$3,600 per acre. Pages 53 through 55 show estimated values of the residence and other buildings using a cost approach. The total of these values is \$108,283. Thus, under the cost approach only, Mr. Starling's appraisal values the 7-acre building site, including the residence and other buildings, at \$133,453. Using this approach, Mr. Starling values the remainder of the 60-acres, including 15.4 acres tillable and 37.6 acres pasture land/wasteland, at a total of \$59,930. His combined value for the building site and sixty acres under this cost approach is, thus, \$193,383.

Mr. Starling has had significant experience appraising Jackson County real estate. He stated that fair market values are generally higher than assessed values. Mr. Starling also testified that the market value of the property is impacted by a "subdivision premium" if the building site and 60 acres of pasture land were sold as a separate unit. He testified that in March 1998 he appraised the entire parcel, the 200 acres of farmland and the 60 acres including the building site, with a value of \$352,000. The total from his updated appraisal in September 1999 was \$351,000. He also stated that if the property is sold in two parcels, it will generate more value. The Bank ultimately asserts the 200 acre parcel has a value of \$258,000 and the 60 acre parcel including the building site and adjoining pasture and timber has a value between \$150,000 and \$190,000.

### VALUATION OF REAL ESTATE

When a creditor files a proof of claim, §506(a) divides the claim into a secured claim to the extent of the value of the collateral and an unsecured claim for the remainder. Harmon v. United States, 101 F.3d 574, 578 (8th Cir. 1996) (citing United States v. Ron Pair Enters., Inc., 489 U.S. 235, 239 & n.3 (1989)). A Chapter 12 Plan must provide that the holder of an allowed secured claim retain the lien and receive distributions through the Plan equaling no less than the allowed amount of the claim. Harmon, 101 F.3d at 583. The amount of the lien and, thus, the allowed amount of the secured claim, is the actual value of the collateral securing the claim. See id. at 584. The value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of the property. 11 U.S.C. §506(a); In re Anderson, 88 B.R. 877, 885 (Bankr. N.D. Ind. 1988) (finding value as continuing farm operation should be used rather than considering non-agricultural factors such as "suburban influence" where debtor intended to reorganize continuing farm operation).

Generally, a creditor's proof of claim constitutes prima facie evidence of the validity and amount of its claim. In re Brown, 82 F.3d 801, 805 (8th Cir. 1996); Fed. R. Bankr. P. 3001(f). This presumption places the burden of producing evidence to rebut the presumption on the debtor. Brown, 82 F.3d at 805. However, the ultimate risk of nonpersuasion as to the allowability of the claim resides with the creditor. Id. The presumption of the prima facie validity of the Bank's claim in Rule 3001(f) applies to this valuation hearing. Debtors have the burden of coming forward with sufficient evidence to rebut the presumption. Then, the burden transfers to the Bank to assume the ultimate burden of persuasion on the issue of the value of the collateral securing its claim. In re Roberts, 210 B.R. 325, 328 (Bankr. N.D. Iowa 1997).

Based on the foregoing, the Court concludes that the value of the 200 tillable acres is \$250,000. The value of the 7-acre building site, including the residence, is \$120,000. The value of the remainder of the 60-acre parcel is \$45,000. The Court bases its conclusions on the appraisal reports, including consideration of their accuracy and any internal inconsistencies, the testimony of the appraisers, evidence of the appraisers' backgrounds and experience and their demeanor while testifying. Under these findings, the total value of Debtors' real estate is \$415,000.

### CHAPTER 12 ELIGIBILITY

Only a family farmer with regular annual income may be a debtor under Chapter 12. 11 U.S.C. § 109 (f). "Family farmer" is a defined term in the Code. 11 U.S.C. §101(18)(A). The definition consists of four requisites for an individual or an individual and spouse to be a "family farmer". A Chapter 12 debtor is one: (a) who is engaged in a farming operation; (b) whose aggregate debts do not exceed \$1.5 million; (c) 80 percent of whose aggregate noncontingent, liquidated debts arise out of the farming operation; and (d) more than 50 percent of whose gross income for the tax year immediately preceding filing was received from farm operations. 11 U.S.C. §101(18)(A). A debtor filing a Chapter

12 petition bears the ultimate burden of proving eligibility for relief under that chapter. In re Tim Wargo & Sons, Inc., 869 F.2d 1128, 1130 (8th Cir. 1989).

### "ENGAGED IN A FARMING OPERATION"

The parties directed much of their argument to the fourth element which requires that 50 percent of Debtors' gross income in the preceding tax year be received from their farm operations. However, the Court must be satisfied that all elements of §101 are satisfied. In so doing, the Court must find that Debtors are "engaged in a farming operation", the first element of §101(18)(A). This element is problematic for Debtors. "Farming operation" is defined in §101(21) as "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." Courts must construe this definition liberally in order to further Congress' purpose of helping family farmers to continue farming. In re Watford, 898 F.2d 1525, 1527 (11th Cir. 1990) (emphasis added).

To be family farmers, Debtors must be engaged in a farming operation "when they file the Chapter 12 petition." Id. (emphasis added). The debtors in Watford had ceased cultivation of their land, stored their soybean harvest on the land and begun a crabbing operation in the Gulf of Mexico. Id. at 1526. They allowed their land to lie fallow since 1985 and filed for Chapter 12 relief in July 1987. Id.

The court in Watford adopted a "totality of the circumstances" test to determine if a debtor is "engaged in a farming operation" even though "not engaged in the physical activity of farming at the time the petition was filed." Id. at 1528. The farmers' intent to continue farming is relevant to the inquiry. Id. The ultimate questions are whether the debtors had abandoned all farming operations at the time of the filing, or whether under the totality of the circumstances the debtors had not abandoned all farming operations, but rather were planning to continue farming operations in some form. Id. at 1529. Another court has stated that "the focus must be on the 'continuation' of farming endeavors and not on reviving abandoned operations." In re Burke, 81 B.R. 971, 976 (Bankr. S.D. Iowa 1987).

In In re Buckingham, 197 B.R. 97, 106-07 (Bankr. D. Mont. 1996), the court found the debtors were not engaged in a farming operation. It noted that although the debtors purported to intend to eventually buy sheep with which to stock their land, they had provided no details as to how they hoped to achieve that end. Id. at 107. The debtors had surrendered and abandoned their farm operation. Id. Their farming activities were insignificant when compared with income the debtors would receive from off-farm employment. Id. Future livestock purchases were left to speculation. Id. at 108. "In sum, the Debtors are not now farming, and they do not have any realistic or concrete prospects to continue farming over the duration of their Plan." Id. (emphasis in original). In In re Mikkelsen Farms, Inc., 74 B.R. 280, 285 (Bankr. D. Or. 1987), the court listed the following factors in determining whether a debtor is conducting a farming operation at the time the Chapter 12 petition is filed:

whether there is physical presence of family members on the farm, whether the debtor owns traditional "farm assets," whether leasing land is a form of scaling down of previous farm operations, what the form of any lease arrangement is and whether the debtor entity had, as of the date of filing, permanently ceased all of its own investment of assets and labor to produce crops or livestock.

See also In re Morgan Strawberry Farm, 98 B.R. 584, 586 (Bankr. M.D. Fla. 1989) (citing factors including that debtors had not farmed land in over three years, there was no indication they intended

to return to farming, no family member was actively participating in farming the land and the land was rented for cash rather than on a crop share basis); In re Indreland, 77 B.R. 268, 271 (Bankr. D. Mont. 1987) (finding debtors engaged in a farming operation where they could feasibly rehabilitate their ranch through debt restructure so as to maintain a farming operation); In re Haschke, 77 B.R. 223, 225 (Bankr. D. Neb. 1987) (finding that the debtors were not "engaged in a farming operation" where they had sold all their farm equipment and had nothing left with which to farm); In re Tart, 73 B.R. 78, 82 (Bankr. E.D.N.C. 1987) (finding the debtors were not "engaged in a farming operation" where they were, at most, only minimally engaged in farming during the taxable year preceding the taxable year in which their petition was filed, had sold all their farmland prior to the filing of their petition, and did not intend to resume any farming operations).

### INCOME FROM FARM OPERATIONS

In considering the fourth element of §101(18)(A), the Court must determine whether income an individual debtor receives from a particular source amounts to farm or non-farm income for the purpose of meeting the definitional requirement of that section. In re Easton, 883 F.2d 630, 633 (8th Cir. 1989). This is done by identifying "those farming activities engaged in or owned or operated by [the debtor] and then determin[ing] whether that individual received more than fifty percent of his or her gross income in the relevant year from those activities." Id. Assessing the true nature of the income rests neither "upon any risk of non-payment [the debtor] might have faced, nor upon the universe of particular circumstances surrounding [the debtor's] financial situation, but rather upon the extent to which the income in question bears the relation to [the debtor's] farming activities prescribed by the words of the statute." Id. (rejecting the totality of circumstances approach to determination of whether the fourth element of §101(18)(A) is met). Where the debtors were engaged in the farming activity of the "raising of livestock", the court in Easton distinguished the farming activity of the "production or raising of crops" on leased farmground in considering whether debtors were eligible for Chapter 12 relief. Id. at 635-36.

Debtors' assert that the capital gains from the liquidation of their cattle herd constitutes farm income. In In re Bircher, 241 B.R. 11, 16 (Bankr. S.D. Iowa 1999), the court concluded that the net capital gain realized from the sale of a 50-acre farm was farm income under §101(18). The sale was a conscious action to downsize the farming operation to keep it going, not to liquidate it. Id. In Cottonport Bank v. Dichiara, 193 B.R. 798, 803 (W.D. La. 1996), the court concluded that the proceeds from the sale of a harvester and tractor are properly classified as farm income. "[U]nlike debtors who have essentially liquidated all of their farm assets, the debtors here have retained ample other machinery . . . or have access to other equipment with which they intend to continue their [] farming." Id. at 804. The court also concluded that the mere presence of significant outside employment does not operate as a bar to classifying other sources of income as income received from farming operations. Id.

The court in In re Sohrakoff, 85 B.R. 848, 849 (Bankr. E.D. Cal. 1998), found that income from the sale of farm land was not income from a farming operation. It found that the logical and strong inference from the sale was that the farmer did not intend to continue farming. Id. "[C]hapter 12 was enacted for those farmers who want to keep their land and continue to farm." Id. (noting that the debtors had filed a partial plan of liquidation). In In re Burke, 81 B.R. 971, 977 (Bankr. S.D. Iowa 1987), the court concluded as follows:

Income received from the sale of farm machinery will be farm income in the case of an individual or individual and spouse unless . . . the sale entails all the machinery and the debtors do not intend to lease or to borrow machinery from another available source.

Cf. In re Fogle, 87 B.R. 493, 495 (Bankr. N.D. Ohio 1988) (finding debtor eligible for Chapter 12 relief where, though debtor sold all farm machinery to son's corporation, he would continue to farm with that corporation).

### CONCLUSIONS

Debtors have the burden of proving that (1) they are "engaged in a farming operation" and (2) more than 50 percent of their income from the 1998 tax year was received from that farming operation. Debtors were not engaged in a farming operation on July 30, 1999, the day they filed their Chapter 12 petition. They had not cultivated their farmland since 1997 nor did they have any interest in crop production on the land other than cash payments from their tenants. Debtors had not raised cattle since they sold their entire herd on February 14, 1998, more than a year before they filed their bankruptcy petition.

Mr. Koppes testified that he intended to continue to run a herd on a more limited basis at the time of the sale. Other evidence, however, undermines this testimony. Debtors both have full-time jobs off the farm. Testimony indicates they assumed the liquidation sale would allow them to retain their home, not their farming operation. Debtors sold much of their machinery in 1998. Their Chapter 12 plan is a partial liquidation plan. They will not be keeping enough of their farm real estate to run a herd on their own land. Debtors offered no specific details on how they would finance the operation of a herd on leased land. They are clearly not able to afford restocking a herd at this time.

Based on the totality of the circumstances, this Court concludes that Debtors have failed to establish that they are engaged in a farming operation for purposes of eligibility for Chapter 12. Although they assert an intent to return to raising cattle, Debtors had abandoned all farming operations at the time they filed their Chapter 12 petition. Although Mr. Koppes did some custom combining in 1999, he did so without compensation for a family member. Chapter 12 is meant to allow the continuance of farming endeavors, not revival of abandoned operations such as Debtors'. Even construing the §101(21) definition of "farming operation" liberally, the Court must conclude that Debtors are not now engaged in farming and do not have any realistic or concrete prospects to begin farming in the near future.

Debtors must also establish the fourth element of §101(18)(A), i.e. that they received more than 50 percent of their 1998 income from farming activities. Schedule F of Debtors 1998 Federal Form 1040 reflects that Debtors received total gross income from farming of \$7,212. Page 1 of Form 1040 shows taxable gains from the sale of livestock and equipment of \$49,911 and wages earned of \$25,341. If the \$49,911 gain from livestock and equipment sales is not income from farming operations, Debtors do not meet the fourth element of §101(18)(A).

In the 1998 taxable year, the farming activities Debtors engaged in, owned or operated included only raising livestock for the six weeks before the liquidation sale on February 14, 1998. According to their Schedule F, Debtors also received money from the sale of grain. The grain, however, was grown in a previous year. No other farming activities by Debtors are presented in this record. The sale of the cattle herd was a total liquidation, not a downsizing of the herd. Although Mr. Koppes continues to express a desire to restock a herd, Debtors have been unable to do so since the sale and have not raised cattle for more than a year prior to filing their Chapter 12 petition.

Based on the foregoing, the Court concludes that the \$49,911 of capital gains Debtors received from the liquidation of their cattle herd is not income received from Debtor's farming activities. Therefore,

Debtors cannot establish that they received more than 50 percent of their income in the 1998 tax year from farm operations. Debtors are not eligible for Chapter 12 relief under §109(f).

**WHEREFORE**, the values of Debtors' real estate are as follows: 200 tillable acres, \$250,000; 7-acre building site, \$120,000; 60-acre parcel, \$45,000.

**FURTHER**, Debtors have failed to satisfy the requirement that they are "engaged in a farming operation".

**FURTHER**, Debtors have failed to satisfy the requirement that they received 50 percent of their 1998 income from farming activities.

**FURTHER**, Debtors Paul and Sandra Koppes are not eligible to be debtors under Chapter 12.

**FURTHER**, Debtors are granted to and including January 19, 2000 to convert to another chapter under Title 11. If they do not do so, this case will be dismissed without further notice or hearing.

**SO ORDERED** this 5th day of January, 2000.

Paul J. Kilburg  
Chief Bankruptcy Judge