883 F.2d 630
United States Court of Appeals,
Eighth Circuit.

In re George Roger EASTON and Elsie M. Easton, Debtors.
OTOE COUNTY NATIONAL BANK, Appellant,
v.
George Roger EASTON and Elsie M. Easton, Appellees.

No. 88–2052.
|
Submitted Dec. 15, 1988.
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Decided Aug. 23, 1989.

Synopsis

Creditor moved to dismiss debtors' Chapter 12 case on ground that debtors allegedly derived more than 50% of gross income other than from farming operation. The United States Bankruptcy Court for the Northern District of Iowa, Michael J. Melloy, J., 79 B.R. 836, denied creditor's motion to dismiss, and creditor appealed. The District Court, Donald E. O'Brien, Chief Judge, 104 B.R. 111, affirmed. On further appeal, the Court of Appeals, Bowman, Circuit Judge, held that cash rent which debtors received from farmland they rented to neighbor for use in production of crops was not "farm income," which debtors could balance against other income to determine eligibility for Chapter 12 relief, unless debtors played some significant operational role or had ownership interest in the crop production which took place on the acreage that they rented.

Vacated and remanded.

Hanson, Senior District Judge, sitting by designation, concurred in part and dissented in part and filed opinion.

Attorneys and Law Firms

***631** Karen M. McCarthy, Sioux City, Iowa, for appellant.

Wanda Howey–Fox, Yankton, S.D., for appellees.

Before BOWMAN and MAGILL, Circuit Judges, and HANSON, Senior District Judge.[*]

Opinion

BOWMAN, Circuit Judge.

In this case we must decide whether the courts below erred in conferring statutory "family farmer" status upon appellees pursuant to 11 U.S.C. § 101(17)(A) (Supp. V 1987). Otoe County National Bank (creditor) appeals from a final judgment of the District Court[1] affirming both the Bankruptcy Court's[2] determination that George Roger Easton and Elsie M. Easton (debtors) meet the statutory definition of "family farmer" and hence are eligible for relief under Chapter 12 of the Bankruptcy Code (Code), 11 U.S.C. §§ 1201–1231 (Supp. V 1987), and its confirmation of debtors' fifth amended plan of reorganization. Each of the courts below stayed its judgment pending appeal. We vacate the judgment of the District Court, and remand for further proceedings.

Debtors own approximately 520 acres of land in Plymouth County, Iowa. They filed their Chapter 12 petition in the Bankruptcy Court on February 13, 1987. In 1986 debtors leased 60 acres of cultivable land to Rick Easton (their grandson) and 290 acres of cultivable land to Larry Ritz (a neighbor) for $85 per acre; George Easton raised cattle on the remaining 170 acres of pastureland. In 1983 Rick Easton obtained a $370,000 loan from creditor for the purpose of constructing a hog-raising facility on a two-acre parcel he had purchased from debtors, who co-signed the note and pledged 150 acres as security for the loan. Rick Easton's hog-raising enterprise proved unable to generate sufficient income to service the loan, and debtors ultimately elected to seek Chapter 12 protection when pressed by creditor for repayment.

The Bankruptcy Court found that debtors "derived a minimal income from the sale of cattle in 1986," and that "[t]he vast majority of [debtors'] income [in 1986] was derived from the cash rent of their real estate and social security."[3] While the Bankruptcy Court found that "not more than 50 percent of [debtors'] income arose from the rental payments received from Rick [Easton], together with the cattle income," it ruled that "all the rental income [*i.e.* rent payments debtors received in 1986 from both Rick Easton and Larry Ritz] ... are [sic] considered farm income for purposes of meeting the farm eligibility test," ***632** Transcript of November 30, 1987 Hearing at 29, and the District Court agreed. Creditor challenges this ruling on appeal.

The Code provides that "[o]nly a family farmer with regular annual income may be a debtor under chapter 12." 11 U.S.C. § 109(f) (Supp. V 1987). The Code defines "family farmer," in relevant part, as follows:

> [An] ... individual and spouse *engaged in* a farming operation whose aggregate debts do not exceed $1,500,000 and not less than 80 percent of whose aggregate noncontingent, liquidated debts ... on the date the case is filed, arise out of a farming operation *owned or operated by* ... such individual and spouse, and ... such individual and spouse receive *from such farming operation* more than 50 percent of ... such individual and spouse's gross income for the taxable year preceding the taxable year in which the case concerning ... sucb individual and spouse was filed.

11 U.S.C. § 101(17)(A) (Supp. V 1987) (emphasis added). As mentioned, the courts below found that debtors do not meet the income requirement of § 101(17)(A) for the test year (1986) unless the rent they received from Larry Ritz is treated as income legally capable of satisfying that requirement. We hold that in so treating the rent debtors received from Larry Ritz[4] the courts below applied an erroneous standard of law.

Under section 101(17)(A), in order for an individual and spouse to qualify as a "family farmer" they among other things must have received more than fifty percent of their gross income in the relevant year from a particular source, namely, "from such farming operation." From a syntactical point of view, identification of the antecedent of the word "such" in the phrase "from such farming operation" admits of two possibilities: it may refer to the farming operation described in the immediately preceding clause of the statute ("a farming operation owned or operated by" the individual and spouse) or it may refer to the farming operation described in the opening clause of the statute (a farming operation "engaged in" by the individual and spouse). To render our disposition in this case it is not necessary that we choose between these constructions,[5] for the courts below granted debtors "family farmer" status without regard to whether debtors satisfied either of these statutory benchmarks with respect to the crop-production enterprise underway on the 290 acres debtors had leased to Larry Ritz. Rather, the courts below found it appropriate to treat as § 101(17)(A) income the rent debtors received from Larry Ritz in 1986 based on what the courts below refer to as the "totality of the circumstances" test articulated in Judge Cudahy's separate opinion in *In re Armstrong,* 812 F.2d 1024, 1030–31 (7th Cir.) (opinion concurring in part and dissenting in part), *cert. denied,* 484 U.S. 925, 108 S.Ct. 287, 98 L.Ed.2d 248 (1987).[6]

In *Armstrong,* a divided panel of the Court of Appeals for the Seventh Circuit held that, in the context of an involuntary bankruptcy action filed against a debtor by a creditor under 11 U.S.C. § 303 (1982), cash rent a debtor receives from a tenant ***633** farmer for the lease of land is not income from a farming operation because such a lease does not expose the debtor to the risk of non-payment in the event of some natural calamity to the crops being produced on the leased acreage. *Id.* at 1028–29. Judge Cudahy, on the other hand, would treat cash rent as income received from a farming operation if in the totality of the circumstances it could be shown that "the land rental was an integral part of [debtor's] farming operation." *Id.* at 1031. In the case at bar, the Bankruptcy Court noted that debtors have owned their acreage for forty years and in the past have themselves farmed the land,[7] are "engage[d] in a traditional farming operation, that is, the raising of cattle," and have debts the majority of which it perceived to "arise out of a family farm operation." *In re Easton,* 79 B.R. at 838. Based on the totality of these circumstances, the Bankruptcy Court concluded that the rent debtors received from Larry Ritz is applicable toward satisfaction of § 101(17)(A)'s income requirement. The District Court endorsed this analysis and found it particularly significant that debtors could conceivably lose their farm if they were to insist that Rick Easton pay his rent when he is financially unable to do so and at the same time make payment on his loan to creditor, secured by 150 acres of debtors' land. *Easton,* 104 B.R. at 112.

The *Armstrong* court was called upon to determine the proper characterization of cash rent payments received by a debtor against whom an involuntary bankruptcy case is filed because under 11 U.S.C. § 303(a) an involuntary case cannot be commenced against a "farmer," defined by the Code as a "person that received more than 80 percent of such person's gross income ... from a farming operation owned or operated by such person." 11 U.S.C. § 101(17) (1982) (now codified at 11 U.S.C. § 101(19) (Supp. V 1987)). Whatever the comparative merits of the "risk" versus the "totality of the circumstances" tests in the *Armstrong* context—and we seriously doubt whether there is any warrant for importing either concept into the construction of the Code's facially unambiguous definition of "farmer"[8]—we do not consider either test appropriate in the determination whether money an individual receives from a given source is income "from such farming operation" within the meaning of § 101(17)(A). As we have said earlier in this opinion, this inquiry requires courts to identify those farming activities engaged in or owned or operated by someone claiming statutory "family farmer" status and then to determine whether that individual

received more than fifty percent of his or her gross income in the relevant year from those activities. For example, in our view it is entirely possible that the cash rent Armstrong received from his tenant farmer could properly be characterized as § 101(17)(A) income because there was some evidence suggesting that Armstrong engaged in the cultivation of crops on the leased acreage. *See Armstrong,* 812 F.2d at 1027. The proper characterization of that income turns, however, not upon any risk of non-payment Armstrong might have faced, nor upon the universe of the particular circumstances surrounding Armstrong's financial situation, but rather upon the extent to which the income in question bears the relation to his farming activities prescribed by the words of the statute.

We believe the Bankruptcy Court's analysis admits of no readily discernible limiting principle, and would if followed lead to the evisceration of § 101(17)(A)'s income requirement. For example, so long as an individual tended some livestock or raised some crops, he would be permitted, under the Bankruptcy Court's analysis, to count as § 101(17)(A) income all rents he received from tenant farmers, however ***634** minimal his income from raising livestock or crops (indeed, perhaps without regard to whether he garnered any income from those activities at all, for in this case the Bankruptcy Court found that debtors have basically retired from farming), so long as it could be said that the individual lived on the land and rented out acreage in an effort to generate sufficient income to service farm debt. Indeed, the Bankruptcy Court's rulings in this very case illustrate the indeterminacy of its approach, for it justified first the inclusion as § 101(17)(A) income the rent paid debtors by Rick Easton and, later and more expansively, the rent paid them by Larry Ritz, on the observation that debtors "have been engaged in farming and have lived upon the farm for over 40 years." 79 B.R. at 838.[9]

Further, we reject the proposition, apparently relied on by the Bankruptcy Court, that the renting out of land *simpliciter* constitutes "farming," and hence by statutory definition, a "farming operation." *See* 79 B.R. at 838 (citing for this proposition *In re Welch,* 74 B.R. 401 (Bankr.S.D.Ohio 1987), which relied in turn upon a definition of "to farm" found in Black's Law Dictionary). To say that the renting out of land is "farming" does not seem to us to square with the statute since all of its other operative terms describe active production of farm commodities or active working of the land. This suggests to us that "farming" is to be understood in its ordinary usage, and not in the strained sense suggested by *Welch.* If the renting of land constitutes a "farming operation" as defined by § 101(20), then an owner of land, whether or not he raises any crops or tends any livestock, would be able to claim the rent he receives from his tenant farmers as § 101(17)(A) income. We doubt that Congress erected Chapter 12 upon that premise. This construction of § 101(17)(A) would permit those who rent out farmland but who have no connection with the production of crops or livestock to conceivably gain statutory "family farmer" status, a possibility which the proponents of Chapter 12 specifically designed § 101(17)(A)'s income requirement to preclude. *See* 132 Cong.Reg. 9985 (1986) (remarks of Sen. McConnell). In fact, we have recently rejected such a result in the context of a corporate debtor seeking "family farmer" status under § 101(17)(B). *See Tim Wargo & Sons, Inc. v. Equitable Life Assurance Society (In re Tim Wargo & Sons, Inc.),* 869 F.2d 1128 (8th Cir.1989).

As we noted earlier, the District Court found it significant that debtors' lease arrangement with Rick Easton was, in theory, not risk-free, since receipt of rent from Rick Easton could result in his failing to make payment on his loan from creditor, which might then elect to exercise its rights against debtors' land. Whether this reasoning provides a sufficient basis for counting as § 101(17)(A) income the rent debtors received from Rick Easton—an issue we need not decide since the Bankruptcy Court found that debtors do not meet the more-than-fifty-percent requirement without counting the rent paid by Larry Ritz—surely it is a non sequitur to conclude that the rent debtors received from Larry Ritz is therefore also § 101(17)(A) income. Since Larry Ritz had not obtained a loan from creditor secured by land pledged by debtors or otherwise guaranteed by them in any fashion, their rental arrangement with him could not have carried within itself the same dire potentiality posited by the District Court with respect to their rental arrangement with their grandson.

While the question of the proper interpretation of § 101(17)(A) is one of first impression in this Circuit, the approach we take in this opinion is not without precedent. For example, in *In re Dakota Lay'd Eggs,* 57 B.R. 648 (Bankr.D.N.D.1986), the question was whether debtor was a "farmer" under the Code in the context of a creditor-filed involuntary bankruptcy action; this inquiry required the court to determine whether debtor received various items of income "from a farming operation ***635** owned or operated" by it. 11 U.S.C. § 101(17) (1982) (now codified at 11 U.S.C. § 101(19) (Supp. V 1987)). The court stated the relevant inquiry as follows: "[T]he determination must be made ... whether [debtor's] income is derived from its own farming or production efforts as opposed to the farming or production efforts of others." *Id.* at 656. Applying this test separately to each claimed item of income, the court declined to treat as statutory income sums debtor received from the sale of eggs which came from flocks neither owned nor managed by it. In *In re*

Guinnane, 73 B.R. 129 (Bankr.D.Mont.1987), a case decided under § 101(17)(A), the court characterized a controverted item of income as farm income because, among other things, it was "not derived from third party efforts, but from the Debtors' efforts." *Id.* at 132. In *In re Haschke,* 77 B.R. 223 (Bankr.D.Neb.1987), the court declined to treat as § 101(17)(A) income cash rent debtors had received because, among other things, the court found "no evidence of the debtors' involvement in the farming of the property." *Id.* at 225. And we read *In re Burke,* 81 B.R. 971 (Bankr.S.D.Iowa 1987), a case cited to us by both parties, to stand for the proposition that rent a debtor receives for use of land under a crop share arrangement is proper § 101(17)(A) income when the debtor plays a significant role in farming the leased acreage.[10] *Cf. In re Martin,* 78 B.R. 593, 597 (Bankr.D.Mont.1987) (money debtor receives for cutting and marketing hay grown on another's land is § 101(17)(A) income). The theme common to these cases is the existence of some indicia of involvement on the part of the debtor in the farming activity which generates the income he seeks to have credited toward satisfaction of the income requirement of § 101(17)(A).

Debtors place principal reliance on *In re Jessen,* 82 B.R. 490 (S.D.Iowa 1988), and *In re Welch,* 74 B.R. 401 (Bankr.S.D.Ohio 1987), in support of the result reached below. We have explained why we believe the *Welch* court's treatment of cash rent does not square with the statute. *Jessen* is but an application of the *Burke* case and thus is, as we have just discussed, not helpful to debtors' position. Debtors also cite *In re Paul,* 83 B.R. 709 (Bankr.D.N.D.1988), and *In re Rott,* 73 B.R. 366 (Bank.D.N.D.1987), in support of their eligibility for Chapter 12 relief. Again, we are not persuaded that either is helpful to debtors' case. In *Paul* the evidence "plainly demonstrate[d]" that the debtors' grain production operation generated sufficient income to satisfy § 101(17)(A) in the relevant year. 83 B.R. at 712. In *Rott,* as in *Burke* and *Jessen,* the court credited cash rent received by debtors toward satisfaction of the statutory income requirement because it perceived the rental arrangement to be temporary. 73 B.R. at 373. As we have just noted, whether this consideration is relevant, debtors' renting out of their cultivable acreage here cannot be characterized, on the record before us, as temporary.

Debtors in the present case, as the lower courts recognized, engaged in the raising of livestock in 1986. The raising of livestock is plainly a "farming operation," *see* 11 U.S.C. § 101(20) (Supp. V 1987),[11] and any money they received from that activity qualifies as § 101(17)(A) income. On the present state of the record, however, we cannot determine whether debtors bear any § 101(17)(A) relation to the "farming operation," that is, to the "production or raising of crops" taking place on the 290 acres rented by Larry Ritz. Although the Bankruptcy Court characterized the money debtors ***636** received from Larry Ritz in 1986 as "cash rent"—thereby perhaps by implication permitting us to conclude that debtors had no involvement in the production of crops on that parcel beyond that of a lessor of land—this financial arrangement does not necessarily preclude the possibility that debtors played a statutorily significant role vis-a-vis the production of crops on that acreage. We vacate and remand so that debtors may have the opportunity to demonstrate that the money they received from Larry Ritz is in fact proper § 101(17)(A) income under the legal standard we have set forth in this opinion. Those sums cannot be counted as § 101(17)(A) income unless debtors show that they had some significant degree of engagement in, played some significant operational role in, or had an ownership interest in the crop production which took place on the acreage they rented to Larry Ritz.

We find the result reached below troubling in a further respect. The Bankruptcy Court ruled that "[t]he majority of the debts owed by the Debtors arise out of a family farm operation, that is the debts represent the grandfather's guarantee of his grandson's debts for the hog confinement facility and hog raising operation." 79 B.R. at 838. The Bankruptcy Court accordingly counted toward satisfaction of § 101(17)(A)'s eighty percent debt requirement the $370,000 debtors owe creditor because "[t]he debt arose out of a farming operation. It's their land that was pledged as a mortgage." Transcript of November 30, 1987 Hearing at 29.

We believe that in evaluating debtors' $370,000 debt to creditor the Bankruptcy Court applied an erroneous legal standard. Certainly this debt arose out of a farming operation, but the inquiry does not end there. Under § 101(17)(A) at least eighty percent of debtors' liquidated, noncontingent debt must arise out of a farming operation *owned or operated by debtors.* Debtors became liable to creditor in the amount of $370,000 because their grandson's hog-raising enterprise failed. On the present state of the record, it does not appear that this debt arises from a farming operation that the debtors either own or operate.

That debtors had pledged land as security for creditor's loan to Rick Easton does not permit a contrary conclusion. Land or an interest in land, without more, is plainly not a farming operation, *see* § 101(20). The Bankruptcy Court's analysis would permit characterization as debt arising out of a farming operation any loan secured by farmland regardless of the purpose to which the borrowed funds have

been put. That approach is not faithful to the language of the statute because it would permit inclusion toward satisfaction of the minimum debt requirement debt incurred by an owner of land without regard to the connection between the debt and the debtor's own farming activity. *See Armstrong,* 812 F.2d at 1030 (debtor's personal guarantee of creditor's loan to seed company is not debt arising out of farming operation); *In re Douglass,* 77 B.R. 714, 715 (Bankr.W.D.Mo.1987) ("[T]he reason or purpose for which the debt was incurred coupled with the use to which the borrowed funds were put ... should be the criteria to determine whether the debt 'arises out of a farming operation'."; debt secured by deed of trust on debtors' service station property is debt arising out of a farming operation where debtors used the borrowed funds to keep their farming operation going); *In re Roberts,* 78 B.R. 536, 537–38 (Bankr.C.D.Ill.1987) (where debtor inherited farm she operates, estate taxes constitute debt arising out of farming operation because debt is incurred as result of acquisition of farming operation from decedent); *In re Rinker,* 75 B.R. 65, 68 (Bankr.S.D.Iowa 1987) (debt incurred by debtors in settlement of will dispute over land farmed by them is debt arising out of a farming operation).

Here, debtors incurred a debt of $370,000 not in acquiring or retaining land they farm, or in financing their own farming activity, but rather in agreeing to co-sign a loan made to finance their grandson's farming operation. The record does not reveal, however, whether debtors, in addition to their function as co-signatories on the note, had any ownership interest, or ***637** played any operational role, in the grandson's hog-raising enterprise. We vacate and remand so that debtors may have an opportunity to demonstrate such a relationship to that farming operation. The $370,000 debt cannot be counted toward satisfaction of § 101(17)(A)'s debt requirement unless debtors show such a relationship.

The courts below evidently believed that debtors are entitled to statutory "family farmer" status since they have lived on their acreage for many years and continue to conduct traditional farming activities on a limited basis. Courts, however, are not free to confer statutory "family farmer" status upon individuals simply because they reside on a farm and carry on some farm-related tasks. That an individual may seem to be a family farmer in the colloquial sense of the term does not mean he or she is a family farmer for purposes of the Bankruptcy Code. For the reasons we have discussed in this opinion, the judgment of the District Court is vacated and the matter remanded for further proceedings consistent with this opinion.

HANSON, Senior District Judge, concurring in part and dissenting in part.

I wholeheartedly agree that the protections afforded by Chapter 12 of the Bankruptcy Code extend only to those debtors who fall within the definition of "family farmer" found at 11 U.S.C. § 101(17)(A). I disagree, however, with the majority's analysis of this provision and with their characterization of the actions of the courts below as conferring "statutory 'family farmer' status upon individuals simply because they reside on a farm and carry on some farm-related tasks." The courts below found statutory "family farmer" status because their review of all of the circumstances surrounding the Eastons' farming operation established that the rental arrangements should be considered an integrated part of this enterprise—a holding which I find is consistent with both the text and intent of the statute at issue. Thus, I write separately to explain my dissent from the majority's characterization of the law. I concur in the remand, though, because I believe it will further strengthen the record establishing the Eastons' rights to chapter 12 protection.

The provision of the bankruptcy code at issue requires that more than 50% of debtors gross income for the taxable year preceding the year of their filing come from a "farming operation" owned or operated by debtors. 11 U.S.C. § 101(17)(A). This provision was added to the Code as part of the Family Farmers Bankruptcy Act of 1986, Pub.L. 99–554, § 255, 100 Stat. 3105–3114. This law created a new chapter of the Bankruptcy Code aimed at providing additional protections to family farmers caught in the agricultural crisis which began in the early 1980's. *See In re Welch,* 74 B.R. 401 (Bkrtcy.S.D.Ohio 1987). Such a law was necessary because of the "difficulties farmers encountered in seeking to reorganize under" the other provisions of the Bankruptcy Code. *Norwest Bank Worthington v. Ahlers,* 485 U.S. 197, 108 S.Ct. 963, 970, 99 L.Ed.2d 169 (1988). The specific provisions at issue in this case were enacted by Congress to "ensure that only family farmers—not tax shelters or large corporate entities—will benefit" from the protections available through the newly created chapter 12. 132 Cong.Rec. S15076 (daily ed. Oct. 3, 1986) (statement of Sen. Grassley).

All parties agree that debtors meet the 50% requirement in 1986, the year at issue, only if the cash rent received from the Ritz's is considered income from the Eastons' farming operation. The bankruptcy and district court both found that this income did qualify as income from their farming operation in this case. The courts made this conclusion based on a review of the "totality of the circumstances" surrounding the rental arrangement.

The majority rejects these holdings finding the "totality of the circumstances" test inappropriate for determining "whether money an individual receives from a given source is income 'from such farming operation' within the meaning of § 101(17)(A)." I believe the majority errs in dismissing this test because the definition of farming operation enacted in law by Congress necessitates this type of fact specific inquiry. ***638** This provision, in its entirety, states that " 'farming operation' includes farming, tillage of the soil, dairy farming, ranching, production of crops, poultry, or livestock, and production of poultry or livestock products in an unmanufactured state." 11 U.S.C. § 101(20) (Supp. V 1987) (emphasis added).

The use of the general phrase "farming" as the first example of an activity which constitutes a "farming operation" is important for two reasons. First, "farming" is an ambiguous description in comparison to the other description of activities in the statute as the phrase relates more to a concept than it does to a specific activity. Thus, by using this phrase Congress indicated that it did not intend to limit the definition of a farming operation solely to the specific activities listed after "farming". Otherwise there would have been absolutely no reason to include the phrase farming in the definition. We do not infer such an intent on Congressional action. Instead, "[i]n construing a statute we are obliged to give effect, if possible, to every word Congress used." *Reiter v. Sonotone Corp.,* 442 U.S. 330, 339, 99 S.Ct. 2326, 2331, 60 L.Ed.2d 931 (1979).

Secondly, the phrase "farming" also envisions a pattern of activity. Thus, courts should not automatically break down all of the actions of someone engaged in farming into separate components before determining whether these activities constitute farming. Some of the actions are more properly viewed in context with each other. For example, although the sale of farm equipment does not appear to be farming when viewed in isolation, it may indeed be farming when viewed in the context of all the other activities and circumstances of the debtor. *Matter of Armstrong,* 812 F.2d 1024, 1026 (7th Cir.1987) (holding that as definition of "farming operation" in Bankruptcy Code begins with general term "farming" it is implicit that definition includes general activities inherent in farming and in perpetuating the farming operation), *cert. denied,* 484 U.S. 925, 108 S.Ct. 287, 98 L.Ed.2d 248 (1987).

Thus, contrary to the majority's assertions, embracing the "totality of the circumstances" test will not result in "no readily discernible limiting principle". It will simply allow the bankruptcy courts, in the appropriate circumstances, to look at a farming operation as a whole without dissecting it into the smallest possible divisions. The majority's failure to recognize this, I fear, will put a straitjacket on the bankruptcy courts which will disable them from being able to fully provide the relief Congress envisioned.

Accordingly, I disagree strenuously with the majority's suggestion that a farmers renting out of a portion of his land, by itself, can never be considered part of a farming operation. The "leasing of farm land, for either cash or a crop share, has been an integral part of many family farm operations throughout this country for years," as has the practice of custom farming, in which a farmer hires all the farm labor done for him. *In Re Mikkelsen Farms, Inc.,* 74 B.R. 280, 285 (Bkrtcy.D.Or.1987). Indeed, the definition of the verb "farm" is "[t]o lease or let; to demise or grant for a limited term and at a stated rental. To carry on business or occupation of farming." *Black's Law Dictionary* 545 (5th Edition 1979). Thus, bankruptcy courts are acting entirely within their discretion when they consider all of the circumstances surrounding a rental agreement to determine whether the income generated is from the debtor's farming operation. Indeed, it seems logical that Congress specifically chose the phrase "farming" in order to give the bankruptcy courts sufficient discretion to target relief to their intended beneficiaries.[1]

A compelling explanation of why a fluid definition of farming is appropriate is ***639** found in *Matter of Burke,* 81 B.R. 971 (Bkrtcy.S.D.Iowa 1987). In this case Judge Jackwig recites the following fact pattern as a prime example of those farmers which Congress intended to help:

> A familiar example is the "financially distressed farm family" of four who began farming in the mid–1960's, first renting then purchasing land. During the prosperous late 1970's, the family purchased additional land for a price in excess of $2,000.00 per acre. Subsequent high interest rates, foreign production, domestic overproduction, depressed markets and the value of the dollar combined to depress commodity prices. The farm no longer was able to generate sufficient income to service its debt. Some production lenders cut off credit. To make ends meet, the husband and wife obtained at least part-time employment off the farm. Some or all of the land was leased.

Id., 81 B.R. at 976.

There is every indication that Congress was fully aware that many farmers were facing this type of situation, and that some were being forced to rent out all or part of their farmland because of problems securing credit for putting in a crop. There is, however, no evidence that Congress intended chapter 12 to be unavailable to such farmers. Thus, I refuse to give an unnecessarily narrow reading to the phrase "farming" when the effect would be to deny relief to the very people Congress sought to help, especially when such a reading is at odds with both the legal definition of the term and with the past and present realities of farming.

Further, I must note that it is established law in this circuit that findings of fact by a bankruptcy court are not to be overturned unless they are clearly erroneous. *In re Martin,* 761 F.2d 472 (8th Cir.1985). The majority, though, fails to give such deference to the court below. Instead, they analyze the issue as a purely legal question. The issues of whether a practice constitutes farming and of whether income is from a farming operation, however, are factual inquiries which Congress put in the hands of the bankruptcy courts, not the appellate courts. Thus, it is error for this court to pre-empt the bankruptcy courts' jurisdiction to determine these issues.

I agree that those operations in which the agricultural landlord is completely non-active with regard to any other farming activities and which are purely pass-through operations are not eligible for chapter 12. This, however, is not such an operation. Instead, the record shows that the Eastons have already established their right to the protections of chapter 12. I concur in the remand simply because I believe an even stronger record can be established. Thus, my concurrence does not extend to the majority's representation of the law, or to the hurdles which the majority says the Eastons must jump to get chapter 12 protection. Accordingly, I urge the courts below to explore all evidence indicating that the rental arrangements are an integral part of the Eastons' farming operation, as well as exploring all ways in which the Eastons influence, direct and participate in the stewardship of the portion of their farm which they rent out to others for cultivation.

I also note that it is not clear to me that the issue of whether debtors meet the 80% debt requirement is properly before this court. Appellants first raised this issue in a motion to alter or amend judgment after the bankruptcy court had ruled that debtors were family farmers within the meaning of the bankruptcy code. This judgment was issued after the bankruptcy court held a hearing on appellant's motion to dismiss based on the allegation that debtors were not family farmers within the meaning of the bankruptcy code. Appellants never raised the debt issue in their motion to dismiss, during the hearings on the motion, or in their post hearing submission. This fact led the bankruptcy court to challenge the legitimacy of raising the issue in the motion to amend judgment. *See* Transcript of Nov. 30, 1987 Hearing at 29.

Specifically, the court ruled from the bench that the debt issue "wasn't even raised in the motion to dismiss. And I guess I have a problem with revisiting the ***640** motion over and over again. * * * And to—to come in and raise it in the context of a motion to amend I think is improper because the facts—I don't think it has any merit, and so I am going to renew my ruling denying the motion to dismiss subject to the—to what I have just stated." *Id.* The Court went on to discuss why it thought the claim was meritless even if properly raised.

Accordingly, I question whether this claim is properly before us. It may be that after fully examining the issue we would find that the debt question is a jurisdictional issue which could be raised at any time, or that the issue was properly presented to the court below. However, I find it necessary to jump at least one of these hurdles before addressing the issue. Thus, I concur in the remand of this issue to give the courts below the opportunity to examine whether this is still a "live" issue, as well as to produce evidence indicating the extent to which the Eastons' and their grandson's farming operations were commingled with regard to the hog-raising enterprise. In my view this would include all evidence indicating that it was the intent of the Eastons to bring their grandson into their farming operation through this joint venture with him.

Finally, it is misleading for the majority opinion to refer to George and Elsie Easton as being "basically retired from farming". The Eastons are engaged in a substantial cow/calf cattle raising operation for which they alone provide all labor. Transcript of May 12, 1987 Hearing at 5. In 1986, the operative year under the bankruptcy code, approximately 170 acres of the Eastons' land were devoted solely to this enterprise. Thus, the Eastons are not "basically retired from farming", nor are they merely carrying on "some farm-related tasks". They are fully and actively engaged in the enterprise of farming. It is also somewhat misleading for the majority to refer to the Eastons' farm of more than 400 acres as "their acreage".

In closing I note one last irony. In *Norwest Bank Worthington v. Ahlers,* 108 S.Ct. 963, the Supreme Court reversed a decision by this court on the grounds that we had failed to adhere to the then applicable bankruptcy code.

The Court wrote "relief from current farm woes cannot come from a misconstruction of the applicable bankruptcy laws, but rather, only from action by Congress." 108 S.Ct. at 970. Congress, fortunately, did act and created an entirely new chapter aimed at farmers like the Eastons. Today, however, this court enacts an obstacle in the path of such farmers through an interpretation of the phrase "farming" which is in no way necessitated by the statute Congress passed. On this aspect of the opinion I must dissent.

All Citations

883 F.2d 630, 58 USLW 2149, 19 Bankr.Ct.Dec. 1217, Bankr. L. Rep. P 73,094

Footnotes

* The HONORABLE WILLIAM C. HANSON, Senior United States District Judge for the Northern and Southern Districts of Iowa, sitting by designation.

1 The Honorable Donald E. O'Brien, Chief United States District Judge for the Northern District of Iowa.

2 The Honorable Michael J. Melloy, Chief United States Bankruptcy Judge for the Northern District of Iowa.

3 *In re Easton,* 79 B.R. 836, 837 (Bankr.N.D.Iowa 1987), *aff'd,* 104 B.R. 111 (N.D.Iowa 1988).

4 Debtors received rent in 1986 from Larry Ritz, Ed Ritz, and Triple J Farm, the latter an entity through which Larry Ritz conducts business. Appendix at 15, 18, 20, 33; Transcript of May 12, 1987 Hearing at 3. The courts below, and the parties in their briefs and at oral argument, refer to the rent debtors received from each of these sources collectively as rent received from or paid by Larry Ritz. For simplicity's sake we continue this usage here.

5 No Circuit Court of Appeals has been called upon to resolve explicitly this particular question. The Court of Appeals for the Eleventh Circuit appears to have parsed § 101(17)(A) in a fashion consistent with the second possible reading we have outlined in the text, though it does not seem to us that the resolution of the case turned on that particular reading. *See Federal Land Bank v. McNeal (In re McNeal),* 848 F.2d 170 (11th Cir.1988).

6 *See In re Easton,* 79 B.R. at 838 ("This Court believes, however, the better reasoned approach is represented by the minority opinion in the *Armstrong* case."); *Easton,* 104 B.R. at 112, ("[T]he court embraces the 'totality of the circumstances' approach taken by the bankruptcy court ... and wholeheartedly agrees with the bankruptcy court's rejection of the approach taken by the majority in *In re Armstrong*....").

7 George Easton testified that he rented out his cultivable land on a dollar-per-acre basis in 1985 and 1986 and that he had this acreage "custom farmed" in 1984. Transcript of May 12, 1987 Hearing at 6.

8 To the extent that Congress considered exposure to "risk" a relevant concept in its definition of "farmer," it articulated as much by prescribing that it is risk attendant to owning or operating a farming operation that serves to distinguish statutory from non-statutory income.

9 Indeed, on this analysis there would seem little reason not to include as § 101(17)(A) income the salary an individual might earn in some other occupation, so long as he continued to do some farming and took on the non-farm employment in an effort to service farm debt.

10 *Burke* also states: "Income received from a cash rent arrangement will be farm income in the case of an individual or individual and spouse only if the evidence reveals that past farming activities have been more than short term or sporadic and that any cessation of farming activities is temporary." 81 B.R. at 976–77. Whether this language is consonant with our explication of § 101(17)(A) today, it is of no help to debtors. Since the courts below found that debtors have substantially retired from active farming, it cannot be said that their cessation from farming the acreage leased to Larry Ritz is temporary.

11 Section 101(20) reads: " '[F]arming operation' includes farming, tillage of the soil, dairy farming, ranching, production or raising of

crops, poultry, or livestock, and production of poultry or livestock products in an unmanufactured state."

1 The suggestions by the majority that the use of the totality of the circumstances test would allow a court to confer family farmer status on a land-holder who has no other attachment to farming evidences a complete misunderstanding of the concept of weighing all of the circumstances. A court weighs all the circumstances to see if rental agreements are part of a farming operation. If all there are, are rental arrangements, then there is no farming operation for these arrangements to be part of.

743 F.3d 689
United States Court of Appeals,
Tenth Circuit.

In re Reson Lee WOODS, a/k/a Lee Woods, d/b/a Bar LS Farms, f/d/b/a Bar LS Properties Inc.; Shaun K. Woods, a/k/a Shaun Woods, d/b/a Bar LS Farms, f/d/b/a Bar LS Properties Inc., Debtors.
First National Bank Of Durango, Appellant,
v.
Reson Lee Woods; Shaun K. Woods, Appellees.

No. 12–1111.
|
Feb. 19, 2014.

Synopsis
Background: Chapter 12 debtors sought confirmation of their proposed plan. The United States Bankruptcy Court for the District of Colorado confirmed plan, and secured creditor appealed on theory that debtors were not "family farmers" eligible for Chapter 12 relief. The Bankruptcy Appellate Panel, Nugent, J., 465 B.R. 196, affirmed, and creditor again appealed.

Holdings: The Court of Appeals, Holmes, Circuit Judge, held that:

debt for debtor's principal residence "arises out of a farming operation," so as not to be excluded from his aggregate noncontingent, liquidated debt in calculating whether at least 50% of such debt arises from farming operation, only if this residence debt is directly and substantially connected to farming operation;

loan debt for debtor's principal residence has "direct and substantial connection to a farming operation" only if proceeds of loan were directly applied to, or utilized in, farming operation; and

mere fact that the residence built with proceeds of construction loan served to house the office, books, and records of hay farm operated by debtors, or that residence was located on land used by debtors for their hay farming operation, was insufficient, without more, to establish the requisite connection, for purposes of assessing debtors' eligibility for Chapter 12 relief.

Vacated and remanded.

Attorneys and Law Firms

***691** Garry R. Appel, Appel & Lucas, P.C., Denver, Colorado, for Appellant.

Cheryl A. Thompson, Thompson Brownlee, Vail, Colorado (Daniel J. Lowenberg, Mountain Law Group, L.L.C., Montrose, Colorado, with her on the brief), for Appellees.

Before HOLMES, O'BRIEN, and MATHESON, Circuit Judges.

Opinion

HOLMES, Circuit Judge.

Appellant First National Bank of Durango ("First National Bank") appeals from the Bankruptcy Appellate Panel's ("BAP's") decision affirming the bankruptcy court's confirmation of the Chapter 12 bankruptcy plan of Appellees Reson and Shaun Woods ("Debtors"). Although First National Bank raises several issues on appeal, we only reach the first: whether Debtors are permitted to seek relief under Chapter 12 as "family farmers." In deciding this issue, we are presented with a question of first impression for our court—namely, when does a debt "for" a principal residence "arise[ ] out of a farming operation"? *See* 11 U.S.C. § 101(18)(A). We conclude that a debt so arises if it is directly and substantially connected to any of the activities constituting a "farming operation" within the meaning of 11 U.S.C. § 101(21). More specifically, when the debt at issue is loan debt, as here, we conclude that an objective "direct-use" test serves as the optimal vehicle for discerning when the direct-and-substantial-connection standard is satisfied. That is, if the loan proceeds were used directly for or in a farming operation, the debt "arises out of" that farming operation. This was not the test applied by the bankruptcy court (or the BAP).

Because we conclude that the bankruptcy court did not apply the proper legal standard and test in its analysis of Debtors' eligibility for Chapter 12 relief, we deem it appropriate and prudent to remand for that court to apply the correct law to the facts of this case. Thus, we **vacate** the bankruptcy court's judgment and **remand** the case to the bankruptcy court for further proceedings.

I

Debtors are a husband and wife who, in 2007, purchased farmland in southwestern Colorado on which to run their hay-**farming operation**. Until they filed for bankruptcy in November 2010, Debtors accumulated various debts, some of which were related to their **farming operation** and others of which were not. One such debt is a $480,000 loan Debtors obtained from First National Bank. Approximately $284,000 of this loan was used to pay off a loan from another bank that was obtained to purchase Debtors' farmland. The parties do not dispute that this portion of the debt "arises out of" a **farming operation**; nor do they dispute that the majority of the remaining loan proceeds—what we call the "construction loan"—were used to construct Debtors' principal residence on the farmland.

It is the construction loan that is our primary focus. This is because Debtors petitioned for **Chapter 12** relief as family ***692** farmers. A "family farmer" is, *inter alia,* an individual or individuals

> not less than 50 percent of whose aggregate noncontingent, liquidated debts (excluding a debt for the principal residence of such individual or such individual and spouse unless such debt arises out of a **farming operation**), on the date the case is filed, arise out of a **farming operation** owned or operated by such individual or such individual and spouse....

11 U.S.C. § 101(18)(A). From the outset of this case—and again on appeal—First National Bank has maintained that, if the construction loan is excluded from the debt total because it does not "arise out of" a **farming operation**, less than fifty percent of Debtors' aggregate noncontingent, liquidated debts "arises out of" a **farming operation**, which would preclude Debtors from qualifying as family farmers. And, if Debtors are not "family farmers," they cannot seek relief under **Chapter 12**. *See id.* § 109(f).

The bankruptcy court disagreed with First National Bank. It concluded that the construction loan should not be excluded from the debt total under § 101(18)(A) because it "ar[ose] from farm operations." Aplt.App. at 797 (Hr'g Tr., dated May 10, 2011). In reaching this conclusion, the bankruptcy court found that the residence was "an integral part of the farm operation in [the] sense that" (1) the **farming operation's** office and records were located in the residence; and (2) the residence was located on the farmland, placing it in proximity to the **farming operation**. *Id.*

The BAP agreed with the bankruptcy court that the construction loan arose out of a **farming operation**. It recognized that "[f]ew courts have considered when a debt 'arises out of a **farming operation**.' " *Id.* at 1381 (B.A.P. Op., filed Feb. 27, 2012). The BAP elected to adopt the approach taken in *In re Saunders,* 377 B.R. 772 (Bankr.M.D.Ga.2007). Accordingly, it applied the following test: "to 'arise out of a **farming operation**' the purpose of a debt must have *some connection* to the debtor's farming activity." Aplt.App. at 1382 (emphasis added) (citation omitted) (internal quotations marks omitted). Relying on the same two factors that the bankruptcy court identified—that is, generally, the presence of the **farming operation's** office and records in the residence, and the residence's proximity to the farm—the BAP concluded that the residence was "connected to [Debtors'] farming activities" and thus "including the construction ... loan in the farm debt calculation was proper." *Id.* at 1383.

This appeal followed.

II

"Although this appeal is from a decision by the BAP, we review only the Bankruptcy Court's decision." *Miller v. Deutsche Bank Nat'l Trust Co. (In re Miller),* 666 F.3d 1255, 1260 (10th Cir.2012) (quoting *C.O.P. Coal Dev. Co. v. C.W. Mining Co. (In re C.W. Mining Co.),* 641 F.3d 1235, 1240 (10th Cir.2011)) (internal quotation marks omitted); *accord Wagers v. Lentz & Clark, P.A. (In re Wagers),* 514 F.3d 1021, 1022 (10th Cir.2007) (per curiam). "We review matters of law de novo, and we review factual findings made by the bankruptcy court for clear error." *In re Miller,* 666 F.3d at 1260 (internal quotation marks omitted). "[W]e treat the BAP as a subordinate appellate tribunal whose rulings are not entitled to any deference (although they certainly may be persuasive)." *Mathai v. Warren (In re Warren),* 512 F.3d 1241, 1248 (10th Cir.2008); *accord Parks v. Dittmar (In re Dittmar),* 618 F.3d 1199, 1204 (10th Cir.2010).

***693** First National Bank contends that the bankruptcy court applied the incorrect legal test to determine whether the construction loan arose out of a **farming operation** pursuant to 11 U.S.C. § 101(18)(A). It urges us to apply a test that focuses on "whether the funds that gave rise to the debt were used in the **farming operation**." Aplt. Opening Br. at 14. First, in Part II.A, we interpret § 101(18)(A) and set forth the proper legal standard for determining whether

a debt "for" a principal residence "arises out of" a **farming operation**; that is, a direct-and-substantial-connection standard. Then, we conclude, at least in the loan context, that an objective "direct-use" test—akin to the one First National Bank advances—does in fact provide the optimal means of discerning whether the direct-and-substantial-connection standard is satisfied.

Ultimately, because the bankruptcy court (and the BAP) applied the wrong legal test, we determine in Part II.B that neither of the factors upon which the bankruptcy court relied can, as a matter of law, support classifying Debtors' principal-residence debt as debt that "arises out of a **farming operation**." And, we conclude that a remand is required so that the bankruptcy court may apply our newly fashioned test in the first instance.

A

Our task is one of statutory interpretation. The interpretation of a statute is a legal question; thus, we review the bankruptcy court's interpretation of the statute de novo.[1] *See In re Stephens,* 704 F.3d at 1283; *Caplan v. B–Line, LLC (In re Kirkland),* 572 F.3d 838, 840 (10th Cir.2009).

***694** We begin by interpreting the phrase "arises out of" in the "family farmer" definition of 11 U.S.C. § 101(18)(A). We read that provision as requiring a direct and substantial connection between the debt and the **farming operation**. Next, we examine the tests that courts have commonly applied in this statutory context when determining whether debt "arises out of" a **farming operation**, in order to assess what test best fits the direct-and-substantial-connection statutory standard. And, in that regard, we conclude that an objective "direct-use" test provides the optimal vehicle for discerning whether the direct-and-substantial-connection standard is satisfied—at least in the loan-debt setting.

1

"[I]nterpretation of the Bankruptcy Code starts 'where all such inquiries must begin: with the language of the statute itself.' " *Ransom v. FIA Card Servs., N.A.,* —— U.S. ——, 131 S.Ct. 716, 723, 178 L.Ed.2d 603 (2011) (quoting *United States v. Ron Pair Enters., Inc.,* 489 U.S. 235, 241, 109 S.Ct. 1026, 103 L.Ed.2d 290 (1989)); *see United States v. West,* 671 F.3d 1195, 1199 (10th Cir.2012) ("[W]e first and foremost look to the statute's language to ascertain Congressional intent."). "[T]he Bankruptcy Code must be construed liberally in favor of the debtor and strictly against the creditor." *In re Warren,* 512 F.3d at 1248 (quoting *Gullickson v. Brown (In re Brown),* 108 F.3d 1290, 1292 (10th Cir.1997)) (internal quotation marks omitted).

"It is well established that 'when the statute's language is plain, the sole function of the courts—at least where the disposition required by the text is not absurd—is to enforce it according to its terms.' " *Lamie v. U.S. Tr.,* 540 U.S. 526, 534, 124 S.Ct. 1023, 157 L.Ed.2d 1024 (2004) (quoting *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.,* 530 U.S. 1, 6, 120 S.Ct. 1942, 147 L.Ed.2d 1 (2000)); *see United States v. Sprenger,* 625 F.3d 1305, 1307 (10th Cir.2010) ("If the terms of the statute are clear and unambiguous, the inquiry ends and we simply give effect to the plain language of the statute." (internal quotation marks omitted)). Further, "[i]t is a fundamental canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme." *Davis v. Mich. Dep't of Treasury,* 489 U.S. 803, 809, 109 S.Ct. 1500, 103 L.Ed.2d 891 (1989); *accord Kunz v. United Sec. Bank (In re Kunz),* 489 F.3d 1072, 1077 (10th Cir.2007).

As noted, a "family farmer" is, in relevant part, an individual or an individual and spouse "not less than 50 percent of whose aggregate noncontingent, liquidated debts (excluding a debt for the principal residence of such individual or such individual and spouse unless such debt arises out of a **farming operation**), on the date the case is filed, arise out of a **farming operation**." 11 U.S.C. § 101(18)(A).

We begin our analysis by examining the subsection's structure, as "the meaning of statutory language, plain or not, depends on context." *United States v. Villa,* 589 F.3d 1334, 1343 (10th Cir.2009) (quoting *Bailey v. United States,* 516 U.S. 137, 145, 116 S.Ct. 501, 133 L.Ed.2d 472 (1995)) (internal quotation marks omitted); *see Salazar v. Butterball, LLC,* 644 F.3d 1130, 1137 (10th Cir.2011) ("The plainness or ambiguity of statutory language is determined by reference to the language itself, the specific context in which that language is used, and the broader context of the statute as a whole." (quoting *Robinson v. Shell Oil Co.,* 519 U.S. 337, 341, 117 S.Ct. 843, 136 L.Ed.2d 808 (1997)) (internal quotation marks omitted)); *cf. Davis,* 489 U.S. at 809, 109 S.Ct. 1500 ("[S]tatutory ***695** language cannot be construed in a vacuum.").

Section 101(18)(A) is perhaps best understood by breaking the provision into its two principal parts: (1) the fifty-percent-farm-debt rule, with its embedded exclusion; and (2) the exception to the rule. The rule requires at least one-half of a family farmer's debt to "arise out of" a **farming operation**. Part and parcel of this rule is an embedded exclusion. It excludes from the aggregate-debt calculation

any debt "for" the family farmer's principal residence. Thus, construed along with its embedded exclusion, the rule provides that an individual (or an individual and his or her spouse) qualifies as a family farmer if at least fifty percent of the individual's aggregate debt "arises out of" a **farming operation**, excluding debt "for" the individual's principal residence. This rule is qualified in certain instances by an exception. That exception provides that the aggregate debt for determining whether the fifty-percent-farm-debt threshold is met *will* include debt for the principal residence if the debt "arises out of" the **farming operation**.[2]

The rule separates those who are family farmers—and thus can file under **Chapter 12**—from those who are not, by requiring, *inter alia,* that at least one-half of the putative family farmer's debt "arise out of" a **farming operation**. In other words, the fifty-percent-farm-debt rule provides a means to identify true family farmers. "Congress intended **Chapter 12** to encourage family farmers to continue farming despite the economic realities that have caused many rural people to exit farming." Katherine M. Porter, *Phantom Farmers: **Chapter 12** of the Bankruptcy Code,* 79 Am. Bankr.L.J. 729, 735 (2005); *see Hall v. United States,* —— U.S. ——, 132 S.Ct. 1882, 1894, 182 L.Ed.2d 840 (2012) (Breyer, J., dissenting) ("**Chapter 12** of the Bankruptcy Code helps family farmers in economic difficulty reorganize their debts without losing their farms."); *Watford v. Fed. Land Bank of Columbia (In re Watford),* 898 F.2d 1525, 1528 (11th Cir.1990) ("Congress' intent in passing **Chapter 12** of the Bankruptcy Code was to allow farmers to keep their land despite their financial troubles.").

With that objective in mind, in **Chapter 12**, Congress provided "specialized bankruptcy relief for farmers[,] ... designed to be more generous to debtors than generally applicable bankruptcy law." Porter, *supra,* at 731; *see* 8 Alan N. Resnick & Henry J. Sommer, *Collier on Bankruptcy* ¶ 1200.01[2], at 1200–4 (16th ed.2013) ("Before the enactment of **chapter 12**, most farmers seeking to reorganize under the Code filed for relief under chapter 11. The plan confirmation requirements of chapter 11, however, often proved difficult for farm debtors to meet, and the success rate for farm reorganizations was low.... In enacting **chapter 12**, ... Congress allowed farmers to confirm reorganization plans without providing for payment in full to unsecured creditors.").

***696** But " '[r]ural' and 'farm' are not synonymous[,]" Porter, *supra,* at 730, and Congress sought to ensure that **Chapter 12's** more generous remedial provisions were only available to those who could be said to be true family farmers. *See In re Watford,* 898 F.2d at 1528 ("Congress was also concerned that family farmers *only* ... benefit from the provisions of **Chapter 12**." (emphasis added)); *In re Vernon,* 101 B.R. 87, 89 (Bankr.E.D.Mo.1989) ("The provisions ensure that only family farmers—not tax shelters or large corporate entities—will benefit. Consequently, Congress has identified precisely whom **Chapter 12** was intended to help." (citation omitted)); *see also* Resnick & Sommer, *supra,* ¶ 1200.01[3][a][i], at 1200–5 ("The definition [of 'family farmer'] has been drafted narrowly so as to limit **chapter 12** eligibility to true 'family' farmers and to exclude investors or speculators who use farm losses to shelter non-farm income."). Thus, the fifty-percent-farm-debt rule was one means of identifying true family farmers, who would be eligible for **Chapter 12** relief.

Part and parcel of the rule is an exclusion that applies in the ordinary course: it excludes from the aggregate debt (of which one-half or more must be farm debt) the debt "for" one's "principal residence." In other words, one is a family farmer if at least one-half of one's non-principal-residence debt arises out of a **farming operation**. *See, e.g., In re Quillian,* No. 07–20199, 2007 WL 3046348, at *2 (Bankr.S.D.Tex. Oct. 15, 2007) ("The exclusion provision in 11 U.S.C. § 101(18) excludes a debt such as a mortgage used for the purchase of the principal residence."). The exclusion prevents, for example, one from being disqualified from **Chapter 12** relief, even though all of one's non-principal-residence debt arises out of a **farming operation**, simply because this debt is less than the debt "for" one's "principal residence."

Finally, we turn to the exception. Under the rule, ordinarily the debt for one's principal residence is not included in the aggregate debt; on the other hand, the exception provides that if such debt "arises out of" a **farming operation**, then it *is* included in the aggregate-debt calculation and also constitutes farm debt for purposes of the rule (because the debt "arises out of" a **farming operation**). In other words, if the exception applies, the aggregate debt *and* farm-debt portion of the aggregate debt increase by the same amount, which necessarily increases the proportion of one's debt that "arises out of" a **farming operation**.

With this background in mind, we turn to our specific interpretive task of giving meaning to the phrase "arises out of" in this exception. In particular, we must decide how a court should determine whether a debt "for" a principal residence "arises out of" a **farming operation** for purposes of applying this exception. Significantly, the parties have not identified any cases, and we are not aware of any, that have specifically interpreted the phrase "arise out of" as it is found in the exception. Instead, the courts that have interpreted this phrase—and, as the BAP noted, not many

have—have done so when interpreting the fifty-percent-farm-debt rule. *See, e.g.,* Aplt. Opening Br. at 16 ("All of the cases interpret the language ['arise out of a **farming operation**'] as it is used the second time it appears in the statute[, i.e., immediately after the phrase "on the date the case is filed"].... [T]his matter therefore appears to be one of first impression.").

The language of the phrase "arise out of" is of course essentially identical as ***697** it appears in the rule and the exception.[3] And, in that regard, we recognize that "[t]he normal rule of statutory construction assumes that identical words used in different parts of the same act are intended to have the same meaning." *Sorenson v. Sec'y of Treasury,* 475 U.S. 851, 860, 106 S.Ct. 1600, 89 L.Ed.2d 855 (1986) (internal quotation marks omitted); *see Nat'l Credit Union Admin. v. First Nat'l Bank & Trust Co.,* 522 U.S. 479, 501, 118 S.Ct. 927, 140 L.Ed.2d 1 (1998) (discussing "the established canon of construction that similar language contained within the same section of a statute must be accorded a consistent meaning"). Indeed, it is noteworthy that the phrase "arises out of" is repeated in the same sentence; for, as the Supreme Court has recently noted, "the presumption that a given term is used to mean the same thing throughout a statute is at its most vigorous when a term is repeated within a given sentence." *Miss. ex rel. Hood v. AU Optronics Corp.,* —— U.S. ——, 134 S.Ct. 736, 743, 187 L.Ed.2d 654 (2014) (quoting *Brown v. Gardner,* 513 U.S. 115, 118, 115 S.Ct. 552, 130 L.Ed.2d 462 (1994)) (internal quotation marks omitted). Consequently, in light of these interpretive principles, we are comfortable looking for guidance to those cases that have construed the phrase "arises out of" in the context of the fifty-percent-farm-debt rule. We do so below, in seeking to determine the appropriate legal test to apply in this factual setting for discerning when the direct-and-substantial-connection standard is satisfied.

However, we also are cognizant of the fact that the phrase as found in the exception has a different—in some respects more narrow—point of focus than the phrase as found in the rule. Notably, the former (that is, the exception) focuses entirely on the debt associated with the putative family farmer's principal residence, whereas the latter (that is, the phrase "arises out of" as found in the rule) relates to all "aggregate noncontingent, liquidated debts." 11 U.S.C. § 101(18)(A). We are not prepared to say at this time that this difference in focus is wholly immaterial and, more specifically, that it has no meaningful implications for how Congress intended the two phrases to operate in the statute. *See United States v. Cleveland Indians Baseball Co.,* 532 U.S. 200, 213, 121 S.Ct. 1433, 149 L.Ed.2d 401 (2001) ("Although we generally presume that identical words used in different parts of the same act are intended to have the same meaning, ... the presumption is not rigid, and the meaning [of the same words] well may vary to meet the purposes of the law." (alteration in original) (citation omitted) (internal quotation marks omitted)); *Cherokee Nation v. Georgia,* 30 U.S. (5 Pet.) 1, 19, 8 L.Ed. 25 (1831) ("It has been also said, that the same words have not necessarily the same meaning attached to them when found in different parts of the same instrument: their meaning is controlled by the context. This is undoubtedly true."); *see also* Antonin Scalia & Bryan A. Garner, *Reading Law: The Interpretation of Legal Texts* 170 (2012) ("Though one might wish it were otherwise, drafters more than rarely use the same word to denote different concepts...."). Therefore, we conduct an independent examination of the statute and expressly underscore that our analysis is focused on the phrase "arises out of" as it appears in the exception to the fifty-percent-farm-debt rule.

***698** In the end, we conclude that a debt "for" a principal residence "arises out of" a **farming operation** only if the debt is directly and substantially connected to the **farming operation**. Then, we proceed to determine what test is optimal in this factual context—which involves loan debt—for discerning whether this direct-and-substantial-connection standard is satisfied. We conclude that an objective "direct-use" test is the best fit.

2

With the statute's structure outlined, we now turn to its plain language. The term "**farming operation**" is defined to *"include* [ ] 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." **11** U.S.C. § **101**(**21**) (emphasis added). This definition is not exhaustive. *See* 2 Nancy C. Dreher et al., *Bankruptcy Law Manual* § 12:4, at 928–29 (5th ed. 2013) ("The definition of '**farming operation**,' which has been in the Code since its original enactment in 1978, is broad in scope.... Thus, the primary business of the family farmer ... need not be the actual tillage of the soil and may be a related agricultural business that fits within this broad definition."); Barnes Gunn Kelley, Note, ***Chapter 12****: Entrepreneur Punishment and Family Favorites,* 15 Drake J. Agric. L. 485, 487–88 (2010) (noting that the statute provides "a non-exhaustive list of possibilities" of what constitutes a **farming operation** and that "[t]his open-ended wording of the statute has left bankruptcy judges with the case-by-case task of determining whose operations are included and whose are excluded").

The phrase "arises out of" is left undefined. "When a statute does not define a term, we typically give the phrase

its ordinary meaning." *FCC v. AT & T Inc.,* —— U.S. ——, 131 S.Ct. 1177, 1182, 179 L.Ed.2d 132 (2011) (internal quotation marks omitted); *see Sandifer v. U.S. Steel Corp.,* —— U.S. ——, 134 S.Ct. 870, 876, 187 L.Ed.2d 729 (2014) ("It is a 'fundamental canon of statutory construction' that, 'unless otherwise defined, words will be interpreted as taking their ordinary, contemporary, common meaning.' " (quoting *Perrin v. United States,* 444 U.S. 37, 42, 100 S.Ct. 311, 62 L.Ed.2d 199 (1979))); *State Bank of S. Utah v. Gledhill (In re Gledhill),* 76 F.3d 1070, 1077 (10th Cir.1996) ("Courts properly assume, absent sufficient indication to the contrary, that Congress intends the words in its enactments to carry their ordinary, contemporary, common meaning." (internal quotation marks omitted)).

To "arise" means "[t]o originate; to stem (from)" or "[t]o result (from)." *Black's Law Dictionary* 122 (9th ed.2009); *see Webster's Third New International Dictionary* 117 (2002) [hereinafter *"Webster's"]* (defining "arise" as "to originate from a specified source"). These definitions all connote *at least* some connection between the object and its source—that is, at least some connection between the debt at issue and a **farming operation**. Further analysis, however, sheds light on the nature of that connection.

The statute's structure—setting forth a baseline rule and an exception—leads us to believe that the exception must be construed narrowly. Recall, under the rule, that ordinarily the debt for an individual's principal residence is not included in the aggregate debt; it is not considered to "arise out of" a **farming operation**. In other words, in the normal course—reflecting the statute's default—a debt "for" a principal residence does *not* "arise out of" any **farming operations** described in § 101(21). Rather, the debt "for" the ***699** principal residence—at least most frequently—would arise out of the need for a farmer, like anyone else, to have a place to live.

Congress, however, created an *exception:* in the ordinary course, the rule functions to exclude debt for a principal residence "unless" the exception applies—that is, "unless such debt [for a principal residence] arises out of a **farming operation**." 11 U.S.C. § 101(18)(A); *see also Webster's, supra,* at 2503 (defining "unless" as "except on the condition that" or "except"). In other words, the rule normally applies "unless" the exception is triggered.

Because this is a scheme whereby a default rule is subject to an exception, we are guided by the interpretive principle that exceptions to a general proposition should be construed narrowly. *See Comm'r of Internal Revenue v. Clark,* 489 U.S. 726, 739, 109 S.Ct. 1455, 103 L.Ed.2d 753 (1989) ("In construing [statutes] in which a general statement of policy is qualified by an exception, we usually read the exception narrowly in order to preserve the primary operation of the provision."); *City of New York v. Beretta U.S.A. Corp.,* 524 F.3d 384, 403 (2d Cir.2008) (following the "interpretive principle that statutory exceptions are to be construed narrowly in order to preserve the primary operation of the [general provision]" (quoting *Nussle v. Willette,* 224 F.3d 95, 99 (2d Cir.2000)) (internal quotation marks omitted)); *see also United States v. Fort,* 472 F.3d 1106, 1123 (9th Cir.2007) (Fletcher, J., dissenting) ("[An] exception must be construed 'narrowly in order to preserve the primary operation of the provision.' " (quoting *Clark,* 489 U.S. at 739, 109 S.Ct. 1455)); 2A Norman J. Singer, *Statutes and Statutory Construction* § 47:11, at 246–47 (6th ed.2000) ("Subsidiary clauses which limit the generality of a rule are narrowly construed, as they are considered exceptions."); *cf.* Singer, *supra,* § 47:11, at 250–51 ("[W]here a general provision in a statute has certain limited exceptions, all doubts should be resolved in favor of the general provision rather than the exceptions.").

Flowing from this interpretive principle—that we must construe exceptions narrowly—is the related concept that exceptions must not be interpreted so broadly as to swallow the rule. *See Cuomo v. Clearing House Ass'n, L.L. C.,* 557 U.S. 519, 530, 129 S.Ct. 2710, 174 L.Ed.2d 464 (2009) (avoiding interpreting an exception in a manner that "would swallow the rule"); *cf. Minter v. Prime Equip. Co.,* 451 F.3d 1196, 1212 (10th Cir.2006) (interpreting the impeachment exception to Fed.R.Evid. 407 "narrowly, lest it swallow the rule"); *Manchester v. Annis (In re Annis),* 232 F.3d 749, 753 (10th Cir.2000) (rejecting a proposed interpretation of a statutory exemption because it "would swallow the rule"). If Congress were of the view that most or all principal residences of farmers "arise out of" their **farming operations**, it could have quite easily reflected this view in the statute's terms. For instance, Congress could have simply set forth the rule with a different embedded exclusion—e.g., that not less than fifty percent of a family farmer's total debt must "arise out of" a **farming operation**, excluding from the debt total any debt for a principal residence that does *not* arise out of a **farming operation**. Were that the definition of "family farmer," it would be clear that, in Congress's view, family farmers' principal residences ordinarily "arise out of" their **farming operations**.

But that is not the scheme Congress chose. Accordingly, we must interpret the phrase "arise out of" in a way that allows the rule's exception to function as just that—an exception. *See* ***700** *Clark,* 489 U.S. at 739, 109 S.Ct. 1455; *Beretta U.S.A. Corp.,* 524 F.3d at 403; *see also Burrage v. United States,* —— U.S. ——, 134 S.Ct. 881, 892, 187 L.Ed.2d 715 (2014) ("The role of this Court is to apply the statute as it is written—even if we think some

other approach might accor[d] with good policy." (alteration in original) (quoting *Comm'r of Internal Revenue v. Lundy,* 516 U.S. 235, 252, 116 S.Ct. 647, 133 L.Ed.2d 611 (1996)) (internal quotation marks omitted)); *Sandifer,* 134 S.Ct. at 878 (same). We believe that construing this language to mean that there must be a direct and substantial connection between the debt for a principal residence and the **farming operation** serves that end. *Cf. Heffley v. Comm'r of Internal Revenue,* 884 F.2d 279, 283 (7th Cir.1989) (noting that "in order to achieve the congressional intent[, certain] exceptions must be narrowly applied and the corresponding exclusions broadly interpreted"). In other words, applying the foregoing settled principles of statutory construction, we believe that construing the phrase "arise out of" to embody a direct-and-substantial-connection standard serves to ensure that the exception operates narrowly, for this standard only permits limited play in the joints between the debt for the principal residence and the **farming operation**. *See Webster's, supra,* at 640 (defining "direct," *inter alia,* as meaning "marked by absence of an intervening agency, instrumentality, or influence: IMMEDIATE"); *id.* at 2280 (defining "substantial," *inter alia,* as meaning "considerable in amount" and "something of moment").

A statutory standard requiring anything less than a direct and substantial connection, in our view, could not have been envisioned by Congress because a lesser standard, in application, would present a serious and unacceptable risk of the exception consuming the rule. For example, in many cases, very little ingenuity would be needed to conjure up an indirect connection of some kind between a family farmer's principal residence and his **farming operation**. Indeed, nearly every family farmer's principal residence could be said to have at least an indirect connection of some kind to his or her **farming operation**; among other things, the connection could be as tenuous as the principal residence being the place where the farmer keeps the clothing in which he farms.

Put another way, in light of our statutory analysis *supra*—indicating that the default rule is premised in part upon the view that ordinarily, debt for a principal residence will *not* "arise out of" a **farming operation**—we cannot conclude that, in enacting the rule's exception, Congress intended to obliterate that foundational view regarding principal-residence debt and render the exception more akin to the rule. Yet, interpreting the phrase "arise out of" as embodying anything less than a direct-and-substantial-connection standard would present an unacceptable risk of precisely that outcome.

We recognize that divining the appropriate standard—*viz.,* the direct-and-substantial-connection standard—only takes us part of the way in the analysis. We next must determine what test provides the optimal vehicle for discerning when this standard is satisfied. With this objective in mind, we examine below the tests that courts have commonly applied. They have done so when construing the phrase "arise out of" as it appears in the fifty-percent-farm-debt rule. From this examination, we identify a test that will permit us to optimally discern—at least in the loan-debt context, as here—when the direct-and-substantial-connection standard is satisfied. Specifically, we conclude that this test is an objective "direct-use" test.[4]

***701 3**

Courts have commonly applied at least three tests in discerning whether debt "arises out of" a **farming operation**: the "but-for" test, the "some-connection" test, and the "direct-use" test. After examining the but-for and some-connection tests and rejecting them because they are not congruent with the direct-and-substantial-connection standard we believe Congress contemplated when it selected the phrase "arise out of," we discuss and endorse the "direct-use" test. At least in the loan-debt context, we consider that test an optimal fit for the direct-and-substantial-connection standard.

The but-for test provides that a debt "arises out of a **farming operation**" if but for the debt, there would be no farm. *See, e.g., In re Reak,* 92 B.R. 804, 805–06 (Bankr.E.D.Wis.1988) (identifying several cases where the courts applied the but-for test); *see also* Kelley, *supra,* at 492 ("The 'but for' test can be expressed as: but for the indebtedness created by the family farmer, there would be no farm."). The but-for test was at least in part derived from the Seventh Circuit's decision in *In re Armstrong,* 812 F.2d 1024 (7th Cir.1987), where the court had to decide what portion of the debtor's income was derived "from a **farming operation**" under an earlier version of 11 U.S.C. § 101. *See* 812 F.2d at 1026. Specifically, the Seventh Circuit held that the money earned from the debtor's sale of his farm machinery was income from his **farming operation** because the "farm machinery was inescapably interwoven with his **farming operation**"—that is, "[h]e bought the machinery so the farm could exist and prosper. But for the machinery, there would be no farm." *Id.*

The bankruptcy court in *In re Rinker,* 75 B.R. 65 (Bankr.S.D.Iowa 1987), relied on *In re Armstrong* to decide whether certain debt arose from a **farming operation**. *See* 75 B.R. at 67–68. The debtor in *In re Rinker* had entered into a settlement with his three siblings to purchase their respective shares of their parents' farmland. *See id.* at 66. Approximately six years later, the debtor filed for **Chapter 12** protection as a "family farmer" because he

was unable to pay his siblings the outstanding amount of the settlement agreement. *See id.* at 66–67. The court looked to the "subject of the settlement"—the farmland—in holding that the debt arose out of a **farming operation**. *Id.* at 68. After recognizing that the debtor's "purpose in settling the case was to preserve the[ ] **farming operation**," the court applied the but-for test, reasoning that "[w]ithout the land, the [debtor] would have no farm." *Id.*

Other courts have followed suit by relying on *In re Armstrong* in applying the but-for test. *See In re Reak,* 92 B.R. at 805–06 (describing the but-for test as a "common thread" in analogous bankruptcy decisions and holding that the debt used to acquire farmland was "inescapably interwoven with **farming operations**" and "but for [that debt], there would be no farm" (internal quotation marks omitted)); *In re Roberts,* 78 B.R. 536, 537 (Bankr.C.D.Ill.1987) (following *In re Armstrong* and holding that "[t]he debts in question in the ***702** instant case arose when the Debtor inherited the farm from her mother. The estate taxes have to be paid in order for the Debtor to keep the farm. But for the payment of the estate taxes, there would be no farm."); *see also In re Teolis,* 419 B.R. 151, 161 (Bankr.D.R.I.2009) (applying the but-for test set forth in *In re Reak*).

In our view, the but-for test does not comport with the phrase "arises out of" as found in the exception. If a court were applying a but-for test, it would ask, but for the debt "for the principal residence," would there be a "**farming operation**"? *See In re Reak,* 92 B.R. at 806 ("[B]ut for the land acquired by the debtor [through the debt at issue], there would be no farm...." (internal quotation marks omitted)); *In re Roberts,* 78 B.R. at 537 ("But for the payment of the estate taxes, there would be no farm."); *In re Rinker,* 75 B.R. at 68 ("Without the [debt for the] land, the [debtor] would have no farm."). Common sense and logic tell us that the answer to this question with respect to debt for a principal residence almost always would be yes—that is, there almost always would still be a **farming operation**, regardless of any debt obtained for a principal residence. In other words, the incurring of debt for family farmers' principal residences would seldom be dispositive of the existence *vel non* of the **farming operations** at which they work. Indeed, in this case, Debtors' **farming operation** preexisted the construction of their residence. The consequence of this situation—of the debt "for" the principal residence, in almost every instance, not being a but-for cause of the existence of the **farming operation**—would be that the exception would almost never apply.

Although we must narrowly construe an exception, *see Clark,* 489 U.S. at 739, 109 S.Ct. 1455, employing the but-for test in this context would have a limiting effect that we are hard-pressed to conclude that Congress intended. In other words, application of the test would almost entirely eviscerate the exception; were we to adopt the but-for test, the exception would rarely, if ever, apply. Given its patent interest in assisting genuine family farmers, we cannot conclude that Congress contemplated a test that would virtually negate a statutory exception that it carefully crafted to help true family farmers satisfy the fifty-percent-farm-debt threshold. *See Sandifer,* 134 S.Ct. at 877 (rejecting petitioner's interpretation of a statutory "exception" because it "runs the risk of reducing [the statutory exception] to near nothingness"); *see also Duncan v. Walker,* 533 U.S. 167, 174, 121 S.Ct. 2120, 150 L.Ed.2d 251 (2001) ("It is our duty 'to give effect, if possible, to every clause and word of a statute.' " (quoting *United States v. Menasche,* 348 U.S. 528, 538–39, 75 S.Ct. 513, 99 L.Ed. 615 (1955))). Thus, in this context we decline to endorse the but-for test.

As noted, other courts have applied what we have labeled a "some-connection" test. This test focuses on whether the purpose (and sometimes the use) of the debt has "some connection" to **farming operations**. *See In re Saunders,* 377 B.R. at 774–76 (collecting cases and concluding that "to arise out of a **farming operation** the purpose of a debt must have *some connection* to the debtor's farming activity" (emphasis added) (internal quotation marks omitted)); *In re Marlatt,* 116 B.R. 703, 705 (Bankr.D.Neb.1990) ("[F]or a debt to arise out of a **farming operation**, there must be *a connection* between the debt and the debtor's farming activity." (emphasis added)).

Notably, in the instant case, the BAP adopted the some-connection test from *In re Saunders,* holding that "to arise out of a **farming operation** the purpose of a debt ***703** must have some connection to the debtor's farming activity." Aplt.App. at 1382 (internal quotation marks omitted); *see also In re Hemann,* No. 11–00261, 2013 WL 1385404, at *7–8 (Bankr.N.D.Iowa Apr. 3, 2013) (relying on the BAP's decision here and applying the some-connection test). The BAP concluded that this test was met because the evidence supported the bankruptcy court's determination that *the purpose* of the construction loan was to construct a farmhouse and that purpose was "connected to the [Debtors'] farming activities." Aplt.App. at 1382–83.

However, we decline to adopt the some-connection test here. This test is inconsistent with our interpretation of the statutory phrase "arises out of." As we understand it, that phrase contemplates a direct and substantial connection between the debt "for" the principal residence and the

farming operation. It follows perforce that a test requiring only *some* connection—no matter how tenuous and insubstantial, or indirect—between the principal-residence debt and the **farming operation** would dilute and conflict with this direct-and-substantial-connection standard. Moreover, we are reinforced in our view that the some-connection test is not the one that Congress envisioned because applying it in the context of the exception would almost certainly result in the exception swallowing the rule. For example, in many cases, it would not be difficult to envision a connection—however remote—between a family farmer's principal residence and his **farming operation**. In other words, nearly every family farmer's principal residence could be said to have *some* connection to his or her **farming operation**; indeed, the connection could be as tenuous and insubstantial as the principal residence being the place where the farmer keeps the clothing in which he farms or the computer or telephone through which he places orders or sells his goods. Thus, were the some-connection test the operative one, the exception would almost certainly swallow the rule; this is not a result that we are prepared to conclude that Congress contemplated. *See Cuomo,* 557 U.S. at 530, 129 S.Ct. 2710. Accordingly, we decline to endorse the some-connection test.

Ultimately, we conclude that—at least in the loan-debt context, as here—an objective "direct-use" test optimally fits with our direct-and-substantial-connection statutory standard. Such a test is singularly focused on whether the loan proceeds were directly applied to or used in a **farming operation**. This test appears to have begun with *In re Douglass,* 77 B.R. 714 (Bankr.W.D.Mo.1987), where the court held that "the reason or purpose for which the debt was incurred coupled with the use to which the borrowed funds were put ... should be the criteria to determine whether the debt 'arises out of a **farming operation**[.']" 77 B.R. at 715. But the test was subsequently modified in important ways by the bankruptcy court in *In re Kan Corp.,* 101 B.R. 726 (Bankr.W.D.Okla.1988); it is the version of the test found there that we ultimately adopt.

The court in *In re Kan Corp.* focused solely on whether the loan proceeds stemming from the debt were directly used in a **farming operation**. In that case, the debtor obtained a bank loan secured by his farmland to purchase a beer distributorship and obtained a second loan to pay off the first. *See In re Kan Corp.,* 101 B.R. at 726. The court reasoned:

> While it may be true that the purpose of [obtaining the second loan] was to save Debtor's farmland and that the proceeds of the **farming operation** were used to meet the payments on the loan, those facts are not material to the issue. ***704** Whether a debt incurred from a loan "arises out of **farming operations**" is determined by the *use made of the loan proceeds.* In this case, the [second] loan ... went to pay off Debtor's obligation to [the first bank], and the proceeds of the [first] loan ... were invested in a beer distributorship.

Id. at 727 (emphasis added). The court held that this debt did *not* "arise out of a **farming operation**" because the loan proceeds were used to purchase a beer distributorship—a business venture completely unrelated to **farming operations**. *Id.*

Significantly, in *In re Kan Corp.,* the court refused to consider "the motive of the debtor" to answer whether a debt arose out of a **farming operation** because looking to "the use made of the loan proceeds" provides "more objective criteria." *Id.; see also Otoe Cnty. Nat'l Bank v. Easton (In re Easton),* 883 F.2d 630, 636 (8th Cir.1989) (rejecting the idea that "any loan secured by farmland" can be characterized as "arising out of a **farming operation**" "regardless of the purpose to which the borrowed funds have been put").[5] In short, in order to satisfy its objective direct-use test, the court held that "the proceeds of the loan must in some way be *directly applied to or utilized in* the **farming operation**." *In re Kan Corp.,* 101 B.R. at 727 (emphasis added).

Thus, we conclude that the version of the use test applied in *In re Kan Corp.*—an objective direct-use test—is the one that fully comports with the direct-and-substantial-connection standard, at least in the loan-debt context. Succinctly stated, a loan debt has a direct and substantial connection to a **farming operation**, and thus "arises out of" that operation, if "the proceeds of the loan" are "directly applied to or utilized in the **farming operation**." *Id.* For the reasons suggested in *In re Kan Corp.,* we reject a version of this test that would focus in part on the "motive of the debtor," *id.;* such a test would be less certain in its application because of the ultimately unfathomable nature of another's thoughts. The objective direct-use test that we adopt reflects an appropriately narrow construction of the exception; however, it leaves open plausible circumstances in which the exception could apply.

As the rule clearly envisions, in many instances, the

proceeds of a debt "for" a principal residence will not be directly used in a **farming operation**, because those proceeds would in fact be used instead to purchase or construct a residence. Put another way, Congress surely envisioned that in many instances, the occupants of the principal residence may be farmers or the residence may be located on a farm, but the proceeds of the loan for the principal residence would not have been used for the activities constituting **farming operations**, such as "dairy farming, ranching, [or] production or raising of crops, poultry, or livestock." **11** U.S.C. § **101**(**21**).

One can easily imagine, however, instances when the proceeds of a loan "for" a principal residence would be applied to such activities. For example, a soybean farmer could obtain a second mortgage on his principal residence in order to buy soybean seeds for planting—and then in fact buy the seeds. The mortgage would certainly amount to a debt "for" his principal residence. Furthermore, it is no less patent that the purchase of the seeds with ***705** the proceeds of that loan debt would constitute a "**farming operation**" within the meaning of **11** U.S.C. § **101**(**21**); at the very least, it would involve "raising of crops." Accordingly, in this scenario, the proceeds from the principal-residence debt would have been directly used in a **farming operation** and, consequently, that debt would properly be deemed to "arise out of" the **farming operation**. That is, the debt would properly be viewed as having a direct and substantial connection to the **farming operation**.

We need not fully explicate here the various situations in which the exception could apply. For our purposes, it is sufficient to underscore that when the debt at issue is loan debt, asking solely whether the loan proceeds were directly used in **farming operations** (as statutorily defined) leaves room for the exception to operate—but, appropriately, only in limited circumstances.

In sum, we have interpreted the statutory term "arises out of" in the exception to the fifty-percent-farm-debt rule of 11 U.S.C. § 101(18)(A) as embodying a direct-and-substantial-connection standard, and we have identified a test that optimally serves—at least in the loan—debt context-as a vehicle for discerning whether that standard is satisfied—i.e., an objective direct-use test. We now turn to the facts of the instant case.

B

Debtors had the burden of establishing their eligibility for **Chapter 12** relief. *See Ames v. Sundance State Bank (In re Ames),* 973 F.2d 849, 851 (10th Cir.1992) ("Debtors [under **Chapter 12**] bear the burden of establishing all elements necessary for confirmation of a plan, including the feasibility of the plan."); *see also Tim Wargo & Sons, Inc. v. Equitable Life Assurance Soc'y (In re Tim Wargo & Sons, Inc.),* 869 F.2d 1128, 1130 (8th Cir.1989) (noting in a **Chapter 12** proceeding that "the burden was debtor's to elicit the relevant facts"); *cf. Hamilton Creek Metro. Dist. v. Bondholders Colo. Bondshares (In re Hamilton Creek Metro. Dist.),* 143 F.3d 1381, 1384–85 (10th Cir.1998) ("The tests of insolvency are applied as of the time of filing, and the petitioner bears the burden of proving one of them is met...." (citation omitted)).

The bankruptcy court concluded that the construction loan arose out of a **farming operation**. In support of this conclusion, the court stated that the residence was "an integral part of the farm operation *in [the] sense that,*" first, "the farm's office, books, and records ... are maintained at the farmhouse," and second, "that the proximity of these debtors to their hands-on, day-to-day, **farming operation** in terms of care of livestock and irrigation, that [the residence] isn't just incidental ... [it] is where they live."[6] Aplt.App. at 797 (emphasis added).

***706** We begin by assessing whether the bankruptcy court's findings are sufficient to support its conclusion under our newly fashioned test. To do so, we ask whether either of the two factors upon which the court relied allows us to conclude that the construction loan is directly and substantially connected to Debtors' **farming operation**. We answer in the negative, recognizing that in the loan-debt context, our true focus must be on whether the loan proceeds from the construction loan were directly used in the **farming operation**.

It is undisputed that the construction loan was used to build Debtors' principal residence. Merely because the residence contained the **farming operation's** office, books, and records does not mean, however, that the proceeds of the loan were "directly applied to or utilized in the **farming operation**." *In re Kan Corp.,* 101 B.R. at 727. In other words, the fact that the residence contains an office and the **farming operation's** books and records has not been shown by Debtors to be anything more than an incidental matter.[7] Were we to hold that such a facially tenuous connection to a **farming operation** was sufficient, the exception would swallow the rule—that is, virtually every family farmer's principal residence could be deemed to arise out of a **farming operation**.

The second factor that the bankruptcy court relied upon rests on an even weaker foundation. The proximity of the residence to the **farming operation** is irrelevant to how the proceeds of the construction loan were used. The fact that Debtors' principal residence is located on the farm cannot reasonably lead us to conclude that the funds derived from

the construction loan were directly used in the **farming operation** itself. Indeed, quite the opposite is true; at best, the funds derived from the construction loan were *indirectly* used in the **farming operation** because they allowed Debtors to construct a residence, which in turn provided convenient access to the **farming operation**.

Put most simply, the debt "for" the principal residence arose out of Debtors' need to have a place to live, not out of the activities constituting **farming operations** under **11** U.S.C. § **101**(**21**). To the extent ***707** that their living in proximity to the **farming operation** could be said to have facilitated Debtors' **farming operation**, that fact alone would not be legally sufficient to make the loan debt that was incurred to construct the principal residence debt that "arises out of" the **farming operation**. In other words, in such a circumstance, the proceeds from the loan debt were not directly used *in* the **farming operation**, such that they could be deemed to be directly and substantially connected to that operation. Once again, were we to hold otherwise, the exception would swallow the rule. Notably, when asked whether "most hay farmers and horse ranchers live on their farms," Mr. Woods testified that, "[t]o [his] knowledge, virtually all of them do that [he] know[s]." Aplt.App. at 289.

In short, under the interpretation of the statutory phrase "arise out of" that we articulate here—which contemplates a direct and substantial connection between the principal-residence debt and the **farming operation**—and under the test that is congruent with this statutory interpretation, the objective direct-use test, the bankruptcy court committed legal error. Specifically, it did so in concluding that two attributes of Debtors' principal residence—(1) that it contains an office and the **farming operation's** books and records, and (2) that it is located in proximity to the **farming operation**—were legally sufficient to classify debt that was incurred for the principal residence as debt that arose out of a **farming operation**.

When we find legal error, we ordinarily do not "weigh the facts ... and reach a new conclusion; instead, [we] must remand to the [trial] court for it to make a new determination under the correct law." *United States v. Hasan,* 609 F.3d 1121, 1129 (10th Cir.2010). We follow such a course here, out of an abundance of caution and in the interest of justice, because we have difficulty concluding that the record leads ineluctably to only one result. *See Pullman–Standard v. Swint,* 456 U.S. 273, 292, 102 S.Ct. 1781, 72 L.Ed.2d 66 (1982) ("[W]here findings are infirm because of an erroneous view of the law, a remand is the proper course unless the record permits only one resolution of the factual issue.").

To be sure, consistent with this opinion and its factual setting, we are confident that ordinarily the proximity of a farmer's principal residence to his **farming operation**—viewed in isolation—will be legally irrelevant to the question of whether the debt "for" that residence "arises out of" a **farming operation**. Furthermore, standing alone, the *mere presence* of an office in a farmer's principal residence ordinarily will not be sufficient to establish that the debt "for" the office portion of that principal residence "arises out of" a **farming operation**. But as we observed above, *see supra* note 7, we do not categorically exclude the possibility that a debt for the construction of an office in a principal residence could be found to "arise out of" a **farming operation**. With the legal landscape now properly defined in this opinion, we believe that Debtors should have an opportunity in the context of a remand to try to establish facts regarding their office supportive of this legal characterization (i.e., "arises out of" a **farming operation**) and possibly other facts as well that may have some material bearing on their eligibility for **Chapter 12** relief.[8]

Lest there be any doubt: we do not express any opinion on the likely outcome ***708** of the bankruptcy court's application to the facts of this case of the proper legal principles—including our newly articulated objective "direct-use" test. Rather, as in *Hasan,* "we simply conclude that findings under the proper legal standard ... are a necessary condition for our review and, accordingly, a remand is required." 609 F.3d at 1131.

III

Because the bankruptcy court failed to apply the correct legal standard and test in determining whether the debt "for" Debtors' principal residence "arises out of a **farming operation**," we **VACATE** the bankruptcy court's judgment and **REMAND** the case to the bankruptcy court to conduct a proper legal analysis—involving notably our newly stated objective "direct-use" test—and for further proceedings consistent with this opinion.

All Citations

743 F.3d 689, 71 Collier Bankr.Cas.2d 143, 59 Bankr.Ct.Dec. 25

Footnotes

1 Debtors contend that the bankruptcy court's decision that the construction loan arose out of a **farming operation** was purely a factual determination that we can only set aside if clearly erroneous. More specifically, Debtors make the rather perplexing argument that "[t]he bankruptcy court did not adopt *any* [legal] 'test' nor does the law require it to do so[;] it simply evaluated the facts of the case and decided that the debt for this particular residence does 'arise out of' a **farming operation**...." Aplee. Br. at 21–22 (emphasis added). Although it is true that the bankruptcy court did not explicitly identify the legal test it applied in reaching its conclusion, the court necessarily must have determined that the facts on which it relied were legally sufficient to meet the statute's requirements. Even if it only did this tacitly, the court's interpretation of the statute's requirements is subject to de novo review. *Cf. Bose Corp. v. Consumers Union of U.S., Inc.,* 466 U.S. 485, 501, 104 S.Ct. 1949, 80 L.Ed.2d 502 (1984) ("Rule 52(a) does not inhibit an appellate court's power to correct errors of law, including those that may infect a so-called mixed finding of law and fact, or a finding of fact that is predicated on a misunderstanding of the governing rule of law."); *Pahls v. Thomas,* 718 F.3d 1210, 1232 (10th Cir.2013) (noting that when a trial "court commits *legal* error en route to a *factual* determination, that determination is thereby deprived of any special solicitude it might otherwise be owed on appeal"). Were this not the case, in virtually every instance in which bankruptcy courts (or, for that matter, district courts) purported to (in Debtors' words) "simply evaluate[ ] the facts," Aplee. Br. at 22, in determining whether the requirements of a particular statute were satisfied, those courts' determinations would be effectively insulated completely from de novo review. Such an outcome would be improper, at the very least because it would not reflect the realities of the adjudicatory process. Specifically, before deciding whether the requirements of a statute are satisfied by certain facts, a court must—even if tacitly-conduct a legal analysis of what the statute's terms require. In other words, a court must first give a statute's language legal meaning in order for it to determine whether a given set of facts satisfies that statute. And it cannot be gainsaid that discerning the import of a statute is a legal process; consequently, that process is subject to de novo review. Accordingly, we apply de novo review here to the bankruptcy court's tacit legal assessment of the statutory requirements of the family-farmer provision. *See Stephens v. Stephens (In re Stephens),* 704 F.3d 1279, 1283 (10th Cir.2013).

2 For clarity's sake, then, the definition provides the following:

- a rule for assessing whether the debt of the putative family farmer qualifies for **Chapter 12** relief—"not less than 50 percent of [that farmer's] aggregate noncontingent, liquidated debts ... on the date the case is filed, [must] arise out of a **farming operation**"
- that contains *an exclusion*—"excluding a debt for the principal residence of such individual"; and
- *an exception* that modifies the aggregate-debt computation of the rule by adding back into the equation debt "for" the principal residence of the putative family farmer, if it can be shown that this debt "arises out of a **farming operation**."

See 11 U.S.C. § 101(18)(A).

3 The difference between "arise" and "arises" as found in the rule and the exception, respectively, is only a product of references to the plural, "debts," and singular, "debt," respectively; this difference, in our view, is not germane to the meaning of the term. Thus, we view the two terms as essentially identical and use them interchangeably.

4 We use the phrase "loan debt" broadly to encompass any type of debt that provides funds to spend on other goods or services. We only hold that an objective "direct-use" test is optimal for determining whether the direct-and-substantial-connection statutory standard is satisfied *in the loan-debt context.* We are only charged with deciding the case before us, which involves loan debt; so, we do not opine on whether an objective "direct-use" test would be similarly optimal in other contexts.

5 Some courts, such as the Eighth Circuit in *In re Easton,* do not view an inquiry into the "purpose" of the loan as being an inquiry relating to the debtor's subjective intent; rather, they seek to identify the purpose of the loan by inquiring into how the loan proceeds are *actually used. See* 883 F.2d at 636. As applied, then, such a purpose test is essentially indistinguishable from an objective direct-use test.

6 Debtors view the bankruptcy court's statement that the residence was "an integral part of the farm operation" as a factual finding that we should review for clear error. We disagree. A complete reading of the bankruptcy court's statement demonstrates that the court concluded that the residence was "an integral part of the **farming operation** *in [the] sense that* " (1) the farm's office, books, and records were there, and (2) it was in proximity to the **farming operation**. Aplt.App. at 797 (emphasis added). The use of the phrase "in [the] sense that" makes clear that the bankruptcy court found that the residence was "integral" to the **farming operation** because of the two specific reasons it identified. And, it in turn tacitly rendered the legal conclusion that the debt for this "integral" principal residence arose out of the **farming operation**. However, because we conclude *infra* that the two reasons that the court relied upon are not sufficient to produce the legally required nexus between the principal residence (and its associated debt) and the **farming operation**—that is, they are insufficient to establish a direct and substantial connection between the two—the legal premise for the court's purported factual finding on the question of nexus (i.e., its "integral-part" finding) is in error; thus, we do not accord that finding a deferential standard of review. *See Pahls,* 718 F.3d at 1232 ("It follows that if the district court commits *legal* error en route to a *factual* determination, that determination is thereby deprived of any special solicitude it might otherwise

be owed on appeal.").

7 With respect to the office, we do not categorically exclude the possibility that a debt for the construction of an office in a principal residence could be found to "arise out of" a **farming operation**. Put another way, we do not categorically negate the possibility that some of the funds stemming from a principal-residence debt actually could be used in a **farming operation**—that is, "arise out of" a **farming operation**—because a portion of the principal residence that was built with those loan funds was directly and substantially connected to **farming operations**, as defined in § 101(21). However, Debtors have failed to adequately demonstrate that such a possibility may be present here; nor have they specifically provided us with a legal or factual basis for parsing out the portion of their principal-residence debt used to construct the office. Here, the only evidence relied on by Debtors regarding the office is the bankruptcy court's finding that it was in the residence and Mr. Woods's testimony that "we made one bedroom [in the residence] larger specifically for an office." Aplt.App. at 288 (Hr'g Tr., dated May 6, 2011). Such evidence is insufficient for us to conclude that a portion of the proceeds from the construction loan was directly and substantially connected to a **farming operation**—that is, directly used in a **farming operation**.

8 Because we do not decide whether Debtors are eligible for **Chapter 12** relief, we need not reach the other issues that First National Bank raises regarding the confirmation of Debtors' **Chapter 12** plan.

End of Document

2017 WL 3772620
Only the Westlaw citation is currently available.
United States Bankruptcy Court,
E.D. Kentucky,
Covington Division.

IN RE Gerald L. PENICK, II Linda S. Penick
Debtors

CASE NO. 17–20178
|
Signed August 28, 2017

Attorneys and Law Firms

Michael L. Baker, Covington, KY, for Debtors.

MEMORANDUM OPINION AND ORDER GRANTING MOTION FOR STAY RELIEF

Tracey N. Wise, Bankruptcy Judge

***1** In this **chapter 12** case, creditor Forcht Bank, N.A. (the "Bank") contends Debtors are ineligible to be in a **chapter 12** proceeding and cannot effectively reorganize within the meaning of § 362(d).[1] The Bank, therefore, has moved for relief from the automatic stay [ECF No. 18] and objects to the confirmation of Debtors' plan [ECF No. 66]. Debtors contend they are eligible for **chapter 12** and that their proposed plan with its clarifications and amendments [ECF Nos. 24, 42, 68] is confirmable. The Court held an evidentiary hearing on July 13, 2017, and these matters are ripe for decision. Although Debtors are eligible under **chapter 12**, their plan is not feasible and the Bank is entitled to relief from the automatic stay.

The following constitutes the Court's findings of fact and conclusions of law pursuant to Federal Rule of Bankruptcy Procedure 7052. The Court has jurisdiction in this matter and venue is proper. 28 U.S.C. §§ 1334, 1409. This is a core proceeding and the Court is authorized to enter final orders adjudicating these matters. 28 U.S.C. § 157(b)(2)(A), (L), (O).

1. Debtors are Eligible for Chapter 12.

Married Debtors Gerald L. Penick, II and Linda S. Penick filed this **chapter 12** case on February 15, 2017. Debtors are 65 and 60 years old, respectively, and reside on their 107–acre property located in a rural area of Dry Ridge, Grant County, Kentucky which they have owned for many years. Seventy-five percent of the acreage is wooded. The only improvement on the property is a large barn which has an upstairs apartment where Debtors live. The barn also houses their equipment and their calf-raising operation. The Bank is the holder of two claims secured by the Grant County real property.

Debtors' claimed farm operations have two components: calves and timber. As to eligibility, the Bank contends only that Debtors' timber operations do not constitute a "**farming operation**" under § 101(21).

A **chapter 12** debtor bears the burden of proving eligibility. *In re Snider*, 99 B.R. 374, 377 (Bankr. S.D. Ohio 1989) ("The burden of proof in establishing eligibility for bankruptcy relief is on the party filing the petition. *In re Rott*, 73 B.R. 366, 371 (Bankr. D.N.D. 1987). Thus, Debtors have the burden of establishing their eligibility to seek relief under **Chapter 12**."). Only a "family farmer" with regular annual income may be a **chapter 12** debtor. 11 U.S.C. § 109(f). To be deemed a family farmer, a debtor must receive more than 50% of his or her gross income for certain taxable periods preceding their **chapter 12** filing from a "**farming operation**." 11 U.S.C. § 101(18)(A). "The term '**farming operation**' includes farming, tillage of the soil, dairy farming, ranching, production or raising of crops, poultry or livestock, and production of poultry or livestock products in an unmanufactured state." **11** U.S.C. § **101**(**21**). The only issue here is whether Debtors' timber operations constitute a "**farming operation**." If so, Debtors are eligible for **chapter 12** relief as the combination of their calves and timber operations exceeds 50% of their gross income as required by § 101(18)(A).

***2** The definition of a "**farming operation**" is not exclusive, § 102(3), (5), and is to be liberally construed. *In re Maike*, 77 B.R. 832, 835 (Bankr. D. Kan. 1987). Nontraditional enterprises may be considered **farming operations**. *Id.* at 839. Many courts consider the totality of circumstances in determining eligibility, including the following:

> 1. Is the location of the operation considered a traditional farm;
>
> 2. The nature of the enterprise at the location;
>
> 3. The type of product and its eventual market (not limited to traditional farm products);

4. The physical presence/absence of family members on the farm;

5. Ownership of traditional farm assets;

6. Whether the debtor is involved in the process of growing/developing crops or livestock;

7. Whether the operation is subject to the inherent risks of farming.

In re Glenn, 181 B.R. 105, 107 (Bankr. E.D. Okla. 1995) (citing *In re Sugar Pine Ranch*, 100 B.R. 28 (Bankr. D. Or. 1989)); *see also In re Perkins*, No. 13-31277, 2013 WL 5863732, at *3 (Bankr. E.D. Tenn. Oct. 30, 2013) (citing the seven factors as "relevant factors" under the " 'totality of the circumstances' test"); *but see In re Easton*, 883 F.2d 630, 634 (8th Cir. 1989) (" 'farming' is to be understood in its ordinary usage").[2]

The Bank contends that state law is instructive in determining whether Debtors' timber activities constitute a **farming operation**, pointing to the Kentucky Uniform Commercial Code's definition of "farm products" that excludes standing timber. But the Uniform Commercial Code is not at issue here, and its provisions have no bearing on the Bankruptcy Code's definition of **farming operation**. *Sugar Pine*, 100 B.R. at 34. In *Sugar Pine*, applying a totality of circumstances test, the court found that the harvesting of merchantable timber on a sustained yield basis constituted part of that debtor's integrated **farming operation**. Similarly, in *Glenn*, the court held that the debtors' timber activities—both selling their own and brokering timber for others—constituted a **farming operation**, where debtors lived in a rural area on a traditional farm, had a cow and calf operation, used traditional farm equipment, and their activities were exposed to risks inherent in farming, including fire. *Glenn*, 181 B.R. at 107–08.

Here, Debtors raise calves and harvest and sell timber and firewood from their property. Considering the totality of the circumstances presented by this case, Debtors' wood and timber activities constitute a **farming operation**. The enterprise is ongoing and not merely a cut of all merchantable timber at one time. Mr. Penick testified he selectively cuts dead and smaller trees, marketing them as firewood to campgrounds, restaurants, individuals, and the federal government (for "heat assistance" programs). Debtors also harvest mature trees on their property, selling the timber in log form and harvesting the tops as firewood. Although Debtors do not plant trees or seedlings, they monitor the reseeding progress. Mr. Penick strategically burns brush and selectively identifies which timber to harvest to ensure the wooded area's canopy is cleared so that the area can reseed and replant itself. Mr. Penick has harvested trees all his life, including before he owned his property. He provided credible testimony regarding his knowledge of the timber operation and his expertise in managing the tree harvesting operation, indicating that a tree's species as well as its size helps determine when it should be cut. Debtors' tree enterprise is subject to the normal risks inherent in farming, including weather and fire.

***3** Both Debtors are directly involved in the farming activities on their property, and their barn and real property obviously are essential to their calf and timber operations. The property houses the timber and calf operations, stores the equipment necessary for those enterprises, and serves as Debtors' residence. The size, nature, and location of the real property evidences that it constitutes a traditional farm. Debtors are eligible to be in **chapter 12**.

2. Debtors' Chapter 12 Plan is not feasible.

In addition to establishing their eligibility to file under **chapter 12**, Debtors also must prove the feasibility of their **chapter 12** plan. 11 U.S.C. § 1225(a)(6). One requirement for feasibility is that Debtors must establish they "will be able to make all payments under the plan and to comply with the plan." *Id.*

Proving feasibility requires more than high hopes for potential success. "[T]o sufficiently establish such reasonable assurance, 'a plan must provide a realistic and workable framework for reorganization.' " *In re Brice Rd. Devs., L.L.C.*, 392 B.R. 274, 283 (6th Cir. BAP 2008) (citation omitted). "[T]he **chapter 12** feasibility standard requires a court to scrutinize a debtor's proposed plan payments in light of projected income and expenses in order to determine whether it is likely the debtor will be able to make the payments required by the plan." *In re Pertuset*, No. 12-8014, 485 B.R. 478, ——, 2012 WL 6598444, at *13, 2012 Bankr. LEXIS 5792, at *35 (6th Cir. BAP Dec. 18, 2012) (citation omitted).

> "[B]ecause the purpose of **Chapter 12** is to promote the reorganization attempts of family farmers, courts generally give debtors the benefit of the doubt on the issue of feasibility, provided a reasonable probability of success is established." [*In re*] *Lockard*, 234 B.R. [484,] 492 [(Bankr. W.D. Mo. 1999)]. They are not required to guarantee "the ultimate success" of their plan "but only to provide a reasonable assurance that the plan can be effectuated, and that reasonable assurance must rise above 'bare agronomic feasibility.' " *In re Wilson*, 378 B.R. 862, 891 (Bankr. D. Mont. 2007) (quoting *Miller v. Nauman (In re Nauman)*, 213 B.R. 355, 358 (9th Cir.

> BAP 1997)). "Sincerity, honesty and willingness are not sufficient to make the plan feasible, and neither are any visionary promises. The test is whether the things which are to be done after confirmation can be done as a practical matter under the facts." *Lockard*, 234 B.R. at 492 (quoting *Clarkson v. Cooke Sales and Service Co. (In re Clarkson)*, 767 F.2d 417, 420 (8th Cir. 1985)); *see also* [*In re*] *Michels*, 301 B.R. [9,] 17 [(Bankr. N.D. Iowa 2003)] ("A plan projecting a marked increased *[sic]* in profitability with no explanation of the cause is not confirmable."); [*In re*] *Howard*, 212 B.R. [864,] 879 [Bankr. E.D. Tenn. 1997)] (holding that feasibility "must be based on objective facts rather than wishful thinking.").

In re Perkins, Case No. 13-31277, 2013 WL 5863732, at *11, 2013 Bankr. LEXIS 4539, at *33–34 (Bankr. E.D. Tenn. Oct. 30, 2013).

Debtors did not provide sufficient evidence of a realistic and workable framework for reorganization. To be sure, Mr. Penick's testimony at the evidentiary hearing reflected his significant experience in his farming enterprise, and he offered clear explanations about the work Debtors perform that demonstrated his knowledge of these areas. Debtors' experience and hard work, however, do not establish feasibility.

Debtors did not introduce documentary evidence at the hearing, such as a monthly budget, to spell out their projected income and expenses to show that their plan is feasible. In contrast, Debtors' tax returns reflect a downward trend for their farming income over last three years. Further, Debtors' four months of pre-hearing operating reports [ECF Nos. 20, 33, 58, 76] reflect that Debtors would not be able to pay their routine expenses plus their anticipated payments to the **chapter 12** Trustee—and those reports admittedly did not reflect all of their expenses (such as restitution payments owed by Mrs. Penick). In fact, Mr. Penick admitted at the hearing that none of those operating reports show that, when all revenues and regular expenses are accounted for, Debtors could pay the Bank and their other creditors as projected in their plan.

***4** Debtors also did not provide evidence at the hearing to establish why their income would increase in the future beyond Mr. Penick's testimony, which was unsupported by any documents or other evidence. For example, Mr. Penick testified about generating additional revenue by raising calves, selling firewood and timber, and performing non-farm labor for a home-building business. However, Debtors offered no written commitments under which they would perform work to produce income post-confirmation.

With regard to their operations, Debtors listed no calves or partnership interests on their schedules as assets [ECF No. 1], despite testimony from Mr. Penick about calves they owned through partnerships. Since they filed their **chapter 12** petition, Debtors have opted not to take on additional calves, which would have contributed additional monthly income to their budget. In fact, at the hearing, Debtors did not identify the price per head of calf raised by contract or the average profit per calf from owned or partnership calves, so the Court cannot discern how much each additional calf would generate as income for Debtors. While Mr. Penick testified regarding Debtors' work ethic and the length of their work days based on their current number of calves, timber-harvesting activities, and non-farming work, his testimony did not sufficiently explain how Debtors could increase their calf stock and still perform the additional labor (cutting more firewood and timber, and doing drywall clean-up) discussed at the hearing.

In sum, Debtors failed to carry their burden to prove the feasibility of their plan. As a result, the Bank is entitled to relief from the automatic stay under § 362(d)(2)(B). The real property at issue is not necessary for an effective reorganization as Debtors did not demonstrate that they can effectively reorganize their **chapter 12** bankruptcy estate.

Conclusion

For the foregoing reasons, the Court ORDERS as follows:

1. Confirmation of Debtors' proposed **chapter 12** plan is DENIED.

2. The Bank's motion for relief from the automatic stay is GRANTED.

3. Debtors shall have fourteen days from the date of entry of this Order to convert their case to another chapter or it will be dismissed without further order or hearing.

All Citations

Slip Copy, 2017 WL 3772620

Footnotes

1 Unless otherwise indicated, all chapter and section references are to the Bankruptcy Code, 11 U.S.C. §§ 101–1532.

2 As other courts have stated, **chapter 12** is intended to protect small family farms. *See*, *e.g.*, *In re Burke*, 81 B.R. 971, 976 (Bankr. S.D. Iowa 1987) ("It is the small family farm that **Chapter 12** was designed to protect. 132 Cong.Rec.S. 15076 (daily ed. Oct. 3, 1986) (statement of Sen. Grassley)."); *see also In re Victorious*, 545 B.R. 815, 821 (Bankr. D. Vt. 2016) ("Congress underscored its intent to protect the small family farm"). For that reason, the Court will follow the "totality of the circumstances" test to determine **chapter 12** eligibility espoused by *Glenn* and *Sugar Pine Ranch* rather than the more restrictive view in *Easton*.

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accordance with *applicable non-bankruptcy law*." Order at 2:7–10. (emphasis added). In other words, Ms. Aniel would still be afforded any protections granted by California law which govern the administration of home foreclosures during the pandemic.

VI. CONCLUSION

For the aforementioned reasons, the Court should **AFFIRM** the bankruptcy court's orders (1) overruling Ms. Aniel's claim and granting HSBC summary judgment and (2) granting HSBC relief from the automatic bankruptcy stay. The Court should also **DENY** Ms. Aniel's request for a stay of the bankruptcy court's order granting HSBC relief from the automatic stay.

IT IS SO ORDERED.

IN RE: David L. MONGEAU, Jennifer L. Mongeau, Debtors.

Case No. 21-40055

United States Bankruptcy Court,
D. Kansas.

Signed October 22, 2021

Background: Unsecured creditor filed motion to dismiss Chapter 12 case, contending that debtors ceased farming prepetition and so were not "family farmers" eligible for Chapter 12 relief. Trial was held.

Holdings: The Bankruptcy Court, Dale L. Somers, Chief Judge, held that although debtors ceased growing crops and liquidated most of their farming assets prepetition, on the petition date they were "engaged in a farming operation" as required to be "family farmers" eligible for Chapter 12 relief.

Motion denied.

1. Bankruptcy ⚿3673

Bankruptcy court may dismiss a Chapter 12 case for "cause." 11 U.S.C.A. § 1208(c).

2. Bankruptcy ⚿2236

Debtors bear the burden of proof to show eligibility for relief under Chapter 12. 11 U.S.C.A. § 109(f).

3. Bankruptcy ⚿2229

To make the determination of whether debtors are eligible for Chapter 12, the bankruptcy court focuses on the structure of the Bankruptcy Code, and the plain meaning of the words used therein. 11 U.S.C.A. § 109(f).

4. Bankruptcy ⚿3671

Chapter 12 was enacted because the other chapters of the Bankruptcy Code did not provide effective reorganization relief to the majority of family farmers.

5. Bankruptcy ⚿2021.1

Bankruptcy Code's definition of "farming operation" does not provide an exclusive list of all farming activities and is not limited to the specific activities delineated in the statute. 11 U.S.C.A. § 101(21).

6. Bankruptcy ⚿2229

Chapter 12 eligibility is determined at the time the case is filed. 11 U.S.C.A. § 109(f).

7. Bankruptcy ⚿2229

There are two elements to determining if a debtor is "engaged in a farming operation," as required to be a "family farmer" eligible for relief under Chapter 12 of the Bankruptcy Code: a temporal element, namely, the debtor must be en-

gaged in a farming operation on the date of filing, and a substantive element, that is, whether the debtor's activities on that date constituted a farming operation. 11 U.S.C.A. §§ 101(18), 101(21), 109(f).

8. Bankruptcy ⚿2229

Whether debtors were "engaged in" farming operation on petition date and whether particular activity constitutes "farming operation," as required for debtors to be "family farmers" eligible for relief under Chapter 12 of the Bankruptcy Code, are determined on case-by-case basis considering totality of circumstances. 11 U.S.C.A. §§ 101(18), 101(21), 109(f).

9. Bankruptcy ⚿2229

In determining whether a debtor is a "family farmer" eligible for relief under Chapter 12 of the Bankruptcy Code, the factors considered in determining whether a particular business constitutes a farming operation vary based upon the circumstances presented. 11 U.S.C.A. §§ 101(18), 101(21), 109(f).

10. Bankruptcy ⚿2229

In determining whether debtors were "engaged" in a "farming operation" and therefor eligible for Chapter 12 relief, the bankruptcy court would consider whether: (1) the debtors had abandoned all farming operations at the time of filing, (2) there was a plan or intent to continue farming operations in some form, (3) the abandonment of farming was a shift to a different type of farming, (4) debtors owned farm assets such as equipment, and (5) debtors' activities were subject to the cyclical risks involved in farming. 11 U.S.C.A. §§ 101(18), 101(21), 109(f).

11. Bankruptcy ⚿2229

Debtors were "engaged in a farming operation" and so were "family farmers" eligible for Chapter 12 relief even though, having liquidated their large farming operation in order to complete a structured wind-down, neither they nor their limited liability company (LLC) were actively engaged in working land or raising cattle on a large scale on the petition date; debtors had not completely abandoned all farming operations, but remained very involved in their extended family's farms, debtors' minor daughter owned cattle that they ran with her uncle's cattle, and they helped work those cattle, debtors partially owned cattle equipment that they worked postpetition to make usable in future livestock operation, debtor-husband spent much time winding up their farming-related financial affairs, debtors intended to continue farming in the future though as a smaller scale cattle operation, debtors still owned some farm assets, and they were winding up the results of risks previously taken. 11 U.S.C.A. §§ 101(18), 101(21), 109(f).

12. Bankruptcy ⚿2229

To be engaged in a farming operation, and therefore be a "family farmer" eligible for Chapter 12 relief, a debtor need not only use assets belonging to them. 11 U.S.C.A. §§ 101(18), 101(21), 109(f).

13. Bankruptcy ⚿2229

Ownership in farm equipment based on a joint venture understanding with a non-debtor may be sufficient for a person to be engaged in a farming operation, and therefore be a "family farmer" eligible for Chapter 12 relief. 11 U.S.C.A. §§ 101(18), 101(21), 109(f).

14. Bankruptcy ⚿2229

Business management side to farming cannot be overlooked in determining whether debtors were "engaged" in a "farming operation" and therefor eligible for Chapter 12 relief; although the word farming brings to mind working the ground or raising animals, managing the business elements of a farm are just as

much a part of modern farming as those other activities. 11 U.S.C.A. §§ 101(18), 101(21), 109(f).

15. Bankruptcy ⚿2229

Debtor cannot rely on the farming activity of others to satisfy a court that debtor is eligible for Chapter 12 relief. 11 U.S.C.A. §§ 101(18), 101(21), 109(f).

16. Bankruptcy ⚿2229

Bankruptcy Code's definition of "farming operation" is to be construed liberally in order to further Congress' purpose of helping family farmers to continue farming. 11 U.S.C.A. §§ 101(18), 101(21), 109(f).

17. Bankruptcy ⚿3682

Under the Bankruptcy Code, a Chapter 12 debtor is entitled to completely liquidate a farming operation. 11 U.S.C.A. § 1222(b)(8).

18. Bankruptcy ⚿3682

Section of the Bankruptcy Code entitling a Chapter 12 debtor to completely liquidate a farming operation reflects a recognition by Congress that many family farm reorganizations, to be successful, would involve the scaling down of the farm operation. 11 U.S.C.A. § 1222(b)(8).

19. Bankruptcy ⚿2229

Fact that debtors undertook an orderly liquidation process prepetition did not compel the conclusion that they were no longer "engaged in a farming operation" and that they were therefore not eligible for relief under Chapter 12 of the Bankruptcy Code; shifts in farming, even dramatic ones, are anticipated by the Code. 11 U.S.C.A. §§ 101(18), 101(21), 109(f), 1222(b)(8).

20. Bankruptcy ⚿2021.1, 2229

"Farming operation" is defined by the Bankruptcy Code to simply include "farming," and there is much more to farming than planting a seed. 11 U.S.C.A. §§ 101(18), 101(21), 109(f).

See publication Words and Phrases for other judicial constructions and definitions.

21. Bankruptcy ⚿2229

Winding down a business that stopped operating prepetition is sufficient to be "engaged" in business activities, as required for a debtor to be eligible for relief under Subchapter V of Chapter 11. 11 U.S.C.A. § 1182(1)(A).

22. Bankruptcy ⚿2229

Performing wind down work for a farm business that ended prepetition is sufficient for a debtor to be "engaged in a farming operation" on the petition date, as required to be eligible for Chapter 12 relief. 11 U.S.C.A. §§ 101(18), 101(21), 109(f).

Tom R. Barnes, II, Topeka, KS, for Debtor.

Memorandum Opinion

Denying American AgCredit's Motion to Dismiss

Dale L. Somers, United States Chief Bankruptcy Judge

Unsecured creditor American AgCredit ("AgCredit") moves to dismiss this Chapter 12 case,[1] contending that Debtors David and Jennifer Mongeau [2] are not eligible for Chapter 12 relief because when they filed their petition they were not "en-

1. Doc. 51. AgCredit appears by W. Thomas Gilman.

2. Debtors appear by Tom R. Barnes, II.

gaged in a farming operation," as required by the definition of "family farmer" in 11 U.S.C. § 101(18).[3] Debtors acknowledge that they ceased growing crops and liquidated most of their farming assets in late 2020, before filing their Chapter 12 petition in early 2021. They contend they are nevertheless eligible to file under Chapter 12 because some of their farming related financial affairs were not resolved on the filing date and are being administered during the Chapter 12 case, they are still minimally involved in cattle operations and have some equipment, and because they intend to return to farming by raising livestock.

Trial was held on August 11, 2021. After considering Debtors' testimony, the parties' briefs, and the arguments of counsel, the Court finds Debtors met their burden of proof to show they are family farmers as defined by the Bankruptcy Code. The Court denies the motion to dismiss.

I. Findings of Fact

Debtors reside in Holcomb, Kansas. David has always maintained off-farm employment in banking. He has been employed as a bank loan officer at his current bank for the last four years and worked for several other large farm lending institutions prior to that, with his main focus being agricultural lending. Jennifer is an accountant who has operated her own CPA firm for several years and works with a lot of farmers, and prior to that worked in other CPA firms.

There is no doubt Debtors consider themselves to be farmers. Both David and Jennifer were raised on farms, both sets of their parents continue to operate large family farms, and their siblings operate farms. Debtors themselves ran their own farm through an entity called Mongeau Enterprises, LLC, owned 50% by David and 50% by Jennifer. It is undisputed that Debtors ran a large farming operation in the years leading up to their Chapter 12 petition: Debtors raised corn, wheat, milo, and soybeans on owned and leased acres, and at one point had over a thousand head of cattle. In each calendar year 2018, 2019, and 2020, Debtors had income of more than $1 million dollars.

At some point, farming for Debtors became unprofitable. Throughout 2020, Debtors undertook an orderly liquidation of their farm assets. By December 31, 2020, all crop and livestock activities in Debtors' (or their LLC's) name had ceased, land leases were terminated, grain was sold and the proceeds paid to creditors, and substantially all equipment was sold at auction or turned over to creditors. Much of Debtors' real property and equipment was purchased by family members for its use in the family's farms. Many of their leases were taken over by family members.

About one month later, on February 1, 2021, Debtors filed a Chapter 12 bankruptcy petition. Debtors' schedules show real property of $267,000 (Debtors' residence);

3. All future references to Title 11 in the text shall be to the section number only. This Court has jurisdiction pursuant to 28 U.S.C. § 157(a) and §§ 1334(a) and (b) and the Amended Standing Order of Reference of the United States District Court for the District of Kansas that exercised authority conferred by § 157(a) to refer to the District's Bankruptcy judges all matters under the Bankruptcy Code and all proceedings arising under the Code or arising in or related to a case under the Code, effective June 24, 2013. D. Kan. Standing Order No. 13-1, *printed in* D. Kan. Rules of Practice and Procedure at 168 (March 2014). A motion to dismiss for a debtor's lack of eligibility to file under a particular chapter of Title 11 is a matter concerning administration of the estate and a core proceeding which this Court may hear and determine as provided in 28 U.S.C. § 157(b)(2)(A). There is no objection to venue or jurisdiction over the parties.

total personal property of approximately $1,220,000, comprised primarily of exempt financial assets; secured liabilities of approximately $78,000; and unsecured liabilities of approximately $6,000,000, comprised primarily of agricultural debt.

It is undisputed that on the petition date, neither Debtors nor their LLC owned any growing crops, stored crops, chemicals, or tractors. Debtors owned one Deere Flex King Blade Plow, which was being held in anticipation of being picked up by the secured creditor John Deere Financial. Debtors also owned one pickup that Debtors use when working on their family's farms. (Debtors drive separate/different vehicles to commute to work.) And Debtors' minor daughter owns cattle that the family runs with Jennifer's brother's cattle. Finally, Jennifer's brother purchased some cattle equipment, and the family consider Debtors part-owners of that equipment because of the sweat equity Debtors put into making the equipment usable.

Debtors regularly assist on their family's farms. Jennifer helps with David's family farm's paperwork. Jennifer gets paid for doing that farm's taxes each year, but then also provides unpaid assistance with other paperwork. Both Debtors help with manual labor, both on their parents' farms and on Jennifer's brother's farm. Debtors assist with cattle on Jennifer's brother's farm because, as mentioned, they keep their daughter's cattle with his herd.

In addition to their physical presence on their family's farms, Debtors both testified that they are active in wrapping up their LLC's farm operation. There are a handful of items that have come in as 2021 income, stemming from 2020 activities, that have required post-petition work on the business-side of farming. David testified that he does this work from his home in Holcomb, as he has always done. Post-petition, Debtors have received and distributed the following: (1) a USDA payment of $128,829.93, which on April 7, 2021, was distributed to creditors; (2) an AgCredit patronage dividend of $6,942.70, which was set off after AgCredit obtained relief from stay; (3) an FSA payment of $5623 relating to livestock; (4) a USDA payment of $831 under the 2013 Livestock Forage Disaster program; and (5) a cooperative patronage refund of $249.29 for year 2020. In addition, Mongeau Enterprises, LLC, Debtors, and others are defendants in litigation brought by First National Bank of Syracuse pending in the District Court of Rooks County, Kansas, and there have been at least some hearings in that case concerning the distribution of certain funds held in trust by the bank that stem from the sale of equipment and crops. And finally, Jennifer testified concerning some farm expenses for custom cutting work that they are still paying and other general clean up to do. David testified that he has "spent a lot of time" on the clean-up work for Debtors' farming operation post-petition: keeping track of income, getting assets and government payments collected, and communicating with creditors.

Debtors testified at length about their plans to return to farming, but on a smaller scale. Debtors do not plan to raise crops, due to a prior default in crop insurance premiums, meaning Debtors would be unable to obtain crop insurance. But Debtors want to start a livestock operation. Debtors testified they have family members with storage facilities that they would be permitted to use to store grain for feeding cattle. Jennifer's uncle has also expressed his desire that Debtors get into a cattle business with him, and Jennifer also testified about her hope they could get into her brother's cattle operation as they already provide labor for him. Jennifer unequivocally testified that yes, Debtors

plan to start a new farming operation, but on a smaller scale, and that Debtors did not intend to abandon farming as they hope to purchase cattle and start anew. Jennifer testified that in her opinion, they are part of their family's farms, because they provide labor in an effort to keep income within the family, in hope to preserve the family farms to pass down to generations. David also testified that his intent is to farm, and to do something with livestock because they could become involved with family member's operations and that is where they would find family help.

II. Conclusions of Law

[1–3] Under § 1208(c), the Court may dismiss a Chapter 12 case for "cause." Debtors bear the burden of proof to show eligibility for relief under Chapter 12.[4] To make the determination of whether Debtors are eligible for Chapter 12, the Court focuses on the statute's structure, and the plain meaning of the words used in the Code.[5]

[4, 5] Chapter 12 was enacted because the other Chapters of the Code did not "provide effective reorganization relief to the majority of family farmers."[6] The Code provides, "[o]nly a family farmer ... with regular annual income may be a debtor under chapter 12" of Title 11.[7] The phrase "family farmer" is then defined to mean an "individual or individual and spouse engaged in a farming operation" whose aggregate debt and gross income satisfy statutory requirements.[8] In this case, the challenge to eligibility is limited to whether Debtors satisfy the "engaged in a farming operation" portion of the definition of "family farmer." The Code indicates the phrase " 'farming operation' includes farming, tillage of the soil, dairy farming, ranching, production or raising of crops, poultry, or livestock, and production of poultry or livestock products in an unmanufactured state."[9] The word "farming" is not itself defined.

[6–8] Case law establishes the test for Chapter 12 eligibility is determined at the time the case is filed.[10] There are two elements to determining if a debtor is "engaged in a farming operation:" a temporal element (the debtor must be engaged in a farming operation on the date of filing); and a substantive element (whether the

4. *In re Woods*, 743 F.3d 689, 705 (10th Cir. 2014) ("Debtors had the burden of establishing their eligibility for Chapter 12 relief."); *In re Ollis*, 609 B.R. 459, 464 (Bankr. D.S.C. 2019) ("A debtor who files a Chapter 12 petition bears the ultimate burden of proving eligibility for relief under that chapter."); *In re Rosenberger*, No. 20-50093, 2020 WL 6940926, at *3 (Bankr. W.D. Va. Sept. 29, 2020) ("The debtor bears the burden of proving her eligibility for relief under a certain chapter of bankruptcy.... She must put forward sufficient evidence to allow the Court to find that she satisfies the section 109(f) eligibility requirements, including the definitional section 101(18) requirement that she was 'engaged in' a farming operation at the time of filing.").

5. *In re Woods*, 743 F.3d at 694.

6. 7 William L. Norton, Jr. and William R. Norton III, *Norton Bankruptcy Law & Practice 3d* § 122:2 (Thomson Reuters 2021).

7. 11 U.S.C. § 109(f).

8. 11 U.S.C. § 101(18)(A). AgCredit does not challenge whether Debtors meet those income requirements.

9. 11 U.S.C. § 101(21). "The definition of 'farming operation' does not provide an exclusive list of all farming activities and is not limited to the specific activities delineated in the statute." *In re Sharp*, 361 B.R. 559, 564 (10th BAP Cir. 2007).

10. *Watford v. Fed. Home Loan Bank of Columbia (In re Watford)*, 898 F.2d 1525, 1527 (11th Cir. 1990).

debtor's activities on that date constituted a farming operation).[11] Whether Debtors were "engaged in" a farming operation on the petition date and whether a particular activity constitutes a "farming operation" are determined on a case-by-case basis considering the totality of the circumstances.[12]

Both parties rely on an Eleventh Circuit Court of Appeals decision, *In re Watford*,[13] to flesh out the definition of family farmer. The Watfords grew soybeans through 1985, then in 1986 they ceased cultivation of their land and stored the beans on their land and began conducting a stone crabbing operation in the Gulf of Mexico. They filed for relief under Chapter 12 in 1987. At an initial hearing, Mr. Watford testified he had plans to use his land to develop fish ponds for recreational use, but at the final hearing testified that he would also harvest fish from the ponds. The bankruptcy court dismissed the case, finding the Watfords were not engaged in a farming operation on the date of filing.

On appeal, the district court affirmed, but the court of appeals affirmed in part, vacated in part, and remanded. The appellate court affirmed that stone crabbing did not constitute a farming operation but reversed the dismissal, because it concluded that the lower courts applied an incorrect legal standard with regard to the Watfords' storage of soybeans and planning for commercial fish ponds. The Eleventh Circuit held that "a farmer who harvested soybeans in 1985, ceased actively tilling of the soil, but continues to plan the reorganization of his farming operation (though the development of fish ponds) could depending on the circumstances be 'engaged in a farming operation.' "[14] The appellate court remanded "for a determination of whether the Watfords had abandoned all farming operations at the time of filing, or whether under the totality of the circumstances the Watfords had not abandoned all farming operations, but rather were planning to continue farming operations in the form of commercial fish ponds or otherwise."[15] The standard adopted by the Eleventh Circuit is "whether, in view of the totality of the circumstances, the debtor intends to continue to engage in a 'farming operation' even though he or she was not engaged in the physical activity of farming at the time the petition was filed."[16]

[9] Making this determination is, of course, the difficult part. The term "engaged" is defined as "involved in activity: occupied, busy."[17] When determining the temporal element, whether debtors were "engaged in" farming on the date of filing, one court has found relevant factors are: (1) "the debtor's daily involvement on the farm, (2) the debtor's legal ownership interest in the farming operation and /or its assets, and (3) the debtor's physical pres-

11. *In re Rosenberger,* 2020 WL 6940926, at *2.

12. *Id.* at *2-3; *In re Maike,* 77 B.R. 832, 836 (Bankr. D. Kan. 1987) (describing the ''totality of the circumstances'' test).

13. 898 F.2d 1525.

14. *Id.* at 1528.

15. *Id.* at 1529.

16. *Id.* The majority of cases have adopted the Eleventh Circuit's totality of the circumstances approach, contrasted to a more restrictive standard from the Seventh Circuit, articulated in *In re Armstrong,* 812 F.2d 1024, 1027 (7th Cir. 1987), that interprets § 101(18) to apply only to farmers whose activities are ''exposed to the inherent risks and cyclical uncertainties traditionally associated with farming.''

17. *See* ''engaged,'' Merriam-Webster Online Dictionary, www.merriamwebster.com/dictionary/engaged (last visited September 28, 2021).

ence on the farm."[18] As to whether a particular business constitutes a farming operation, there is no widely accepted list; the factors courts have considered vary based upon the circumstances presented.[19]

[10, 11] Debtors and AgCredit each present lists of factors which courts generally consider when determining whether debtors are "engaged" in a "farming operation" and therefor eligible for Chapter 12 relief. The two lists have several factors in common. The common factors are whether: (1) the debtors had abandoned all farming operations at the time of filing, (2) there is a plan or intent to continue farming operations in some form, (3) the abandonment of farming was a shift to a different type of farming, and (4) debtors own farm assets such as equipment. The additional factors enumerated by Debtors include consideration of whether the activities are subject to the cyclical risks involved in farming. The Court finds the four factors listed by both parties, plus the additional factor of risk identified by the Debtors, are appropriate for consideration under the circumstances of this case.

Applying these factors, AgCredit argues Debtors had ceased all farming operations, had no plans to resume either growing crops or raising livestock, had not shifted to a different type of farming, had no farm assets, such as equipment and chemicals, and the winding up of financial affairs which remained to be completed did not expose Debtors to any of the inherent risks of farming. Debtors see the facts differently of course. Debtors acknowledge they had ceased actively tilling the ground and raising crops, but argue they are still engaged in farming because they are winding up the affairs of their LLC postpetition, maintain active connections to farming, and because they fully intend to begin a new livestock operation once the wind-up of their former operation is complete.

The Court concludes that whether the plain meaning of "engaged" is used or the totality of the circumstances test is used, Debtors were engaged in a farming operation at the time of filing their Chapter 12 petition.

[12, 13] First, Debtors had not completely abandoned all farming operations at the time of filing. Debtors were "engaged"—they are very involved in their extended family's farms, Debtors' daughter has cattle that the family runs with other cattle owned by extended family, and Debtors help work those cattle. Debtors partially own cattle equipment that they have worked postpetition to make usable in a future livestock operation. To be engaged in a farming operation, a debtor need not "only use assets belonging to

18. *In re Rosenberger,* 2020 WL 6940926, at *3.

19. *E.g.,* compare *In re McLawchlin,* 511 B.R. 422, 428 (Bankr. S.D. Tex. 2014) (identifying the following factors: (i) whether the location of the operation would be considered a traditional farm, such as a rural area, (ii) the nature of the enterprise at the location, such as whether a service or product is being provided, (iii) the type of product and its eventual market, such as whether it is traditionally agricultural though this is not strictly limiting, (iv) the physical presence of family members on the farm, (v) ownership of traditional farm assets, (vi) whether the debtor is involved in the process of growing or developing crops or livestock, and (vii) perhaps the key factor being whether or not the practice or operation is subject to the inherent risks of farming) with *In re Mikkelsen Farms, Inc.,* 74 B.R. 280, 285 (Bankr. D. Or. 1987) (''whether there is a 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'').

them."[20] And ownership in farm equipment based on a joint venture understanding with a non-debtor can be sufficient.[21]

[14] Yes, Debtors had ceased growing crops and had sold the majority of their equipment prior to filing. But there is a business management side to farming that cannot be overlooked. Of course, the word farming brings to mind working the ground or raising animals. But modern farming is much more: analyzing government programs; analyzing crop insurance; analyzing the various markets; determining land values; identifying and adapting the appropriate technology; proper nutrition for livestock; determining soil conditions; balancing environmental issues; determining proper veterinarian procedures for livestock; complicated reporting to various government agencies; maintaining books, creditor-relations; addressing the tax implications of farming—all constitute just a partial list. All these aspects of farming are important and managing the business elements of a farm are just as much farming as plowing the ground.[22] David testified that he spent a lot of time winding up the remaining financial affairs related to Debtors' farming operations. The evidence establishes Debtors received and distributed significant income from their 2020 farming activities. Income from farming does not solely consist of payments for farm outputs from a grain buyer or a cattle barn. Modern farming depends and relies on intricate relationships with large creditors and federal and state governments. Receipt, accounting, and distribution of this income is part of modern farming. AgCredit argues that any bookkeeper could do the same. But that is not the question. The question is whether handling the business of farming is part of being a farmer. The answer is: of course it is. Thus, when the Court looks to see if a debtor is engaged in a farming operation, it is looking at the totality of circumstances for the debtor's eligibility, and this business side should not be overlooked.

[15] Second, there is an intent to continue farming operations in the future, and Debtors' termination of their prior farm operation is part of a shift to a smaller scale cattle operation. Debtors finished liquidating their large-scale farm operation at the end of 2020. They filed their bankruptcy petition just over a month later, on February 1, 2021. Debtors repeatedly testified about their involvement in their extended family's farm operations, and their desire and intent to leverage that involvement into a cattle operation of their own. Debtors currently run their daughter's cattle with Jennifer's brother's cattle operation and have already started building back their equipment through their joint venture with their brother on the cattle equipment. The Court recognizes that a debtor cannot rely on the farming activity of others to satisfy a court that the debtor is eligible for Chapter 12 relief,[23] but that

20. *In re Howard*, 212 B.R. 864, 873 (Bankr. E.D. Tenn. 1997).

21. *See In re Rosenberger*, 2020 WL 6940926, at *3 (noting the debtor testified as to "the existence of an understanding" between herself and another person concerning a joint venture in a farming operation).

22. *See, e.g., id.* (describing the debtor's "involvement on the business-management side of the operation," including maintaining books and preparing tax returns).

23. *See, e.g., In re Buckingham*, 197 B.R. 97, 103 (Bankr. D. Mont. 1996) ("the activity must not only be a farming activity, but it must also be one related to the debtor's own farming operation and not just the farming operations of others" (internal quotation omitted)).

is not all that is happening here. The Court relays the facts concerning Debtors' active participation in their family's farms to indicate the likelihood and concreteness of the plans to resume farming. Debtors do not have much now, but they have lots of family help and involvement. After listening to the testimony of Debtors, the Court readily concludes Debtors intend to continue farming in the future and the liquidation of their LLC was part of a shift to a smaller scale farm endeavor.

Third, Debtors do own some farm assets. Debtors have a pickup they use to physically assist in their family's farm operations. Again, Debtors are just starting the process of building back their cattle equipment. Debtors have always managed the business side of their farm operations out of their home in Holton. At filing Debtors still had possession of the Deere Flex King Blade Plow. Debtors are also defendants in pending litigation concerning the distribution of funds that arose from their sale of equipment and crops.

[16] Finally, the risk factor should not be discounted. Debtors are not currently growing crops. They are not currently raising a large herd of cattle. As a result, they do not have the risks associated with those farming activities. But they are winding up the results of the risks previously taken. And the definition of "farming operation" is "to be construed liberally in order to further Congress' purpose of helping family farmers to continue farming."[24]

[17–20] The Court recognizes Debtors were not actively engaged in working land or cattle on the petition date on a *large* scale. Debtors candidly testified that they liquidated their large farming operation in order to complete a structured wind-down. To be sure, ownership of farm assets and the risk associated thereon are important factors in determining who is a "family farmer." But under the Bankruptcy Code, a Chapter 12 debtor is entitled to completely liquidate a farming operation under § 1222(b)(8).[25] This Code provision "reflects a recognition by Congress that many family farm reorganizations, to be successful would involve the scaling down of the farm operation."[26] "It would make little sense to block a debtor from the relief provided by Congress under Chapter 12 simply because Debtors made a reasonable financial decision to end a nonprofitable farming operation which would cause the Debtors to fall deeper into debt. This seems to be contrary to the goal of a Chapter 12."[27] The Court rejects the contention that the fact Debtors undertook an orderly liquidation process prepetition compels the conclusion that they are no

24. *In re Watford*, 898 F.2d at 1527.

25. Under § 1222(b)(8) a Chapter 12 plan may "provide for the sale of all or any part of the property of the estate or the distribution of all or any part of the property of the estate among those having an interest in such property."

26. *In re Williams*, No. 15-11023, 2016 WL 1644189, at *3 (Bankr. W.D. Ky. Apr. 22, 2016); *see also In re Mikkelsen Farms, Inc.*, 74 B.R. 280, 285-86 (Bankr. D. Or. 1987) ("The provisions of § 1222(b)(8) permit a Chapter 12 plan of complete liquidation. If a farm were liquidated there would be no income from farm operations to fund the plan if needed. An interpretation of § 101(18) to require annual income to be only from farm operations could, on occasion, deny a debtor the right, which it would otherwise have, to liquidate pursuant to § 1222(b)(8). . . . Thus, I find that a family farmer who otherwise qualifies under § 101(17) may be a family farmer with regular income within the meaning of § 101(18) if it can show it will have regular annual income, from whatever source, that is sufficiently stable and regular to fund the plan.").

27. *In re Williams*, 2016 WL 1644189, at *3.

longer "engaged in a farming operation." Shifts in farming, even dramatic ones, are anticipated by the Code.[28] Remember, a "farming operation" is defined by the Code to simply include "farming," and as this Court has repeatedly stressed, there is much more to farming than planting a seed.

[21, 22] The Court concludes, weighing the factors set out above applied to the facts and circumstances of this case, Debtors meet the definition of family farmer in the Code. Debtors are eligible for relief because they were "engaged in a farming operation" on the date they filed for relief under Chapter 12. The Court analogizes this situation to cases under Subchapter V of Chapter 11. A debtor is eligible for relief under Subchapter V if the debtor satisfies the eligibility requirements of § 1182(1)(A). Included in those eligibility requirements is that the debtor be "engaged in a commercial or business activity." Similar to the issue herein, courts have struggled with what it means to be "engaged in" a business activity. Some courts have concluded that winding down a business that stopped operating prepetition is sufficient to be "engaged" in business activities.[29] This Court finds those cases persuasive. No matter what farming used to be, today farming is a business.[30]

28. *Id.* (''The court's reading of the statutory definitions and case law bearing on eligibility, however, confirms that Congress anticipated such changes and sought to permit those engaged in farming to continue the agricultural lifestyle, even in the face of interruptions and dramatic shifts, as the Debtor's case illustrates.'').

29. *E.g.*, *In re Vertical Mac Constr., LLC*, No. 6:21-bk-01520-LVV, 2021 WL 3668037, at *3 (Bankr. M.D. Fla. July 23, 2021) (concluding that maintenance of bank accounts, working with insurance adjusters and defense counsel to resolve claims, engaging in efforts to sell assets qualify as engagement in commercial or business activities); *In re Port Arthur Steam Energy, L.P.*, 629 B.R. 233, 237 (Bankr. S.D. Tex. 2021) (concluding that actively pursuing litigation against a third party and other wind down work all qualified as ''engaged in commercial or business activities''); *In re Offer Space, LLC*, 629 B.R. 299, 306 (Bankr. D. Utah 2021) (concluding that wind down activities of exploring counterclaims in a lawsuit and ''taking reasonable steps to pay its creditors and realize value for its assets'' was active engagement in a commercial or business activity''); *In re Ikalowych*, 629 B.R. 261, 284 (Bankr. D. Colo. 2021) (concluding that performing wind down work of about twelve hours a month postpetition such as storing business records and dealing with tax accountants and tax issues qualified as engaged in commercial or business activities); *In re Blanchard*, No. 19-12440, 2020 WL 4032411, at *2 (Bankr. E.D. La. July 16, 2020) (concluding a debtor's engagement in commercial or business activities could be currently engaged in or formerly engaged in); *In re Wright*, No. 20-01035-HB, 2020 WL 2193240, at *3 (Bankr. D.S.C. Apr. 27, 2020) (concluding that ''addressing residual business debt'' was engaging in business activities); *cf. In re Johnson*, No. 19-42063-ELM, 2021 WL 825156, at *7 (Bankr. N.D. Tex. Mar. 1, 2021) (concluding the debtors were not ''engaged in commercial or business activities'' because they were not occupied or busy in defunct companies and there was no evidence the cessation was temporary in nature or evidence of an intent to resume operations); *In re Thurmon*, 625 B.R. 417, 420, 423 (Bankr. W.D. Mo. 2020) (debtors were not ''engaged in commercial or business activities'' because they had sold their business with no intent to return to it and were not active or involved in any business activities, although their LLC was still in good standing under state law and still owned some outstanding accounts receivables and two cars).

30. The Court recognizes there may be some difference between being ''engaged in'' an ''operation'' versus ''engaged in'' a ''commercial or business activity.'' *See In re Blue*, 630 B.R. 179, 190 (Bankr. M.D.N.C. 2021) (contrasting engagement in ''operations'' from engagement in ''activities,'' and concluding even though the debtor had ceased business operations, it was engaged in business activities by maintaining bank accounts and winding down its business). But again, the modern definition of farming includes commercial and business ''activities.''

The wind down work for farming is no different than the wind down work for other businesses.

III. Conclusion

For the foregoing reasons, the Court concludes Debtors have met their burden of proof to show they are eligible for Chapter 12 relief. The Court denies AgCredit's motion to dismiss.

The Court does not mean to imply that the way Debtors and their counsel did things in this case are the way they should be done from a timing standpoint. The Court is only stating that Debtors have carried their burden based on the unique and individual facts of this case. Counsel for Chapter 12 debtors should proceed with caution in this area in the future.

The foregoing constitutes Findings of Fact and Conclusions of Law under Rules 7052 and 9014(c) of the Federal Rules of Bankruptcy Procedure which make Rule 52(a) of the Federal Rules of Civil Procedure applicable to this matter.

Judgment

Judgment is hereby entered denying AgCredit's motion to dismiss. The judgment based on this ruling will become effective when it is entered on the docket for this case, as provided by Federal Rule of Bankruptcy Procedure 9021.

It is so ordered.

STATE BANK OF SOUTHERN UTAH, Appellant,

v.

Allen BEAL, Appellee.

Case No. 2:20-cv-00298-DBB

United States District Court, D. Utah.

Signed 09/16/2021

Background: Creditor filed motion for extension of deadlines for it to file denial-of-discharge and nondischargeability complaints, and Chapter 7 debtor moved to dismiss creditor's complaints as untimely filed. The United States Bankruptcy Court for the District of Utah, R. Kimball Mosier, Chief Judge, 616 B.R. 140, dismissed complaints. Creditor appealed.

Holdings: The District Court, David B. Barlow, J., held that sufficient evidence supported finding that creditor did not timely file complaint, despite argument that a system malfunction caused the late filing.

Affirmed.

1. Bankruptcy ⚿3780

In resolving a mixed question of law and fact in a bankruptcy matter, the district court conducts a de novo review if the question primarily involves a question of legal principles and applies the clearly erroneous standard if the question is primarily a factual inquiry.

2. Bankruptcy ⚿3784

Review of a bankruptcy court's use of equitable power is for abuse of discretion.

3. Federal Civil Procedure ⚿1754

It is appropriate on a motion to dismiss to resolve questions of timeliness of the filing of the complaint. Fed. R. Civ. P. 12(b).

1. The United States Trustee's motion to convert is GRANTED. Case No. 19-26914-beh (*In re H2D Motorcycle Ventures, LLC*) and Case No. 19-26915-beh (*In re JHD Holdings, Inc.*) are hereby converted to Chapter 7, effective immediately.
2. The debtors' motion to distribute the sale proceeds (titled "*Debtors' Motion for Order Authorizing Distribution of Proceeds from Sale of Debtors' Dealership-Related Assets*" at ECF Doc. No. 346) will be held in abeyance pending the appointment of Chapter 7 trustees, and receipt of their recommendations as to the motion(s).
3. The various outstanding motions to approve administrative expenses also will be held in abeyance pending the appointment of Chapter 7 trustees, and receipt of their recommendations. (at ECF Doc. Nos. 253 (*First Extended*); 280 and 281 (*CARS*); 338 (*Rattet PLLC*); 339 (*PBS*); 340 (*BT*); and 341 (*Davidoff Hutcher & Citron LLP*)).
4. HDCC's motion for relief (titled "*Motion for Relief from the Automatic Stay*" at ECF Doc. No. 372) also will be held in abeyance pending the appointment of Chapter 7 trustees, and receipt of their recommendations as to the motion. The automatic stay of section 362(a) will remain in effect as to HDCC pending a final hearing and determination by this Court. The thirty-day period of section 362(e)(1) is hereby extended for 90 days given the compelling and complicated circumstances of these cases.

IN RE: Shirley HOEL and Roger Hoel, Debtors.

Case No. 20-10509-12

United States Bankruptcy Court, W.D. Wisconsin.

Signed July 20, 2020

Background: Trustee moved to dismiss debtors' Chapter 12 case, on ground that debtors were not "family farmers" eligible for such relief.

Holdings: The Bankruptcy Court, Catherine J. Furay, Chief Judge, held that debtors who derived only 30% of their income from cattle breeding and sales, subject to the vagaries of fluctuating cattle prices and risk of loss from injury or disease, and whose remaining income was at fixed prices for boarding third parties' horses, were not "family farmers."

Motion granted.

1. Bankruptcy ⚿2229

Statutory list of activity that will qualify as a "farming operation" under the Bankruptcy Code is not exclusive, and given the remedial purposes of Chapter 12, the term is to be broadly construed. 11 U.S.C.A. § 101(21).

2. Bankruptcy ⚿2229

While the term "farming operation," as used in the Bankruptcy Code, is to be broadly construed, it is not to be construed so broadly as to eliminate the definition altogether by bringing in operations clearly outside the nature or practices one normally associates with farming. 11 U.S.C.A. § 101(21).

3. Bankruptcy ⚿2229

To be eligible for Chapter 12 relief, individual must be "engaged in a farming

operation" when the Chapter 12 petition is filed. 11 U.S.C.A. §§ 101(18, 21), 109(f).

4. Bankruptcy ⚿2229

Significant factor for court in whether a particular activity performed by debtor constitutes a farming operation, as required for debtor to qualify as a "family farmer" eligible for Chapter 12 relief, is whether the debtor bears any of the inherent risks traditionally associated with farming. 11 U.S.C.A. §§ 101(18, 21), 109(f).

5. Bankruptcy ⚿2229

Court's view of what is a "farming operation," in deciding whether debtor is a "family farmer" eligible for Chapter 12 relief, must be pragmatic. 11 U.S.C.A. §§ 101(18, 21), 109(f).

6. Bankruptcy ⚿2229

Implicit in the definition of "farming operation" under the Bankruptcy Code is the inclusion of general activities inherent in farming and the means necessary to perpetuate the farming operation the definition speaks of. 11 U.S.C.A. § 101(21).

7. Bankruptcy ⚿2229

To determine whether the debtor is "family farmer" eligible for Chapter 12 relief, courts first review the activities in which the debtor engages and compare them to the activities required to grow or produce crops or livestock, and then examine the risk factors assumed by debtor: whether the fluctuation in market prices materially impacts the debtor, whether the debtor bears the risk of changes in the cost of feed, seed, or fertilizer, or the risk of disease or injury, and whether debtor's income is based on a fixed fee or rate of payment or is it subject to uncontrollable events. 11 U.S.C.A. §§ 101(18, 21), 109(f).

8. Bankruptcy ⚿2229

Debtors who derived only a small portion of their income, 30%, from cattle breeding and sales, subject to the vagaries of fluctuating cattle prices and risk of loss from injury or disease, and whose remaining income was at fixed prices for boarding third parties' horses, were not "family farmers" eligible for Chapter 12 relief. 11 U.S.C.A. §§ 101(18, 21), 109(f).

Wade M. Pittman, Pittman & Pittman Law Offices, LLC, Madison, WI, for Debtors.

Leslie Brodhead-Griffith, Office of the Standing Chapter 12 Trustee, Madison, WI, for Trustee.

MEMORANDUM DECISION

Hon. Catherine J. Furay, U.S. Bankruptcy Judge

Shirley and Roger Hoel ("Debtors") filed a Chapter 12 petition. The Standing Chapter 12 Trustee ("Trustee") filed a Motion to Dismiss the case ("Motion"). The question presented is whether the Debtors satisfy the Chapter 12 eligibility requirements under 11 U.S.C. § 101(18)(A)(i).

Background

Debtors' gross income in 2019, the year preceding the filing, was $47,650 excluding both social security ($30,748) and insurance sales ($4,802). Debtors claim their farm income has two components—cattle sales and breeding ($14,650) and horse boarding ($33,000). Debtors say the risks related to boarding horses are that if a horse becomes ill, they may have to transport it to a vet. Further, if the price of hay or feed rise, the Debtors' cash flow may tighten. Finally, Debtors suggest that if they have to transport a horse to a vet, they "bear the time burden when pulled away from the farming operation."

Debtors have not provided an accounting of the payments received from boarding. No boarding contracts or agreements have been supplied. It appears there are two boarded mares, five boarded geldings, and three boarded heifers.

The Debtors also hold an interest in a business called Central Wisconsin Save the Animals Group, Inc. It is a nonprofit. It provides rescue services for neglected or abused horses and other small animals. Donations are solicited and, apparently, are identified as deductible. Fundraising events may also be part of the operation of the nonprofit.

Discussion

[1, 2] Under 11 U.S.C. § 109(f), "Only a family farmer ... with regular annual income may be a debtor under chapter 12 of this title." Chapter 12 of the Bankruptcy Code provides for the adjustment of debts of a "family farmer" as the term is defined in the Code. The relevant parts of section 101(18) state:

> The term "family farmer" means—
>
> (A) individual or individual and spouse *engaged in a farming operation* whose aggregate debts do not exceed $10,000,000 and not less than 50 percent of whose aggregate noncontingent, liquidated debts ... on the date the case is filed, arise out of a farming operation ... *and* such individual or such individual and spouse receive from such *farming operation* more than 50 percent of such individual's or such individual and spouse's gross income for— (i) the taxable year preceding [the date the case was filed]. ...

11 U.S.C. § 101(18) (emphasis added).

> The term "farming operation" includes farming, tillage of the soil, dairy farming, ranching, production or raising of crops, poultry, or livestock, and production of poultry or livestock products in an unmanufactured state.

11 U.S.C. § 101(21). This list is not exclusive. Rather, given the remedial purposes of Chapter 12, it is to be broadly construed. *See In re Watford*, 898 F.2d 1525, 1527 (11th Cir. 1990); *In re Poe*, 2009 Bankr. LEXIS 2068, 2009 WL 2357160, at *3 (Bankr. N.D. W. Va. July 29, 2009); *In re Sugar Pine Ranch,* 100 B.R. 28, 31 (Bankr. D. Or. 1989). But the construction is not so broad "so as to eliminate the definition altogether by bringing in operations clearly outside the nature or practices one normally associates with farming." *In re Cluck,* 101 B.R. 691, 695 (Bankr. E.D. Okla. 1989) (internal quotation omitted).

The Debtors concede that in the second or third taxable years prior to filing this case, they did not receive more than 50 percent of their gross income from a farming operation. So the relevant inquiry focuses on their 2019 income and its source.

[3] To be eligible for relief, an individual must be "engaged in a farming operation" when the Chapter 12 petition is filed. Two approaches have developed since the passage of Chapter 12 to analyze what is a farming operation. One approach focuses on whether the operation is mainly service oriented, and the income is a fee. The other approach focuses on whether the operation involves traditional farming risks—fluctuating market prices, feed prices, uncertain weather, risk to livestock from disease and injury, and upkeep of the animals.

[4] Two main standards have evolved for determining whether an individual is "engaged in a farming operation." In *In re Armstrong,* the Seventh Circuit interpreted section 101(18) to mean that only those farmers whose activities involved the inherent risks and cyclical uncertainties that are associated with farming were protect-

ed from involuntary Chapter 11 proceedings. 812 F.2d 1024, 1027 (7th Cir. 1987). As noted by one treatise, "A significant factor in a court's analysis of whether a particular activity constitutes a farming operation is whether the debtor bears any of the inherent risks traditionally associated with farming." 2 Collier on Bankruptcy ¶ 101.21 (16th ed. 2010). *See also In re McNeal,* 848 F.2d 170, 171 (11th Cir.1988) (finding that a debtor's income did not arise from a "farming operation" because his business activities were not exposed to the inherent risks and cyclical uncertainties traditionally associated with farming).

[5, 6] The *Armstrong* court clearly established that the view of what is a farming operation must be pragmatic. *Armstrong,* 812 F.2d at 1026. "Implicit in [the definition of farming operation] is the inclusion of general activities inherent in farming and . . . the means . . . necessary to perpetuate the farming operation the definition speaks of." *Id.*

Nearly all of the cases discussing the meaning of "farming operation" are more than two decades old. They sometimes assume a standard that fails to recognize the changes in the production practices and business arrangements used to cultivate plants or animals. As noted by a 2017 USDA publication, "Farmers [have] altered how they manage risk, relying heavily on contracting, more complex forms of legal organization, and Federal crop insurance."[1]

Considering the new risk environment in agriculture, high machinery replacement costs, and aging farm owners, custom farming is an example of a viable method of accomplishing crop production. Custom farming is used extensively in the Midwest. For the custom farmer, it may provide a way to retain machinery used by that farmer by generating more revenue to service home farm debt or machinery costs. The custom farmer, for example, provides the equipment and labor in exchange for a fee. In some cases, the fee is a fixed sum, but in others there can be a base sum and a percentage of the profits from the harvest and sale of the crop.

The same factors may lead to scaling back their operation, the sale of machinery or land by a farmer, or temporary rental of some of the farmer's land to address financial trouble. As acknowledged by the *Armstrong* court, it would be "illogical, undesired and unnecessary" based solely on those actions for a debtor to be considered a non-farmer. *Armstrong,* 812 F.2d at 1027.

In *Poe,* the Bankruptcy Court for the Northern District of West Virginia concisely summarizes the cases discussing whether the boarding or training of horses constitutes a "farming operation." 2009 WL 2357160, at *3-5. As noted, the cases are mixed. Two cases have determined that type of operation is not a farming operation,[2] and two cases have concluded that such activities do constitute a farming operation.[3] The *Poe* case decided that raising horses was farming but boarding was not. *Poe,* 2009 WL 2357160, at *6.

Central to all the decisions is (1) analyzing whether the activities undertaken are

1. Bob Hoppe, *How the Farm Business Has Changed,* USDA, (Feb. 21, 2017), https://www.usda.gov/media/blog/2012/01/10/how-farm-business-haschanged#:~:text=Over%20a%20relatively%20short%20time,in%20production%20to%20larger%20farms.

2. *In re McKillips,* 72 B.R. 565 (Bankr. N.D. Ill. 1987); *In re Cluck,* 101 B.R. 691 (Bankr. E.D. Okla. 1989).

3. *In re Showtime Farms, Inc.,* 267 B.R. 541 (Bankr. E.D. Tex. 2000); *In re Buchanan,* 2006 U.S. Dist. LEXIS 50968, 2006 WL 2090213 (M.D. Tenn. July 25, 2006).

of the type that someone would perform in connection with the business of growing crops or raising animals, and (2) weighing the uncertainties of farming like the "vagaries and whims of weather and pestilence, yield and demand"[4] and the cyclic and unpredictable income generated.

The *Poe* court thought the series of cases applied different approaches. It described the first approach as:

> [focusing] on the following factors: (1) the debtors' operations were primarily service-oriented as opposed to being self-contained farming operations which produce agricultural goods for consumption; and (2) where the measure of a debtor's compensation is a fee rather than a share of the profits from some future sale, the debtor's profits are not at the mercy of the weather, the farm economy, or other uncontrollable circumstances of farming—any such effect being minute and indirect.

Poe, 2009 WL 2357160, at *4.

The second approach was described by *Poe* as focusing on traditional farming risks, such as "(1) fluctuating market prices, (2) feed prices, (3) uncertain weather, (4) risk to livestock from disease and injury, and (5) upkeep of the animals." *Poe,* 2009 WL 2357160, at *6.

[7] Closer analysis, however, suggests that all the cases have a consistent approach merely couched in differing language. All the courts review the activities to compare them to the activities required to grow or produce crops or livestock. Then the risk factors assumed by the debtor are examined. Does fluctuation in market prices materially impact the debtor? Does the debtor bear the risk of changes in the cost of feed, seed, or fertilizer? Does the risk of disease or injury threaten the income or expenses of the debtor? Are there factors like weather that are outside the debtor's control? Is the debtor's income based on a fixed fee or rate of payment or is it subject to uncontrollable events?

[8] Here, the Debtors have income from cattle sales and breeding. They own the cattle. The risks of fluctuating feed prices and other upkeep costs are borne by Debtors. Fluctuating market prices for cattle sales or breeding impact Debtors. They must pay any veterinary bills and solely bear the risk that disease or injury may affect the income derived from sales and breeding. That income, however, is only 30% of the total income they claim flows from farming.

The balance of the income derives from boarding horses. Debtors suggest that if a boarded horse becomes ill or injured, they would "bear the burden of transporting the horses to the vet, and bear the time burden when pulled away from the farming operation." If transporting the horses to the vet was part of the farming operation, they would be not "pulled away" from it. Debtors, apparently, receive a flat fee for boarding since they argue they bear the risk of tightened cash flow if feed prices or other costs rise. Yet they have absolute control over establishing the terms of the boarding agreements. They could choose to terminate the agreement if its terms were onerous or they could include adjustments to the fee if prices increase or if extra services such as transporting a horse were required.

As noted, no boarding agreements or contracts have been provided. There is no indication Debtors are compensated by the owner of the animals they say they board, but it is clear the Debtors claim they do

4. *Armstrong,* 812 F.2d at 1030.

not own the animals. In fact, it appears the Debtors operate a nonprofit taking in neglected or abused animals. While the care of such animals is laudable, it is also a volunteer effort assumed by the Debtors with no expectation of compensation by the owner of the animals. Instead, Debtors rely on charitable contributions.

While both a family farmer and a boarding operator may face some of the same risks, the effect of those risks is different for each. The "family farmer" bears all the risks of raising horses. If an animal is lost to disease or serious injury, the family farmer receives no profit on the animal and has lost all that he or she has invested in it. In contrast, while profits from a boarding might vary if an animal dies or is seriously injured, that is a short-term loss until a new boarder is located, and there is no meaningful expense to replace the animal. If market prices for feed increase, the operator of a boarding facility could simply pass this cost on to the owner. The family farmer, on the other hand, bears this risk alone and it would lead to less profit or no profit in the future sale of the animal.

Conclusion

For these reasons, the Trustee's Motion to Dismiss is granted.

This decision shall constitute findings of fact and conclusions of law pursuant to Bankruptcy Rule 7052 and Rule 52 of the Federal Rules of Civil Procedure.

A separate order consistent with this decision will be entered.

IN RE RACING SERVICES, INC., Debtor.

PW Enterprises, Inc. and Robert Carlson, Appellants,

v.

Susan Bala and Kip Kaler, as Chapter 7 Trustee for Racing Services, Inc., Appellees.

Case No. 3:18-cv-263
Bankruptcy Case No. 04-30236

United States District Court,
D. North Dakota.

Signed 06/18/2020

Background: When, some 11 years after case was commenced, State of North Dakota was ordered to return millions of dollars in unauthorized taxes that it had collected from the prepetition activities of Chapter 7 debtor, an off-track horse race betting service provider, and state subsequently paid the bankruptcy estate $15.872 million pursuant to court-approved settlement agreement, amended claims were filed by claimants, to which objections were raised. The United States Bankruptcy Court for the District of North Dakota, Thad J. Collins, J., 595 B.R. 334, sustained objections, and appeal was filed.

Holdings: The District Court, Peter D. Welte, Chief Judge, held that:

(1) bankruptcy court, in disallowing unjust enrichment claim filed by professional gambler, properly rejected his assertion that he had a greater entitlement to the returned taxes;

(2) bankruptcy court properly disallowed contract-based claim filed by professional gambler; and

(3) bankruptcy court properly disallowed contract-based and unjust enrichment