UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF	)	
	)	
DUANE FREDERICK AHLERS,	)	CASE NO. BK90-81770
	)	
DEBTOR	)	CH. 12
	)	Fil. No. 115, 121,
	)	130, 124, 132

MEMORANDUM

Hearing was held on an objection to a modified plan and a motion for relief from the automatic stay, both filed by Farm Credit Bank of Omaha (FCB) on September 14, 1992. Appearing on behalf of the debtor was Mark Johnson of Norfolk, Nebraska. Appearing on behalf of the movant was A. Frank Baron of Baron, Sar, Goodwin, Gill, Lohr & Horak of Sioux City, Iowa.

Background

This debtor is operating under a Chapter 12 plan which was confirmed on November 6, 1991. The FCB holds an allowed secured claim of $333,743.00 secured by liens on the debtor's real property. Pursuant to the plan, FCB is undersecured. The plan provides for the debtor to pay FCB the present value of the undersecured claim as of the confirmation date and provides that FCB will retain its lien until the payments are completed.

The debtor has been unsuccessful and unable to make all of his payments to FCB. The debtor has filed a modification of the confirmed Chapter 12 plan and proposes by the modification to surrender all but twenty acres of the property securing the FCB lien. Debtor has designated the remaining twenty acres as a farm homestead pursuant to Neb. Rev. Stat. § 76-1901 et seq. (Reissue 1990). The homestead would be valued on a pro rata basis determined by the average per acre price of all of the property securing the FCB claim. Payments for the retained property would be made over time under the terms of the plan.

FCB objects to confirmation of the modified plan on two grounds. First, FCB contends that the plain language of the "cramdown" provisions of Section 1225(a)(5)(B) and (C) requires the debtor to surrender all of the property securing the allowed secured claim to creditor, or in the alternative, to allow creditor to retain its lien on the entire property for the value

of the allowed secured claim. Creditor also objects to debtor's valuation methods.

In addition to objecting to the plan, the FCB has filed a motion for relief from the automatic stay on the basis that the debtor has no equity in the collateral and, by the terms of the modified Chapter 12 plan, the collateral is not necessary to an effective reorganization. Therefore, the FCB believes the automatic stay should be lifted pursuant to 11 U.S.C. § 362(d)(2).

Decision

The modified plan is not confirmable and the modification is, therefore, denied. The motion for relief from the automatic stay is granted.

Discussion

A. The Modified Plan.

A hearing was held on the modified plan and on the motion for relief from the automatic stay. Briefs were requested on the issues raised concerning the modified plan and the FCB waived its right to a prompt determination of the motion for relief, pending a determination of the confirmability of the modified plan. This memorandum will deal with both confirmability and relief from stay.

Under Section 1229 of the Code, a debtor may modify a confirmed plan at any time after confirmation, but before completion of payments under the plan. However, Section 1229(b)(1) incorporates the confirmation requirements contained under Section 1225(a). A modified plan that affects the rights of secured creditors cannot be confirmed unless:

1. each secured creditor has accepted the plan. Section 1225(a)(5)(A);

2. the plan provides that the holder of such claim retain the lien securing such claim and the value, as of the effective date of the plan, of property to be distributed by the trustee or the debtor under the plan on account of such claim is not less than the allowed amount of such claim. Section 1225(a)(5)(B) (emphasis added); or

3. the debtor surrenders the property securing such claim to such holder. Section 1225(a)(5)(C) (emphasis added).

Although certain provisions of Chapter 12 provide debtors with additional flexibility when dealing with secured creditors, the statute does not permit the involuntary impairment of creditor's allowed secured claim. Theoretically, a debtor could transfer estate property to the creditor under § 1222(b)(7) or (8) which could offset part of the outstanding balance of the allowed secured claim. This practice is permissible in Chapter 11 plans. Section 1123(a)(5)(D). In re Simons, 113 Bankr. 942 (Bankr. W.D. Tex. 1990); In re Fursman Ranch, 38 Bankr. 907 (Bankr. W.D. Mo. 1984). Several courts have allowed Chapter 12 debtors to surrender Federal Land Bank stock in order to partially reduce claims held by secured creditors. In re Neff, 89 Bankr. 672 (Bankr. S.D. Ohio 1988). But see In re Shannon, 100 Bankr. 913 (Bankr. S.D. Ohio 1989).

Certain courts consider surrender of collateral in full or partial satisfaction of the underlying claim an impermissible impairment of the claim. These courts interpret the "cramdown" provisions of Section 1225(a)(5)(B) and (C) to require either the surrender of all encumbered collateral, or the preservation of the lien on all of the secured property, and the distribution of property under the plan equal to the present value of the creditor's claim. In re Townsend, 90 Bankr. 498, 502 (Bankr. M.D. Fla. 1988); In re Lairmore, 101 Bankr. 681 (Bankr. E.D. Okla. 1988). In First Brandon Nat'l Bank v. Kerwin-White, 109 Bankr. 626 (D. Vt. 1990), the District Court refused to confirm a plan providing for the partial surrender of encumbered collateral in full satisfaction of the underlying oversecured debt. The court held that ". . .if less than all the collateral or other property is distributed to the most senior creditor in satisfaction of the debt without retention of the lien, the creditor might not realize the full amount of his original secured claim and thus, can genuinely claim that he is being discriminated against." Id. at 630.

Conversely, certain courts have permitted the transfer of encumbered collateral in partial satisfaction of a secured debt. In In re Indreland, 77 Bankr. 268 (Bankr. D. Mont. 1987), the court permitted a Chapter 12 debtor to surrender a parcel of encumbered real estate in partial satisfaction of the underlying secured claim. The remainder of the claim was paid over the life of the plan. The court ruled that "transfer of property, either in part or in whole to satisfy a secured claim is permitted in Chapter 12, under 1222(b)(7) or (8) and 1225(a)(5)(B) or (C)." Id. at 273 (emphasis added). See also In re Massengill, 72 Bankr. 1008 (Bankr. E.D.N.C. 1987).

Cases in the Eighth Circuit and the District of Nebraska that have touched upon this issue include In re Hanna, 912 F.2d

945 (8th Cir. 1990) and In re Mahlin Farms, Inc., Neb. Bkr. 88:141 (D. Neb. 1988). In Hanna, the Eighth Circuit discussed Section 1225(a)(5)(B) in the light of the practical reality of a cattle operation. The court held that although that section requires a plan to provide that the creditors shall retain "the lien" in the encumbered property, a cattle rancher would be unable to survive if required to forward all proceeds from the sale of the original herd to the creditor. Thus, in the limited case of cattle farming, the court allowed the debtor to sell some of the cattle and to use the proceeds to fund the plan if the creditor was able to retain its lien on the entire herd and there was sufficient value in the remaining herd to adequately protect the interest of the oversecured creditor.

Although the court stated that the sale of cattle did not violate Section 1225, it reversed the order of confirmation on other grounds. It appears that the lesson of the Hanna case is that courts should adopt a literal interpretation of the phrase "the lien" in Section 1225(a)(5)(B). Courts should consider whether the terms of the plan permit the creditor to retain "the lien" and be adequately protected concerning the right to full payment of the claim if part of the collateral covered by "the lien" is used in the operation.

In Mahlin Farms, the district court reversed the confirmation order concerning a Chapter 12 plan which proposed to divide the creditor's oversecured claim into two claims. The plan proposed each claim would be secured by a separate parcel of land. Prior to the division of the claim, the creditor was cross-collateralized on the parcels and was free to foreclose on either parcel of land if the debtor was delinquent in his payments. Under the terms of the plan, the creditor would have been permitted to foreclose only on the parcel securing a claim upon which the debtor was delinquent in payment.

The district court held that although this plan satisfied Section 1225(a)(5)(B)(i), it did not satisfy Section 1225(a)(5)(B)(ii). The analysis of the district court was that by separating the collateral securing the original claim the debtor had deprived the creditor of the "qualitative" aspect of his claim. "The qualitative aspect speaks to the relative degree of assurance that the debt will be paid. . . .The court must be concerned with the problem of protecting Metropolitan's interest in the collateral, including the right to foreclose and realize the cash value of the collateral." Mahlin Farms at 143, quoting In re Johnson, 63 Bankr. 550 (Bankr. D. Colo. 1986).

The court went on to state that the debtor must guarantee that the creditor's claim will be adequately protected until the

creditor receives the full value of the claim. Until the creditor receives the full value, the creditor is entitled to retain the lien in the collateral.

As in the Hanna case, the district court in Mahlin has adopted a literal interpretation of the phrase "the lien" as it appears in Section 1225(a)(5)(B). The lien has a quantitative and qualitative aspect. The quantitative aspect secures the creditor to the full amount of the claim. The qualitative aspect provides a "fail-safe" method of protecting the quantitative aspect, i.e., the right to foreclose on all of the collateral securing the lien. Any modifications to either of those rights would be a violation of Section 1225(a)(5)(B)(i).

Under the terms of the plan proposed by debtor in this case, modification does not appear to affect the quantitative aspect of the claim. The modification provides that all but twenty acres of land will be surrendered to the Farm Credit Bank. The Farm Credit Bank presumably would be allowed to sell the land and apply the proceeds to costs, interest, and principal on the allowed secured claim. It would then have a continuing allowed secured claim in the remainder of the property. However, debtor purposes to value the remaining portion of the claim based upon a procedure which uses the average per acre price of all of the property securing the creditor's claim, as determined by an appraisal, applying the average per acre price to the remaining twenty acres, including the homestead and out buildings.

The cases that have considered this procedure have unanimously determined that it is improper. In re Braxton, 124 Bankr. 870 (Bankr. N.D. Fla. 1991); In re Branch, 127 Bankr. 891 (Bankr. N.D. Fla. 1991). The debtor has provided no statutory or case law authority for such a valuation procedure.

As in Mahlin Farms, a valuation based upon such a procedure may impair the qualitative aspect of the claim of the Farm Credit Bank. For example, the crop acres being surrendered may be worth a particular dollar amount per acre. If the total property was sold, including crop acres and the "homestead" with the buildings, a buyer may pay more or less per acre depending upon the buyer's need for the building site. An appraiser, and presumably a buyer, could determine the contribution value of the twenty acres which contains the homestead. That contribution value may be zero or may be significant if the parcel is sold as one whole. On the other hand, the value of the building site, if kept, may be different, either higher or lower, from the value of the same site if included in the sale of all the crop land.

These are fact questions and also involve speculation. Until all of the property is sold and the creditor recovers all of the proceeds to apply on the claim, or until part of the property is sold and the balance of the claim is paid over time, there is no accurate way to determine the impact of such a procedure upon rights of the creditor.

b. The Motion for Relief from Automatic Stay.

The debtor admits that he cannot effectively reorganize under the terms of the current plan, or without obtaining confirmation of the modified plan. He, therefore, proposes the modified plan and suggests that the underlying state law, Neb. Rev. Stat. § 76-1901 to -1916 (Reissue 1990), the Farm Homestead Protection Act (FHPA), is sufficient authority for confirmation of a modification as proposed. This statute authorizes a farm debtor to designate a parcel of agricultural land encumbered on or after November 21, 1986, as a redemptive homestead. Neb. Rev. Stat. § 76-1902. This designation vests debtor with certain statutory rights.

Section 76-1903 grants an eligible debtor, who is a party to a foreclosure proceeding upon a farm homestead, two months in which to cure any defaults of outstanding mortgage payments. If debtor cures the default prior to this two-month period, the pending foreclosure action is dismissed and the original payment schedule is reinstated.

If debtor's homestead is subject to an action for foreclosure under any mortgage or trust deed executed on or after November 21, 1986, he may file a petition in state court requesting redemption of the farm homestead. Neb. Rev. Stat. § 76-1906. The petition must contain a written appraisal prepared by a licensed appraiser of the fair market value of the property as a whole, the redemptive homestead, and the balance of the real estate. Neb. Rev. Stat. § 76-1907. If the petition is confirmed by the state court, the debtor has ten days in which to pay cash equal to the fair market value of the redemptive homestead. If the payment is made, debtor takes the property free and clear of all encumbrances. Neb. Rev. Stat. §§ 76-1909(1), -1910(2).

The only case the Court has found that discusses the effect of the FHPA on bankruptcy proceedings under Chapter 12 is Matter of Lauck, 76 Bankr. 717 (Bankr. D. Neb. 1987). In that case, the debtor separated the farm homestead from the balance of the property, paid the fair market value of the homestead and amortized the payments for the balance of the property over the balance of the plan. Creditor claimed that the debtor's use of fair market value as a means of valuing the homestead was a

violation of Neb. Rev. Stat. § 76-1909 and § 76-1912. The court held:

> The parties apparently prefer that this Court decide this case based upon an analysis of the newly enacted state statute. This statute has not been interpreted by the Nebraska Supreme Court, [a fact that is still correct] and, since this Court believes that federal bankruptcy law can be used to determine the legal issue, it will decline the opportunity to interpret the Nebraska statute in this case.

Matter of Lauck, 76 Bankr. 717, 718 (Bankr. D. Neb. 1987).

Because federal bankruptcy law provides a sufficient basis to decide this case and because of the absence of conflict between Neb. Rev. Stat. § 76-1901 et seq. and the Code, this Court once again declines to base any decision on the Nebraska statute. If, after the relief from stay is granted, the Farm Credit Bank brings such a foreclosure action, the debtor, if eligible pursuant to the terms of the statute, will have the right to exercise all state law remedies, including remedies and rights under the FHPA.

Summary

The modification is not confirmable and is not confirmed. The motion for relief from the automatic stay, based upon evidence that the debtor has no equity and the property is not necessary for an effective reorganization, is granted.

Separate journal entry shall be filed.

Clerk shall provide one copy of the memorandum and the journal entry to each party.

DATED: December 2, 1992.

BY THE COURT:

/s/ Timothy J. Mahoney
Timothy J. Mahoney
Chief Judge

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF	
DUANE FREDERICK AHLERS,	CASE NO. BK90-81770 A
DEBTOR(S)	CH. 12
	Filing No. 115, 121, 130, 124, 132
Plaintiff(s)	
vs.	JOURNAL ENTRY
	DATE: December 2, 1992
Defendant(s)	HEARING DATE: September 14, 1992

Before a United States Bankruptcy Judge for the District of Nebraska regarding objection to modified plan and motion for relief filed by Farm Credit Bank of Omaha.

APPEARANCES

Mark Johnson, Attorney for debtor

A. Frank Baron, Attorney for movant

IT IS ORDERED:

The modification is not confirmable and is not confirmed. The motion for relief from the automatic stay, based upon evidence that the debtor has no equity and the property is not necessary for an effective reorganization, is granted. See memorandum entered contemporaneously herewith.

BY THE COURT:

/s/ Timothy J. Mahoney
Timothy J. Mahoney
Chief Judge