Agricultural Law Update

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INSIDE

IN FUTURE ISSUES

Diesel fuel excise tax refunds

IRS Notice 88-132, 1988-52 I.R.B. 22, issued December 27, 1988, explains the procedure for claiming the interest-bearing refund of the diesel fuel excise tax. The refund with interest was created by the Technical and Miscellaneous Revenue Act of 1988 (TAMRA). Prior to TAMRA, farmers could claim the excise tax as a refundable credit on Form 4136, which is filed with their income tax return, or, if the excise taxes paid on fuel used in the second or third quarter of 1988 exceeded $1,000, they could claim a quarterly refund on Form 843.

Notice 88-132 states that the claim for refund with interest is also to be filed on Form 843. The claim must be filed no later than June 30, 1989, but it cannot be filed before the fuel for which the refund is claimed has been used.

In addition to the information required on the form, taxpayers are required to write "ONE TIME CLAIM" in red beside the title of Form 843 and on the envelope sent to the IRS. Furthermore, taxpayers must make the following declaration: "All of the fuel to which this claim relates was bought from a producer (including a wholesale distributor) or an importer and I have the name and address of such seller in my records." The taxpayer must then list, by month purchased, the number of gallons of taxable fuel that is eligible for the interest-bearing refund multiplied by the $.151 rate of tax. The sum of the amount shown in this statement must be the same as the amount written in block 6 of Form 843. The IRS will calculate the interest that is to be paid on the refund and add that amount to the amount reported in block 6.

If a farmer paid more than $1,000 in excise tax in the second or third quarter of 1988, the taxes for that quarter cannot be included in the claim for refund with interest. If those taxes were not claimed on a timely filed claim for a quarterly refund (quarterly refund claims were due by the last day of the quarter following the quarter in which the fuel was used), then the tax can be claimed only as a refundable credit on the taxpayer's income tax return. – *Philip E. Harris*

Coop's demand notes found not to be securities

The Eighth Circuit Court of Appeals held in *Arthur Young & Co. v. Reves*, 856 F.2d 52 (8th Cir. 1988) that demand notes issued by an agricultural cooperative were not securities within the meaning of either the federal or Arkansas securities acts. The court therefore reversed a $6.1 million judgment entered against the cooperative's auditors, Arthur Young & Company, for violations of section 10(b) of the Securities Exchange Act of 1934 and section 67-1256 of the Arkansas Statutes [recodified at Ark. Code Ann. § 23-42-106 (1987)].

The cooperative had been raising operating funds by selling to its members and to the public promissory notes payable on demand, bearing periodically changing interest at favorable rates. When the cooperative went bankrupt, the bankruptcy trustee and a class of note holders instituted suit against multiple defendants, including Arthur Young. The class claimed that the auditors had violated the securities acts by fraudulent statements and omissions regarding the valuation of cooperative assets made in financial statements to the members.

The court of appeals reversed on the basis that the demand notes in issue did not constitute securities within the meaning of either the federal or Arkansas statutes. The court first acknowledged that the statutory definitions were not to be read literally, but rather were to turn on economic realities. The court then applied the test for a security developed in *S.E.C. v. W.J. Howey Co.*, 328 U.S. 293 (1946), which requires some investment based on an expectation of profit derived from the efforts of others. In concluding that the test was not satisfied, the court stated that the transaction was more akin to a commercial lending arrangement than to an investment. Since the notes were payable on demand, and since the return to noteholders took the form of interest fixed by an established market rather than a share of earnings or capital appreciation, the court refused to find the expectation of profit required by the *Howey* test. It therefore held that the demand notes did not fall within the definition of securities under either statute and that the class was entitled no relief against Arthur Young. – *Mary Beth Matthews*

Bibliography of agricultural law review articles

The following is a listing of recent law review articles relating to agricultural law. Persons desiring to obtain a copy of any article should contact the law school library nearest them.

Alien land ownership

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Bankruptcy

Chapter 11

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King, *Chapter 12: Adjustment of Debts of a Family Farmer With Regular Income*, 29 S. Tex. L. Rev. 615-37 (1988).

Biotechnology

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Mellor, *Patents and Genetic Engineering – Is It a New Problem?*, 10 Eur. Intell. Prop. Rev. 159-63 (1988).

Farmers Home Administration

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Land use planning

Serase, *Agriculture – 1980's Industry and 1947 Definition*, J. Plan. & Envtl. L. 447-60 (1988).

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Torts

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Article Nine: secured transactions

Kershen & Hardin, *Congress Takes Exception to the Farm Products Exception of the UCC: Retroactivity and Preemption*, 36 U. Kan. L. Rev. 1-80 (1987).

Kershen & Hardin, *Congress Takes Exception to the Farm Products Exception of the UCC: Centralized and Presale Notification Systems*, 36 U. Kan. L. Rev. 383-528 (1988). – *Drew Kershen*

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Corporate farming – state divestiture law prevails

The North Dakota Supreme Court in *State v. Liberty National Bank and Trust Company*, 427 N.W.2d 307 (N.D. 1988) decided whether a national bank was required to sell foreclosed farmland within a federal holding period of five years, 12 U.S.C. section 29, or within a state holding period of three years, N.D. Cent. Code § 10-06-13(5).

The defendant is a national bank subject to the National Bank Act of 1864, 12 U.S.C. section 21 et seq. Liberty National had secured a loan to an individual with a real estate mortgage on farmland. After default, the farmer conveyed the farmland to the bank by warranty deed in order to avoid foreclosure. The state brought an action against the bank pursuant to its corporate farming laws, specifically N.D. Cent. Code section 10-06-13(5), to force the bank to divest itself of the farmland. The State alleged that the bank had held the land for more than three years and that none of the statutory exemptions for holding the land for a longer period applied. The bank admitted that none of the statutory exceptions applied, but claimed that the state holding period was preempted by the federal holding period.

At the time that court addressed this issue, the bank had sold the farmland. Although the issue between these parties was moot, the court found the issue presented to be one of "great public interest," which has "important consequences in the State's future enforcement of corporate farming laws." Moreover, the court found that since banks are under a continual obligation to divest themselves of foreclosed real estate, the issue presented is "capable of repetition, yet evading review." The court therefore decided to hear the case on its merits.

The court noted that the primary objective of section 29 of the National Bank Act is to prevent national banks from accumulating and holding large amounts of real estate in what, effectively, constitutes mortmain. In *National Bank v. Matthews*, 98 U.S. 621, 626 (1878), the United States Supreme Court outlined this and two other objectives of section 29: to keep the capital of banks "flowing in the daily channels of commerce" and to deter banks from engaging in "hazardous real estate speculations." Congress enacted the five-year period to protect banks from forced divestitures under unfavorable financial circumstances.

Both the federal and North Dakota divestiture provisions were intended to prevent the accumulation of farmland and ranchland by corporations. Nonetheless, Liberty National argued that there was an "actual conflict" between the two statutes since if the bank were forced to comply with the state statute it would be unable to utilize the full holding period permitted by the federal law.

However, the court found that there was not an "actual conflict" between 12

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Circuits disagree on status of migrant pickle workers

In *Brock v. Lauritzen*, 624 F. Supp. 966 (E.D. Wis. 1985) (Lauritzen I), under facts quite similar to those in *Donovan v. Brandel*, 736 F.2d 1114 (6th Cir. 1984), the court found migrant pickle harvesters to be employees of the farmer, rather than independent contractors. In a critical aside, the court in *Lauritzen I* observed that *Donovan v. Brandel* disregarded the economic reality test and was poorly decided. See also *Brock v. Lauritzen*, 649 F. Supp. 16 (E.D. Wis. 1986) (Lauritzen II).

The farmers appealed summary judgment orders in both of the *Lauritzen* cases. In *Secretary of Labor v. Lauritzen*, 835 F.2d 1529 (7th Cir. 1987), *cert. denied* Oct. 11, 1988, 1988 W.L. 107988, the Seventh Circuit held, as a matter of law, that migrant pickle workers were employees, not independent contractors. The farmers were ordered to comply with wage, recordkeeping, and child labor provisions of the Fair Labor Standards Act.

The Seventh Circuit departed from the Sixth Circuit in its application of the specific criteria and in its overall look at the quesiton of economic dependence – which is the final and determinative question in the analysis.

On the question of permanent relationship, the Seventh Circuit found that migrant workers can be employed on a permanent and exclusive basis for the duration of the harvest season. *Lauritzen I* had found otherwise, but gave the factor little weight. *Brandel* found only a temporary relationship and considered this to be a factor pointing to an independent contractor relationship.

On the question of level of skill, the Seventh Circuit found that the skill of pickle harvesters was consistent with that on good employees in any line of work. *Brandel* had found a high degree of skill in caring for pickle plants and harvesting pickles.

In *Lauritzen*, the investment by pickle harvesters extended only to their gloves, an small and irrelevant stake in the operation, pointing to an employment relationship according to the Seventh Circuit. The Sixth Circuit also noted minimal investment, but minimized the factor in its independent contractor finding.

On the question of opportunity for economic gain – profit and loss – the Seventh Circuit found that the pickle harvesters had no investment to lose. The fact that their wages would be reduced if the crop was poor was deemed not to be a factor significant enough to point to independent contractor status. The Sixth Circuit saw a significant opportunity for economic gain in that workers received fifty percent of the proceeds from the sale of harvested pickles.

On the question of control, the Seventh Circuit found that the employer had a pervasive right to control, that the employer made occasional supervisory visits to the fields, and that the workers perceived that the employer had a "right to fire." The Sixth Circuit was more impressed by the fact that the farmer did not set hours of work and did not conduct day-to-day field supervision.

The Seventh Circuit also found that hand harvesting was an integral part of the business of pickle production, which is the employer's business. The Sixth Circuit was of a similar view.

On the overall question of economic dependence, the Seventh Circuit found that the migrant pickle pickers depended on the farmer's "land, crops, agricultural expertise, equipment, and marketing skills." Accordingly, the migrant pickle harvesters were held to be employees, not independent contractors. The Sixth Circuit came to an opposite conclusion.

In fairness to the Sixth Circuit, it should be noted that the evidence in *Donovan v. Brandel* was particularly well developed for the farmers. In an earlier case the Sixth Circuit had left standing a decision that other migrant pickle workers were employees. *Donovan v. Gillmore*, 535 F. Supp. 154 (N.D. Ohio), *appeal dismissed*, 708 F.2d 723 (6th Cir. 1982). *Gillmore* was reexamined after *Brandel* and reaffirmed without analysis in an unpublished order.

In a concurring opinion in the Seventh Circuit decision, Judge Easterbrook was critical of the overall approach in cases determining independent contractor v. employee status. Easterbrook sees little guidance for future cases and argues that farmers, as well as migrant workers, are left in the dark as to their status. He would turn to the right to control test of the Restatement (Second) of Agency section 2(3)(1958) as consistent with the underlying goal of the statute and as a means to arrive at more predictability in the law.

Other cases where Circuit Courts have found agricultural workers to be employees, not independent contractors, include: *Beliz v. W.H. McLeod & Sons Packing Co.*, 765 F.2d 1317 (5th Cir. 1985); *Real v. Driscoll Strawberry Associates*, 603 F.2d 748 (9th Cir. 1979); *Hodgson v. Okada*, 472 F.2d 965 (10th Cir. 1973).

For additional reading, consult Linder, *Employees, Not-so-Independent Contractors and the Case of Migrant Farmworkers: A Challenge to the "Law and Economics" Agency Doctrine*, 15 N.Y.U. Rev. L. & Soc. Change 435 (1986-87).

– Donald B. Pedersen

AG LAW CONFERENCE CALENDAR

Environmental law

Feb. 16-18, 1989, Hyatt Regency, Washington, D.C.

Topics include: Superfund Amendments and Reauthorization Act of 1986; land use regulations; Clean Water Act developments; and underground water developments.

Sponsored by Environmental Law Institute and The Smithsonian Institution.

For more information, call 215-243-1630 or 1-800-CLE-NEWS.

AgBiotech '89

March 28-30, 1989, Hyatt Regency, Arlington, VA.

Topics include: patents and regulatory affairs; state and local public relations regarding environmental release.

Sponsored by Biotechnology Magazine.

For more information, call 1-800-243-3238, ext. 232.

Fifteenth Annual Seminar on Bankruptcy Law and Rules

April 6-8, 1989, Marriott *Marquis* Hotel, Atlanta, GA.

Topics include: lender liability; creditor strategies; setoff and recoupment.

Sponsored by Southeastern Bankruptcy Law Institute.

For more information, call 404-396-6677.

Inverse Condemnation and Related Government Liability

Mar. 2-4, 1989, Westin Century Plaza Hotel, Los Angeles, CA.

Topics include: physical taking and damaging; valuing "just compensation" in non-physical and temporary takings; overview of Supreme Court's 1987 decisions

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For more information, call 215-243-1630 or 1-800-CLE-NEWS.

Farm Bankruptcies under Chapter 12

Videolaw seminar.

Topics include: cash flow, income tax aspects; conversion to Ch 12; tax liens.

Sponsored by American Bar Association.

For more information, call 1-800-621-8986 or 312-988-6200.

Conference for Employers of Farm Labor

Feb. 8-9, 1989. Ramada Inn, Kennett Square, PA.

Feb. 14-15, 1989. Holiday Inn, Gettysburg, PA.

Topics include: employment of youth; immigration reform; employment of migrant and seasonal agricultural workers; the Pennsylvania Seasonal Farm Labor Act; public disclosure of chemicals and pesticides.

Sponsored by Penn State University College of Agriculture.

For more information, call 814-865-7656.

Obtaining operating capital in a Chapter 12 reorganization

by Jerry L. Jensen

The current financial crisis in American agriculture has forced many farmers to seek relief under the federal bankruptcy laws. Many of these farmers have filed under Chapter 12, a new separate chapter for family farmers.

The legislative history of Chapter 12 indicates that it was designed to give family farmers facing bankruptcy a fighting chance to reorganize their debts and keep their land. To effectuate the legislative purpose of Chapter 12, a family farmer will need to continue farming, generating revenue to make plan payments and rehabilitate his debt. Once the Chapter 12 petition is filed, most farmers will need to obtain operational financing in order to continue farming. A farmer requires large amounts of capital for feed, fuel, fertilizer, seed, labor, and other expenses. Unavailability of operational financing will likely force the farmer to quit farming and liquidate his operation.

Since there is no provision in the Bankruptcy code which requires or encourages a creditor to extend credit to the Chapter 12 debtor, the debtor will need to convince a lender that it is protected under the provisions of the Code and that lending will prove beneficial. Many opponents of Chapter 12 argued that it would dry up the availability of agricultural credit and make remaining agricultural credit more expensive.

Obtaining credit under section 364

If the Chapter 12 debtor cannot use cash collateral and has no unencumbered funds, he will probably need to obtain new credit in order to continue farming. Because of the need for post-petition financing, the Code contains provisions in section 364 specifically dealing with the rights and procedures for obtaining credit. However, the debtor should not commence bankruptcy with the hope of finding a new lender post-filing, as many agricultural lenders are reluctant to finance a bankruptcy debtor.

Obtaining unsecured credit

The farmer-debtor may be able to obtain credit from a relative, friend, supplier, private lender, the Farm Credit System, or a government lender. Every lender should become familiar with section 364 before extending credit to a Chapter 12 debtor. Any credit, other than unsecured credit or unsecured debt "in the ordinary course of business," must be approved by court order. 11 U.S.C. § 364 (1982 & Supp. IV 1986).

A trustee or debtor-in-possession may obtain unsecured credit in the ordinary course of business, unless the court orders otherwise. This unsecured credit will be allowed under section 503(b)(1) as an administrative expense payable before other prioritized and unprioritized unsecured debts. 11 U.S.C. § 364(a) (Supp. IV 1986). In addition, the court can authorize the debtor to obtain unsecured credit other than in the ordinary course of business. This new creditor will also be given an administrative expense priority. 11 U.S.C. § 364(b)(1982).

The creditor should be aware of the risks involved in extending credit under section 364(a) or (b). The priority afforded by the grant of an administrative expense priority may not be enough protection for the new creditor. See 11 U.S.C. §§ 726(b), 507(b), and 364(c)(1).

Obtaining credit as superpriority administrative expense

Because the new creditor will not have any special priority under either section 364(a) or (b), it is doubtful the Chapter 12 debtor will be able to induce a new lender to extend operating credit under either of these provisions. If the trustee is unable to obtain unsecured credit allowable under section 503(b)(1) as an administrative expense, the court, after a notice and hearing, may authorize the obtaining of credit or the incurring of debt with: (1) priority over all administrative expenses; (2) security in the form of a lien on unencumbered assets; or (3) security in the nature of a junior lien on property that is subject to a lien pursuant to section 364(c). 11 U.S.C. § 364(c)(1982).

This superpriority provided to the farm supplier or lender gives them a superior administrative claim that must be satisfied prior to any other administrative expenses. § 364(c)(1). This is a valuable method of protection for the new creditor. However, the creditor must be aware that administrative expenses often remain totally unpaid, especially if the farm reorganization fails and results in liquidation.

Obtaining credit through grant of senior lien

Since creditors may be unwilling to extend credit on the basis of a junior lien or superpriority administrative expense, the Code authorizes the obtaining of credit secured by a senior or equal lien on property of the estate that is already subject to a lien. § 364(d). Credit extended under sections 364(a),(b), or (c) is not secured by any particular assets of the estate. Therefore, there is a risk of nonpayment. Any credit extended under section 364(d) will be secured by particular assets of the estate. The new creditor will be assured of recovering at least the value of the secured property. The senior lien granted under section 364(d) is a very valuable method of protection for the new creditor. All creditors would be well advised to seek a senior lien when extending credit to a Chapter 12 debtor. However, the court can authorize the obtaining of credit under section 364(d) only if the debtor in possession establishes that he was unable to obtain credit otherwise and that there is adequate protection of the interest of the lienholder in the property on which the senior lien will be granted. § 364(d)(1)(A),(B).

Adequate protection

Since the debtor is granting a new lien on property already subject to a security interest, the pre-petition lien-holder must be provided with adequate protection. § 364(d)(1)(B). The providing of adequate protection had been a major stumbling block for many farmers attempting to reorganize under the Bankruptcy Code. The drafters of the new Chapter 12 provisions noted that lost opportunity costs payments presented serious barriers to farm reorganization because farmland values had dropped dramatically. Because of this stringent requirement, many family farm reorganizations were "throttled in their infancy" when a secured creditor filed a motion for relief from automatic stay. H.R. Rep. No. 958, 99th Cong., 2d Sess. 49. Because of the harsh effects of 11 U.S.C. § 361 on the successful family farm reorganization, a new adequate protection standard was developed to be used exclusively in Chapter 12 cases. § 1205.

Section 1205 eliminates the need to pay lost opportunity costs. There is no indubitable equivalent language contained in section 1205. It is clear that what needs to be protected is the value of property, not the creditor's interest in property. H.R. Rep. No. 958, 2d Sess. 49-50. In addition, section 1205 includes a new means for providing adequate protection. A Chapter 12 debtor can provide adequate protection for farmland by pay-

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ing the "reasonable rent customary in the community where the property is located." § 1205(b)(3).

The concept of paying reasonable rent may be a valuable method of providing adequate protection for the Chapter 12 debtor. The payment of customary rental value would probably be the cheapest method of providing adequate protection to farm lenders with liens on agricultural land. This new method of providing adequate protection was recently discussed in *In re Kocher*, 78 Bankr. 844 (Bankr. S.D. Ohio 1987). In dicta, the court suggested that section 1205(b)(3) provides that payment by the debtor of a fair rental value constitutes adequate protection "per se." The debtor does not need to provide the creditor with any more than the fair rental value of the land. The legislative history to section 1205(b)(3) suggests that courts may follow the dicta in *Kocher* and limit secured parties to reasonable rent even when this will not compensate the secured creditor for the decline in farmland value. 132 Cong. Rec. S3529 (daily ed. Mar. 26, 1986) (statement of Sen. Grassley).

This is not the only issue created by the rental value form of adequate protection. The courts have also had to address whether a farmland lender is entitled to rental payments even if the farmland value is stable. The Code does not indicate whether reasonable rent is required to be paid to all farmland creditors or just where there is a decrease in the value of property. The legislative history appears to indicate that the farmland secured creditor should be entitled to reasonable rental payments regardless of whether there is a decline in value during the stay period. Additionally, unlike the other three subsections in section 1205, the statutory language is not limited to the situation where farmland is declining in value. However, allowing the secured creditor to receive rental payments when there is no decline in value of the land would in effect give them lost opportunity payments. *See In re Turner*, 82 Bankr. 465 (Bankr. W.D. Tenn. 1988).

It appears clear that a secured creditor can obtain rental payments during the automatic stay if the land is declining in value. However, the issue of whether rental payments can be a basis for adequate protection in a section 364 situation is not as clear. Section 1205(b) states that when adequate protection is required under sections 362, 363, or 364 of an interest of an entity in such property, adequate protection may be provided by paying the reasonable customary rent to the entity for the use of the farmland. § 1205(b)(3). However, if this sort of adequate protection were allowed under section 364(d), serious consequences would result for the secured farmland lender.

The payment of reasonable customary rent will not always provide protection in the amount of new credit extended. If the Chapter 12 plan fails and is converted to a Chapter 7, the secured property will be sold and the new creditor will receive the amount of new credit extended before the pre-bankruptcy secured creditor receives anything. If the market value of the property is less than the new creditor's and pre-bankruptcy creditor's liens, the pre-bankruptcy lender will suffer a loss to the extent that the new credit extended exceeds the reasonable rental payments.

If section 1205(b)(3) is construed to allow Chapter 12 debtors to provide adequate protection by only paying reasonable rent, when the creditor's ownership position is being reduced by the grant of a senior lien under section 364, there may be constitutional problems. In situations where the reasonable rental payments are less than the amount of the new senior lien, there would be an unconstitutional taking under the Fifth Amendment of the Constitution. *See Wright v. United Central Life Ins. Co.*, 311 U.S. 273 (1940); *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555 (1935).

Cross-collateralization clauses

The provisions of section 364 were designed to encourage lenders to lend money to reorganizing debtors and thereby effectuate the rehabilitation theme of bankruptcy. However, the providing of administrative expense priority or senior lien status alone may not be enough to entice new lenders.

In order to encourage new creditors to make operational loans to Chapter 12 debtors, the court may need to allow the inclusion of a cross-collateralization clause in a loan secured under a section 364(c) or (d) financing order. Cross-collateralization is an arrangement in which the creditor lends money post-petition secured by a section 364(c) or (d) court order. The new lien, however, secures not only the post-petition loan but also the pre-petition unsecured indebtedness. *In re Monarch Circuit Industries*, 41 Bankr. 859, 861 (Bankr. E.D. Pa. 1984).

Cross-collateralization may be particularly adaptable to the Chapter 12 situation because of the enormous amount of unsecured credit held by farm creditors. A cross-collateralization clause enables a creditor to improve its pre-petition status by action after bankruptcy.

The use of a cross-collateralization clause may provide the inducements needed to encourage a new lender to extend post-petition operational financing. Without the use of a cross-collateralization provision, the Chapter 12 debtor will probably have a difficult time finding new operational credit, in spite of the priorities and protections contained in section 364.

Post-petition property and proceeds

The debtor should determine whether there are any unencumbered assets that can be used to meet post-filing operating expenses. In most farm cases, a creditor's security agreement applies to all proceeds, products, offspring, rents and profits of the secured property. Therefore, the debtor is normally prohibited from using these proceeds and products to finance the operation of the farm. However, there are provisions in the Bankruptcy Code that can terminate pre-petition security interests in after-acquired property and proceeds. § 552.

Section 552(a) of the Code nullifies certain pre-petition liens on post-petition property to the extent that such liens include after-acquired property. The effect of the filing of the bankruptcy petition is to prevent the lien from floating to new post-filing collateral, which is consistent with the "fresh start" concept of the Code.

Section 552(a) is not as harsh on creditors as it appears because of the extremely important exception in section 552(b). That section allows a creditor to retain its security interest in all pre-petition collateral and in the post-petition proceeds, products, offspring, rents, or profits of pre-petition collateral. However, section 552(b) further provides that the court may, after notice and a hearing, restrict the reach of the creditor's lien, based on the equities of the case.

It appears to be quite clear that section 552(b) will not allow a pre-petition secured creditor to obtain a post-petition lien on crops planted after filing the petition. However, if the crops were planted prior to commencement of the case, the pre- petition security interest will continue, since the security interest attached to the crops when planted. *See*

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In re Hamilton, 18 Bankr. 868 (Bankr. D. Col. 1982); *In re Kruse*, 35 Bankr. 958 (Bankr. D. Kan. 1983); *In re Sheehan*, 38 Bankr. 859 (Bankr. D.S.D. 1984).

With regard to livestock, a valid pre-petition security interest in livestock should continue to the offspring of such livestock pursuant to section 552(b). *See In re Bohne*, 57 Bankr. 461 (Bankr. D.N.D. 1985). However, if the debtor acquired livestock post-petition, which were not offspring of the pre- petition livestock, section 552(a) would avoid the security interest in the after-acquired livestock. *See In re Big Hook Land & Cattle co.*, 81 Bankr. 1001, 1003 (Bankr. D. Mont. 1988).

Unlike the case with crops or livestock, the courts have split on the question of whether milk produced post-petition by cows owned pre-petition are "proceeds, products, rents, or profits" covered under section 552(b). *See In re Lawrence*, 41 Bankr. 36 (Bankr. D. Minn. 1984); *In re Nielson*, 48 Bankr. 274 (Bankr. D.N.D. 1984); *In re Hollie*, 42 Bankr. 111 (Bankr. M.D. Ga. 1984).

The question of whether government payments or proceeds come under section 552(b) protection is especially important to the Chapter 12 debtor. Most farmers rely heavily on government farm program benefits to help meet the expenses of operating their farms. The Chapter 12 debtor should not encounter any problem in using government payments to finance his farming operation if the benefits are received for crops planted after filing the petition. *See* 11 U.S.C. § 552(a)(1982). However, if the government payments are received for crops planted before the filing of the petition, the payments will probably be considered proceeds, with the result that any pre-petition lien will survive the bankruptcy filing. *See* 11 U.S.C. § 552(b)(1982 and Supp. IV 1986).

If a pre-petition lien in farm products is cut off under section 552(a) or (b), the Chapter 12 debtor will be allowed to use his property and any proceeds of his collateral to finance the farming operation. The debtor can freely use the proceeds without obtaining court approval or providing adequate protection. These proceeds may be very valuable to the reorganizing farm debtor.

Sale of existing assets to generate operating funds

If the Chapter 12 debtor does not have any unencumbered assets, the farmer-debtor may need to seek court or trustee approval to sell unencumbered assets in order to finance the continued operation of the farm. Cash proceeds of farmland, farm equipment, or stored farm products may be the only source of operational financing for the Chapter 12 debtor.

Since most of the debtor's assets will likely be subject to liens, the debtor must follow the procedures set forth in section 363 before any sale proceeds can be used to meet operational expenses. Although section 363(c)(1) allows the Chapter 12 debtor-in-possession to use or sell estate property in the ordinary course of business, the sale will not be free and clear of liens unless one of the provisions in section 363(f) is met.

The debtor will not he allowed to use the cash collateral unless the court authorizes the use under section 363(c)(2). The drafters of Chapter 12 did not include any special standards for the court to use when considering whether the use of cash collateral should be allowed. The general test for authorization to use cash collateral is whether the secured party who has an interest in the collateral will receive adequate protection for the use of the cash collateral.

Sale of farmland or farm equipment

If the Chapter 12 debtor has a larger farming operation than actually necessary, he may want to consider selling an unneeded tract or section of land. The Act allows a Chapter 12 trustee to sell farmland or farm equipment free and clear of any interest in such property, after court authorization. The proceeds of the sale will be subject to any security interest in the property. § 1206. The debtor is not required to seek the consent of the secured creditor prior to selling the assets.

Sale of farm products through granting of replacement liens

If the Chapter 12 debtor does not have any unneeded farmland or farm equipment to sell, the farmer will probably have to use the cash proceeds of crops or livestock in order to finance the continued operation of the farm. Farmers who have granted crop liens will find most of their current working capital subject to the restrictions against use of cash collateral. *See* U.C.C. § 9-306(2). Therefore, unless they can obtain either the creditor's consent or court approval, the chances of beginning the reorganization may be hopeless. Since the debtor must provide adequate protection to the secured creditor before the court will approve the use of cash collateral, in most Chapter 11 farm reorganizations the debtor usually grants a replacement or rollover lien on future farm products to the lender.

The issue of granting a replacement or revolving lien as adequate protection has been extensively litigated in Chapter 11 farm reorganizations. Since section 1205 also provides that a replacement lien can be used to satisfy the adequate protection standard, this issue is certain to be frequently litigated. § 1205(b)(2). At least one bankruptcy court has determined that a replacement lien will constitute adequate protection in a Chapter 12 case. *In re Westcamp*, 78 Bankr. 834 (Bankr. S.D. Ohio 1987). *But. see In re Stacy Farms*, 78 Bankr. 494 (Bankr. S.D. Ohio 1987).

In a Chapter 11 case, *In re Martin*, 761 F.2d 472 (8th Cir. 1985), the Eighth Circuit held that when determining whether to allow the use of cash collateral, the court must establish the value of the secured creditor's interest, identify the risk to the secured creditor's value resulting from the debtor's request of use of cash collateral, and determine whether the debtor's adequate protection proposal protects value as nearly as possible against risk to that value consistent with the concept of indubitable equivalence. The court suggested several factors to be considered hy the bankruptcy court in determining whether the value of the secured party's lien in the stored crops was sufficiently protected. *Id.* at 477.

Conclusion

If the Chapter 12 debtor wishes to continue farming and successfully reorganize his debts, he must have access to operational financing funds. There are basically three sources of operational financing: obtaining post-petition financing under section 364 of the Code use of unencumbered assets; or the use of cash collateral.

If the farmer cannot convince the bankruptcy court to authorize the use of cash collateral or if no unencumbered assets or cash collateral are available for use, the farmer's chances of remaining in farming appear remote. Current agricultural lenders appear reluctant to extend operating credit to the Chapter 12 debtor even though they may be able to obtain a superpriority status or senior lien on estate property under section 364 of the Code. The drafters of Chapter 12 did not add any new incentives that would encourage lenders to grant post-petition credit.

STATE ROUNDUP

OKLAHOMA. *Centralized notification system for farm products.* The Oklahoma Secretary of State selected October 24, 1988, as the effective date for Oklahoma's centralized notification system for farm product liens. Beginning on October 24, buyers may register to receive master lists of security interests in farm products. The Secretary of State designated November 30, 1988, as the first date for distribution of the master list to registered buyers. Oklahoma received USDA's certification (7 U.S.C. § 1631) for its centralized notification system on December 23, 1987.

– *Drew L. Kershen*

OKLAHOMA. *Dairy farmer escrow accounts.* Effective November 1, 1988, an Oklahoma dairy farmer who has *not* been paid by a milk processor has the right to demand that the processor create a segregated, interest-bearing escrow account for the unpaid dairy farmer. To gain this protection, the dairy farmer must give the milk processor notice of nonpayment within either thirty days of the agreed upon final payment date or fifteen business days of the dairy farmer's receipt of notice of dishonor of the milk processor's check. Dairy farmers must send the required notice to the milk processor by registered mail, return receipt requested. Once the milk processor receives the notice, the processor must create the escrow account and pay into it a proportionate share of all payments received by the milk processor for the sale of dairy products. The milk processor must continue to make deposits into the escrow account until an amount sufficient to make full payment to the demanding dairy farmer has been deposited therein. Full payment is defined to include the purchase price of the raw milk, interest on the purchase price, and reasonable attorney's fees incurred in collecting the payment. The money in the escrow account is deemed to be the property of the dairy farmer for whom it was deposited. If the milk processor fails to create the escrow account after receiving proper demand, the milk processor is subject to misdemeanor fines and incarceration. The law does not apply to a cooperative association while acting as a marketing agent for its members. 1988 Okla. Sess. Laws Ch. 139 to be codified at Okla. Stat. tit. 2, §§ 751-756.

This escrow account protection for Oklahoma dairy farmers closely resembles the mandatory trusts for unpaid cash sellers that exist for livestock and poultry sellers under the Packers and Stockyards Act (PSA) and for vegetable and fruit sellers under the Perishable Agricultural Commodities Act (PACA). *See* Wilder, *The Poultry Producers Financial Protection Act of 1987*, 5 Agric. L. Update 1-2 (March 1988). Indeed, the Oklahoma law's statutory definition of full payment adopts the judicial definition of full payment from PSA cases. *Pennsylvania Agricultural Cooperative Marketing Association v. Ezra Martin Co.*, 495 F. Supp. 565 (M.D. Pa. 1980) and *First State Bank of Miami v. Gotham Provisions Co.*, 1 Bankr. 255 (Bankr. S.D. Fla. 1979). However, PSA and PACA are federal laws that clearly preempt conflicting state UCC Article 2 and 9 provisions. *Cf. In re Samuels & Co., Inc.*, 526 F.2d 1238 (5th Cir.), *cert. denied sub nom., Stowers v. Mahon*, 429 U.S. 834 (1976).

The Oklahoma Session Law creating the dairy farmer escrow account does not contain any express repealer of relevant UCC provisions. Oklahoma courts thus must face the issue of whether the dairy farmer escrow account law impliedly repealed Oklahoma's contrary UCC Article 2 and 9 provisions. At the same time, the statutory language that the escrow account is the property of the demanding dairy farmer means that the escrow account is not part of the bankruptcy estate if the milk processor goes bankrupt. 11 U.S.C. § 541. Oklahoma's dairy farmer escrow account should be recognized in bankruptcy to the same extent that bankruptcy law recognizes the mandatory trusts of PSA and PACA. On the other hand, if federal courts do not believe that the Oklahoma law has created a true trust, the federal courts could treat the dairy escrow account as a statutory lien which bankruptcy trustees may avoid under 11 U.S.C. § 545.

– *Drew Kershen*

CORPORATE FARMING – STATE DIVESTITURE LAW PREVAILS

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U.S.C. section 29 and N.D. Cent. Code section 10-06-13 merely because of the different holding periods. Rather, the court said, the inquiry is "whether the state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." The court determined that the primary purpose of the state holding period is the same as the primary purpose of the federal holding period since each statutory provision is intended to prevent the accumulation of farmland and ranchland by corporations. The court also found that the state law actually enhances what is also the primary purpose of the federal statute. Therefore, the state law is valid under the Supremacy Clause.

The court was also impressed by the act that the state law had a more narrow purpose – protection for farmers – than the federal statute. It therefore appeared that the state law was contained within the broader federal law, thus obviating any apparent conflict.

The North Dakota Supreme Court has issued a stay of mandate in this case to allow an appeal to the U.S. Supreme Court.

– *Julia R. Wilder*

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Transfers of grazing permits rejected

The Interior Board of Land Appeals has held that the Bureau of Land Management may reject an application to transfer grazing preferences filed by the transferee more than ninety days after the sale of the base property to said transferee. 43 C.F.R. §4110.2-3(b) requires that such applications be filed within 90 days of the date of sale. *George Fasselin v. Bureau of Land Management*, 102 IBLA 9 (April 5, 1988).

It also was held that BLM may reject an application to transfer grazing preferences filed after the transferor has lost ownership or control of the base property by virtue of the filing of a petition in bankruptcy and a subsequent judicial sale of the property. *Id.*

– *Donald B. Pedersen*

AMERICAN AGRICULTURAL LAW ASSOCIATION NEWS

Future Annual Meetings

For those long range planners, the locations for the 1989 through 1992 Annual Meetings of the American Agricultural Law Association are:

1989: Nikko Hotel, San Francisco
1990: Minneapolis/St. Paul
1991: Atlanta
1992: Chicago

1989 American Agricultural Law Association membership renewal

Membership dues for 1989 are due February 1, 1989. For the 1989 calendar year, dues are as follows: regular membership, $50; student membership, $20; sustaining membership, $75; institutional membership, $125; and foreign membership (outside U.S. and Canada), $65. Dues should be sent to William P. Babione, Office of the Executive Director, Robert A. Leflar Law Center, University of Arkansas, Fayetteville, AR 72701. Statements will mailed to the membership shortly.