UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In the Matter of

ARMBRUST FARM, LTD., Case No. 86-1259-W

Debtor. Chapter 12

ORDER

On December 17, 1987 a number of matters came on for hearing in Council Bluffs, Iowa. They included: objection to plan, motion to prohibit debtor's use, sale or lease of collateral, motion for relief from stay and motion to marshall assets of debtor filed by Citizens State Bank (Citizens) and the debtor's application for employment of appraiser, accountant and attorney. Frank W. Pechacek appeared on behalf of the debtor and Charles L. Smith appeared on behalf of Citizens. The matters have been submitted on briefs, transcripts of the hearing and the deposition of Jacob H. and Marjorie M. Armbrust and certain documentary evidence.

FACTS

The debtor is a family farm corporation located in Pottawattamie County, Iowa. The major assets of the corporation include 220 acres of farmland, farm equipment and some farm products. Jacob H. Armbrust and Marjorie M. Armbrust, husband and wife, are the major shareholders of

the corporation. The Armbrust's four children also are shareholders. Marjorie is president, secretary and treasurer of the corporation. Jacob is vice-president.

Jacob inherited the farm from his father in February, 1979. Sometime thereafter, Jacob made a special use election under 26 U.S.C. section 2032A, which permits real property used for "farming purposes" to be valued for estate tax purposes on the basis of its use as a farm or business rather than on some speculative use. See generally,, Bagleiter, Section 2032A: Did We Save The Family Farm?, 29 Drake L. Rev. 15 (1979-80). 26 U.S.C. section 6324B creates a lien in favor of the United States on any property which qualifies under section 2032A to protect the government's interest in the event a recapture tax or additional estate tax is imposed. The lien will become unenforceable after fifteen years provided that the qualified heir continues to employ the property for the qualified use. On August 25, 1982 the Internal Revenue Service (IRS) filed a notice of federal estate tax lien with the county recorder for Pottawattamie County in the amount of $81,729.93

The Armbrusts entered into a mortgage agreement with the Federal Land Bank (FLB) on December 3, 1979. The FLB's mortgage constitutes a superior mortgage on the farm. The debtors propose to fix the FLB's allowed secured claim at $74,970.03.

Citizens, the debtor and Jacob and Marjorie Armbrust executed a promissory note in the amount of $90,000.00 on

June 11, 1985. The Farmers Home Administration (FmHA) guaranteed 90% of the $90,000.00 note or $81,000.00. To secure the note, the debtor and the Armbrusts granted Citizens a mortgage to the farm. This mortgage was recorded after the FLB mortgage and the IRS tax lien. They also granted Citizens a blanket security agreement. Citizens has filed a proof of claim in the amount of $95,717.92 plus $30.51 per them from April 14, 1987. $3,384.00 remains on a separate note secured by a 15,000 bushel bin. Also outstanding is a $20,108.73 operating loan from 1985 secured by a blanket lien. [1]

There is no dispute that Citizens had a security interest in the debtor's 1986 bean crop. In 1987 the debtor planted 140 acres of beans. Problems with government acreage limitations forced the debtor to plow up 36 acres. Of the 140 bushels of beans planted, 130 bushels were 1986 beans.

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[1] A proof of claim filed by Citizens reveals that a balance of $22,994.48 remained on this operating loan at the time of filing. On September 25, 1987 this court partially granted Citizen's motion to prohibit debtor's use, sale or lease of collateral and motion for relief from stay. The court permitted Citizens to sell the debtor's 1986 corn crop and apply the proceeds to the cost of hauling the grain and then to the note. At the hearing an officer of Citizens stated that $2,426.00 in corn proceeds were applied to the debt. The court also allowed Citizens to negotiate a $459.75 proceeds check from 1986 beans. Citizens also applied this amount to the debt. $22,994.48 less these amounts equals $20,108.73.

The parties stipulated that the value of the land is $180,000.00 and that the value of the machinery is $14,150.00. In calculating Citizen's allowed secured claim the debtor reduced the value of the farm by the amount owed to the FLB, the amount of the IRS tax lien, $1,700.00 owed to an electrical cooperative and $4,327.00 in real estate taxes.

On October 14, 1987 the debtor filed an application for employment of an accountant, attorney and an appraiser. The debtor filed this case on May 7, 1987. In its application, the debtor states that it did not file the application with the petition because a petition had to be prepared hurriedly. The debtor contends it had no intention of filing bankruptcy but that a filing became necessary when the Commodity Credit Corporation offset government program payments against a delinquent account stemming from spoiled grain. The debtor further maintains that the pressure of time and the work involved in getting appraisers lined up did not give counsel for the debtor sufficient time to consider fee arrangements. Finally the debtor states that this is the first Chapter 12 petition filed by counsel and counsel was unaware that prior court approval of employment was required. Finally, the debtor argues that no party has been prejudiced by the late application.

I.

Citizens objects to the debtor's use of the IRS tax lien to reduce their allowed secured claim. It argues in

part that the debtor should not be able to subtract a hypothetical lien that never will be actually due and owing as long as the operation continues for the required 15 years. The debtor asserts that the lien is in full force and effect now and therefore must be considered in calculating Citizens' allowed secured claim.

11 U.S.C. section 1225(a)(5) requires that the plan must provide the secured creditor with property of a value equal to the allowed amount of the creditor's secured claim. The extent of a creditor's secured claim is analyzed pursuant to 11 U.S.C. section 506(a) which provides that an allowed claim is a secured claim only "to the extent of the value of such creditor's interest in the estate's interest in such property." As a general rule, if there are liens against the property that are senior to the creditor's lien, the amount of debt secured by senior liens must be deducted in determining the extent to which the creditor holds a secured claim. 3 Collier on Bankruptcy, § 506.04 at 506-19 (15th ed. 1986).

The flaw in the debtor's analysis is that a senior lien used to reduce the secured claim of a junior lienholder somehow must be treated in the plan of reorganization. See In re Edwardson, 74 B.R. 831, 835, 836 (Bankr. D. N.D. 1987) (secured creditor's claim was reduced by the real estate taxes due but the debtors were directed to provide for the payment of those taxes in the plan). Although the IRS filed a proof of claim indicating a secured claim in the amount of

$81,729.93, the debtor's plan does not provide for payment of that claim or for lien retention by the IRS. The IRS has not objected to the plan nor has the debtor objected to the proof of claim. Presumably both the IRS and the debtor anticipate that the lien will never be enforced. This presumption is reasonable in light of the debtor's articulated intention to continue farming and to carry through a plan of reorganization.

Given the debtor's failure to treat the IRS estate tax lien in its plan and the unlikelihood at this point in time that the lien will be enforced, the debtor may not utilize the value of the tax lien to reduce the allowed secured claim of Citizens. In the event that enforcement of the lien is triggered, the relative positions of the interested parties could be reassessed accordingly by this court (if the three year plan has not been completed) or by the appropriate nonbankruptcy court (if the case has been closed). Whereas the debtor in effect would gain $81,729.93 at Citizens' expense if the debtor reduced the secured claim of Citizens, received a discharge upon completion of the three year plan and enforcement of the tax lien was not triggered.

II.

Citizens claims that it has an interest in the debtor's 1987 bean crop. Citizens reasons that its security extends to 90% of the matured 1987 bean crop because it had a validly perfected security interest in the debtor's 1986

bean crop and because the debtor used 1986 beans to plant 90% of the 1987 crop.

In analyzing the Bank's claim, the court first turns to 11 U.S.C. section 552 which provides:

> (a) Except as provided in subsection (b) of this section, property acquired by the estate or by the debtor after the commencement of the case is not subject to any lien resulting from any security agreement entered into by the debtor before the commencement of the case.
>
> (b) Except as provided in sections 363, 506(c), 522, 544, 545, 547, and 548 of this title, if the debtor and an entity entered into a security agreement before the commencement of the case and if the security interest created by such security agreement extends to property of the debtor acquired before the commencement of the case and to proceeds, product, offspring, rents, or profits of such property, then such security interest extends to such proceeds, product, offspring, rents, or profits acquired by the estate after the commencement of the case to the extent provided by such security agreement and by applicable nonbankruptcy law, except to any extent that the court, after notice and a hearing and based on the equities of the case, orders otherwise.

Id. This statutory scheme in essence means that a bankruptcy filing severs prepetition security interests with one important exception--security interests in property acquired prior to filing extend to proceeds of such property acquired by the estate after filing. It is undisputed that the debtor planted the 1987 bean crop after filing bankruptcy. Citizens stakes its claim to the crop on the proceeds exception to section 552. In determining what constitutes

proceeds, reference must be made to state law. In re Hugo, 50 B.R. 963 (Bankr. E.D. Mich. 1985).

Iowa Code section 554.9306(l) defines proceeds as including "whatever is received upon the sale, exchange, collection or other disposition of collateral or proceeds." The Iowa Supreme Court construed this provision in Farmers Co-op Elevator v. Union St. Bank, 409 N.W. 2d 178 (Iowa 1987). One of the issues before the court was whether fattened livestock that consumed encumbered feed were "proceeds" of the feed. The court ruled that the hogs were not proceeds. In so holding, the court cited with approval First National Bank of Brush v. Bostron, 39 Colo. App. 107, 564 P.2d 964, 966 (1977) wherein that court stated that "(the livestock producer] received nothing when he disposed of the collateral by feeding it to the ... cattle ... the collateral was consumed." The results reached in those decisions are appropriate in this case. Here, the debtors received nothing when they disposed of the 1986 beans by planting them. There was no sale, exchange or collection of the beans. Furthermore, the biological transformation of the beans into soybean plants is not an "other disposition" for purposes of section 554.9306. Therefore, the mature soybean plants are not "proceeds" of the 1986 beans.

Citizens' reliance upon In re Hugo, 58 B.R. 903 (Bankr. E.D. Mich 1986) in support of its position is misplaced. In Hugo, the debtors had used proceeds from their 1983 potato crop to plant the 1984 crop. The issue before the court was

to what extent could the proceeds be traced under sections 9-306(3) and (4) of the Uniform Commercial Code. There was no question that the money the debtors received from selling the 1983 crop were proceeds. In contrast, the instant case involves the threshold question of whether proceeds even exist under section 554.9306(l). Hugo simply is inapposite to the resolution of the issue before the court.

III.

Citizens' motion to marshall assets is premised upon an assumption that Citizens has a valid security interest in the 1987 bean crop. Given the court's foregoing conclusion that this is not so, Citizens' arguments in support of its motion have no foundation.

IV.

Citizens moves for relief from the automatic stay with respect to the real estate. More particularly, Citizens maintains that the debtor has not offered Citizens adequate protection, has no equity in the property and has no reasonable prospect of reorganization.

The requirements for obtaining relief from the. automatic stay are contained in 11 U.S.C. section 362(d), which provides:

> On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay-
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> (1) for cause, including the lack of adequate protection of an interest

> in property of such party in interest; or
>
> (2) with respect to a stay of any act against property under subsection (a) of this section, if--
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> (A) the debtor does not have any equity in such property; and
>
> (B) such property is not necessary to an effective reorganization.

With respect to the burdens of proof, 11 U.S.C. section 362(g) states:

> In any hearing under subsection (d) or (e) of this section concerning relief from the stay of any act under subsection (a) of this section--
>
> (1) the party requesting such relief has the burden of proof on the issue of the debtor's equity in property; and
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> (2) the party opposing such relief has the burden of proof on all other issues.

Citizens argues that its interest in secured property is not adequately protected and that the debtor has not offered to provide adequate protection. It maintains that the debtor should be required to pay rent for use of the farmland and machinery. The adequate protection standards are set out in 11 U.S.C. section 1205:

> (a) Section 361 does not apply in a case under this chapter.
>
> (b) In a case under this chapter, when adequate protection is required under section 362, 363, or 364 of this title of an interest of an entity in property, such adequate protection may be provided by--

> (1) requiring the trustee to make a cash payment or periodic cash payments to such entity, to the extent that the stay under section 362 of this title, use, sale, or lease under section 363 of this title, or any grant of a lien under section 364 of this title results in a decrease in the value of property securing a claim or of an entity's ownership interest in property;
>
> (2) providing to such entity an additional or replacement lien to the extent that such stay, use, sale, lease, or grant results in a decrease in the value of property securing a claim or of an entity's ownership interest in property;
>
> (3) paying to such entity for the use of farmland the reasonable rent customary in the community where the property is located, based upon the rental value, net income, and earning capacity of the property; or
>
> (4) granting such other relief, other than entitling such entity to compensation allowable under section 503(b)(1) of this title as an administrative expense, as will adequately protect the value of property securing a claim or of such entity's ownership interest in property.

Unlike 11 U.S.C. section 361, this provision eliminated both the "indubitable equivalent" standard and the requirement that debtors must compensate creditors for "lost opportunity costs." [2] Subsection 3 provides that adequate

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[2]In In re American Mariner Industries, Inc., 734 F.2d 426 (9th Cir. 1984) and Grund National Bank v. Tandem

(Footnote Continued)

protection may be provided by paying rent for use of mortgaged farmland. However, use of the land alone does not mean that rents must be paid. Section 1205(b) states in part that "[I]n a case under this chapter, when adequate protection is required under section 362..., such adequate protection may be provided by--[paying rent]." (Emphasis added.) This language requires an initial determination of whether adequate protection is required. In re Turner, No. 87-11346-B (Bankr. W.D. Tenn., Jan. 29, 1988) (LEXIS, Bkrtcy library, Bankr. file). Elimination of the "indubitable equivalent" language clearly shows that it is the value of the collateral that requires protection, not the value of the creditors' interest in the collateral. In re Westcamp, 78 B.R. 834, 837 (Bankr. S.D. Ohio 1987); In re Kocher, 78 B.R. 844, 848-49 (Bankr. S.D. Ohio 1987). To prevail under section 1205, a creditor must show the value of the secured

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(Footnote Continued)
Mining Corp._, 754 F.2d 1436 (4th Cir. 1985), the courts construed the adequate protection requirement to mean that payments must be made to creditors in an amount equal to the interest an undercollateralized creditor could earn on money equivalent to the value of its collateral. In other words, debtors were required to compensate creditors for "lost opportunity costs." Congress perceived "lost opportunity costs" to be a major impediment to successful farm reorganizations and therefore removed Chapter 12 from the ambit of section 361. H.R. Rep. No. 958, 99th Cong., 2nd Sess, 49 reprinted in 1986 U.S. CODE CONG. & ADMIN. NEWS 5246, 5250. It should be noted that the United States Supreme Court recently ruled in the context of section 362(d)(1) that an undersecured creditor is not entitled to lost opportunity costs to assure adequate protection. United Savings v.Timbers of Inwood Forest, U.S. 108 S.Ct. 62b (1986).

property is imperiled. Turner, supra.

The classic protection for a secured debt and one justifying continuation of the stay is the existence of an "equity cushion," which is defined as "the value in the property above the amount owed to the creditor with a secured claim that will protect that creditor's secured interest from decreasing in value during the period that the automatic stay remains in effect". In re Jug End in the Berkshires, Inc., 46 B.R. 892, 899 (Bankr. Mass. 1985). The existence of liens junior to the movant's lien are not relevant to a determination under 11 U.S.C. section 362(d)(1). Id. at 901.

In this case an equity cushion exists. Given the court's earlier conclusion that the amount of the IRS tax lien should not be taken into account in determining Citizens' allowed secured claim, the lien will not be considered in determining whether Citizens is protected by an equity cushion. The sum of Citizens' lien and prior liens totals $176,714.95. [3] The parties agree that the value of the land is $180,000.00. Subtracting $176,714.95 from $180,000.00 leaves an equity cushion of $3,285.05. Additionally, a

[3]The court questions whether the electrical cooperatives lien of $1,700.00 is superior to Citizens' lien and therefore must be taken into account in determining whether Citizens is adequately protected. The parties did not address the issue. For the purpose of this decision, the court assumes the electrical cooperative's lien is superior to Citizens' lien.

federal mortgage guaranty may constitute adequate protection. Commonwealth of Pennsylvania State Employees Retirement Fund v. Roave, 14 B.R. 542 (E.D. Pa. 1981). The FmHA guarantee of $81,000.00 provides Citizens with a further measure of protection. Therefore, no adequate protection payments are warranted at this time.

Citizens also seeks relief from stay pursuant to 11 U.S.C. section 362(d)(2). The stay may be modified under that subsection if two requirements are met: the debtor lacks equity in the property, and the property is not necessary to an effective reorganization. This court subscribes to the majority view which defines equity in debtor's property as the difference between the property value and all encumbrances against it. See, In re Jug End, 46 B.R. at 900-901 and cases cited therein; In re Irving A. Horns Farm, Inc., 42 B.R. 832, 836 (Bankr. N.D. Iowa 1984). Taking into account the stipulated value of the land less amounts owed to Pottawattamie County for real estate taxes, the FLB, the electric co-op and Citizens, equity in the property exists. Again the IRS lien has been excluded from the calculation.

Relief from stay under section 362(d)(2) may be granted even if there is an equity cushion for the moving party and the debtor is able to provide an alternate means of adequate protection. In re Jug End, 46 B.R. at 900-901. The Eighth Circuit has adopted other court interpretations of the "necessary for an effective reorganization" standard as

requiring a debtor not only to show that the property is essential to reorganization but to demonstrate that an effective reorganization is realistically possible. In re Ahlers., 794 F.2d 388, 398-99 (8th Cir. 1986). The showing a debtor must make to sustain its burden is governed by the facts. Matter of Weiser, 74 B.R. 111, 116-17 (Bankr. S.D. Iowa 1986). "Uncertainties should be resolved in the debtor's favor during the period in which the debtor is entitled to file a plan of reorganization." In re 6200 Ridge, Inc., 69 B.R. 837, 843 (Bankr. E.D. Pa. 1987).

At this stage of the proceedings, it is questionable whether a reorganization is realistically possible. The proposed plan and attendant cash flows are based upon fixing Citizen's allowed secured claim at $7,273.74 and amortizing this amount over 10 years at 10.5% for yearly payments of $1,209.31. The debtor calculated Citizens' allowed secured claim by estimating the value of the land at $170,000.00 and then subtracting from that amount the following:

1) Federal Land Bank mortgage	$ 74,970.03
2) IRS tax lien	81,729.23
3) Rural Electric Co-op lien on furnace	1,700.00
4) Real estate taxes	4,327.00
Total	$162,726.26

The variables of the calculation now must be changed to reflect the parties' stipulation that the land is worth $180,000.00 and the court's finding that the IRS lien cannot be taken into account in determining Citizens' allowed

secured claim. With these changes in mind, Citizens' allowed secured claim increases to $95,717.92. Using the same amortization period and discount rate proposed in the plan, the debtor's yearly payments to Citizens would amount to $15,575.00. These changes would have a significant effect on the debtor's cash flow. For example, the previously submitted cash flows show a projected cushion of $3,258.36 for 1988. With the discussed changes, the cushion is eliminated and results in a negative cash flow of $11,107.64.

The monthly reports show the debtor is having difficulty meeting projections. The reports from May through December 1987 show a total farm income during that period of $14,195.25, all of which was received from either government payments or proceeds from federal crop insurance. For 1987, the debtor projected receiving $37,295.00 from government programs and the sale of crops. The debtor has offered no explanation for this shortfall.

These problems well may prove to be insurmountable. However, the court is not inclined at this time to find that the situation is hopeless. It is the practice in this district to allow debtors to amend plans after the preliminary hearing to meet the valid concerns of their creditors. The debtor will be given an opportunity to do so. Any objections to feasibility will be taken up at the final confirmation hearing.

V.

Citizens also moves for relief from the stay to pursue collection actions against Jacob and Marjorie Armbrust who are co-obligors on the debtor's notes. Generally the automatic stay provisions of 11 U.S.C. section 362(a) apply only to the debtor. Austin v. Unarco Industries, Inc., 705 F.2d 1, 4 (lst Cir. 1983); Pitts v. Unarco Industries, Inc., 698 F.2d 313, 314 (7th Cir. 1983); In re Kalispell Feed and Grain Supply, Inc., 55 B.R. 627, 628 (Bankr. D. Montana 1985); Matter of Johns-Manville Corp., 26 B.R. 405, 409 (Bankr. S.D. N.Y. 1983); Royal Truck and Trailer v. Armadora Maritima Salvadoreana, 10 B.R. 488, 490 (N.D. Ill. 1981). In reaching this conclusion, courts have turned to the legislative history of section 362 which in pertinent part provides:

> The automatic stay also provides creditor protection. Without it, certain creditors would be able to pursue their own remedies against the debtor's property. Those who acted first would obtain payments of the claims in preference to and to the detriment of other creditors. Bankruptcy is designed to provide an orderly liquidation procedure under which all creditors are treated equally. A race of diligence by creditors for the debtor's assets prevents that.

U.S. Code Cong. & Admin. News 1978, pp. 5787, 6297 quoted in, Johns-Manville, supra at 410 (emphasis in the original).

Despite widespread acceptance of this rule, bankruptcy courts have relied upon the equitable power conferred by

section 105 to issue stays in situations not covered by section 362. See In re Monroe Well Service, 67 B.R. 746 (Bankr. E.D. Pa. 1986)(surveying cases in which section 105 has been applied to enjoin creditors of the debtor from proceeding against non-debtor third parties). This court in Matter of Dodder, No. 87-692-D (Bankr. S.D. Iowa, filed December 31, 1987) utilized its section 105 powers to restrain actions against non-debtors. There this court applied the four-pronged test articulated by the Eighth Circuit in Dataphase Systems, Inc. v. C.L. Systems, Inc., 640 F.2d 109, 114 (8th Cir. 1981) in determining whether to enjoin creditors. The four factors that must be considered are:

(1) the threat of irreparable harm to the movant;

(2) the state of balance between this harm and the injury that granting the injunction will inflict on other parties litigant;

(3) the probability that the movant will succeed on the merits; and

(4) the public interest.

Dodder, slip op. at 6.

The debtor has not addressed Citizens' contention that it be permitted to pursue an action against the Armbrusts. The debtor presented no evidence at the hearing with respect to the Dataphase test. Since the court rendered the Dodder decision after that hearing, the debtor will be given an opportunity to address whether actions against the Armbrusts should be enjoined.

VI.

The debtor seeks court approval for employing an accountant, attorney and appraiser. At the hearing, the court stated it would consider the debtor's application as an application for appointment nunc pro tunc since the debtor filed the application more than five months after it filed a petition for relief. This court in Matter of Independent Sales Corp., 73 B.R. 772 (Bankr. S.D. Iowa 1987) set out in detail the Code provisions governing the appointment of attorneys and a number of cases that discussed the standards for nunc pro tunc appointment. The court need not repeat that lengthy discussion. Summarily stated, the actual employment of professional persons is controlled by section 327 and Bankruptcy Rule 2014(a) and a nunc pro tunc appointment will be granted only upon a showing of "extraordinary circumstances." Some of the factors the court will consider in determining whether "extraordinary circumstances exist include:

> [W]hether the applicant or some other person bore responsibility for applying for approval; whether the applicant was under time pressure to begin service without approval; the amount of delay after the applicant learned that initial approval had not been granted; the extent to which compensation to the applicant will prejudice innocent third parties; and other relevant factors.

Independent Sales, 73 B.R. at 777 quoting Matter of Arkansas Co., Inc., 798 F.2d 645, 650 (5th Cir. 1986). Application of these standards to the instant case leads the court to

conclude the debtor has not shown "extraordinary circumstances" that merit nunc pro tunc appointment at this time.

The debtor advances three reasons for the untimely filing:

(1) That debtor's counsel was under unusual pressure to begin service and therefore did not have sufficient time to consider fees. The debtor contends that this unusual pressure stemmed from the fact that the government exercised a set-off against a farm program payment which stripped the debtor of working capital and thus necessitated a bankruptcy filing;

(2) That this case was debtor's counsels first Chapter 12 bankruptcy filing and that he and the debtor were unaware that prior approval of counsel, appraiser and accountant was required; and

(3) That the dilatory application has resulted in no harm to any party.

The debtor's first reason is not persuasive. In this district, it is not unusual for debtor in possession bankruptcies to be filed under time constraints imposed by events such as sheriff's sales or the inability to obtain credit at planting time. Applications in most cases are filed with the petitions for relief and are approved by the court as a matter of course. If an emergency does arise where it is impossible to file an application with the petition, the court expects that an application will be

filed soon after the petition filing. Here, more than five months elapsed between the filing of the petition and the submission of the application.

The debtor's second reason is likewise not compelling. Those who seek to practice in the bankruptcy court are expected to apprise themselves of the relevant statutes and rules. Indeed, debtor's counsel practices in a firm that frequently appears in bankruptcy court. Other members of counsels firm are aware of the application requirements or should be.

Finally, it is too early to tell whether third parties will be prejudiced by the untimely application. In the event the case proves unsuccessful, third parties such as creditors will be harmed by the delay caused by the filing. If the plan is confirmed and the debtor complies with the terms of the plan, creditors will benefit. Therefore, the court will deny an application nunc pro tunc without prejudice to file another application if appropriate after the confirmation hearing. The court approves employment of the appraiser, attorney and accountant for services rendered on October 14 and thereafter.

CONCLUSION AND ORDER

WHEREFORE, based on the foregoing analysis, the court finds the following:

(1) the IRS estate tax lien of $81,729.93 is not to be considered in calculating Citizens' allowed secured claim;

(2) Citizens has no interest in the debtor's 1987 bean crop;

(3) the real estate in question provides an equity cushion at this time;

(4) the real estate in question is "necessary for an effective reorganization";

(5) Citizens is adequately protected;

(6) matters pertaining to Citizens' motion for relief from stay as it relates to actions against the Armbrusts as co-obligors of the debtor's notes are continued pending a hearing on whether the Dataphase criteria have been satisfied; and

(7) the debtor has failed to show "extraordinary circumstances" exist at this time to warrant a nunc pro tunc approval of employment of appraiser, accountant and attorney.

THEREFORE, IT IS HEREBY ORDERED that:

(1) Citizens' objection to any deduction of the value of the IRS estate tax lien in calculating its allowed secured claim is sustained;

(2) Citizens' motion to prohibit debtor's use, sale or lease of collateral and motion to marshal assets of the debtor are denied;

(3) Citizens' motion for relief from stay is denied without prejudice; and

(4) Debtor's application for nunc pro tunc employment

of appraiser, accountant and attorney is denied without prejudice. The court approves employment of the appraiser, attorney and accountant for services rendered on October 14, 1987 and thereafter.

Signed and filed this 8th day of March, 1988.

LEE M. JACKWIG

CHIEF U.S. BANKRUPTCY JUDGE

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IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF IOWA
WESTERN DIVISION

ARMBRUST FARM, LTD., Bankr. No. 87-1259-W

Debtor.

ARMBRUST FARM, LTD.,

Appellant, CIVIL NO. 88-38-W

vs. ORDER

CITIZENS STATE BANK,

Appellee.

This matter is before the court on Plaintiff Armbrust Farm, Ltd.Is (hereinafter "Debtor") appeal and Defenda Citizens State Bank's (hereinafter "Bank") cross-appeal of an order of the Honorable Lee M. Jackwig, Chief United States Bankruptcy Judge, Southern District of Iowa, entered on May 8, 1988. After careful consideration, this cour denies the Debtor's appeal and the Bank's cross-appeal. Accordingly, the judgment of the Bankruptcy Court is here affirmed.

I. Facts.

The Debtor is a family farm corporation located in Pottawattamie County, Iowa. The major assets of the corporation include 220 acres of farm land, farm equipment, and some farm products. Jacob H. Armbrust and Marjorie M. Armbrust, husband

and wife, are the major shareholders of the corporation. The Armbrusts' four children also are shareholders. Mrs. Armbrust is president, secretary and treasurer of the corporation. Mr. Armbrust is vice president.

Mr. Armbrust inherited the farm from his father in February 1979. Sometime thereafter, Mr. Armbrust made a special use election under 26 U.S.C. 2032A, which permits real property used for "farming purposes" to be valued for estate tax purposes on the basis of its use as a farm or business rather than on some speculative use. Title 26, United States Code, section 6324B creates a lien in favor of the United States on any property which qualifies under section 2032A to protect the government's interest in the event a recapture tax or additional estate tax is imposed. The lien will become unenforceable after fifteen years provided that the qualified heir continues to employ the property for the qualified use. On August 25, 1982, the Internal Revenue Service (IRS) filed a notice of federal estate tax lien with the County Recorder for Pottawattamie County in the amount of $81,729.93. The purpose of the IRS lien is to secure potential Recapture Tax under section 2032A. The Recapture Tax would be due (1) should the Debtor fail to use the qualified real estate in a trade or business, or (2) should the Armbrusts or their family members fail to materially participate in the farm operation for any period in violation of their agreement.

The Debtor, and Jacob and Marjorie Armbrust executed a promissory note in favor of the Bank in the amount of $90,000.00 on June 11, 1985. The Farmers Home Administration (FMHA)

guaranteed 90% of the $90,000.00 note, or $81,000.00. The Debtor contends that a minimum of $80,000.00 plus accrued interest was for the purpose of paying federal estate taxes. The Bank contends that said loan was for raising crops and livestock. To secure the note, the Debtor and the Armbrusts granted the Bank a mortgage on the farm. This mortgage was recorded after the IRS tax lien. They also granted the Bank a blanket security agreement. The Bank has filed a proof of claim in the amount of $95,717.92 plus $30.51 per them from April 14, 1987. $3,384.00 remains on a separate note secured by a 15,000-bushel bin. Also outstanding is a $20,108.73 operating loan from 1985 secured by a blanket lien.

The parties do not dispute that the Bank had a security interest in the Debtor's 1986 bean crop. In 1987, the Debtor planted 140 acres of beans. Problems with government acreage limitations forced the Debtor to plow up 36 acres of the 140 bushels of beans planted, 130 bushels were from the 1986 crop.

The parties stipulated that the value of the land is $180,000.00 and that the value of the machinery is $14,150.00. In calculating the Bank's allowed secured claim, the Debtor reduced the value of the farm by the amount owed to the Federal Land Bank ($74,970.03), the amount of the IRS tax lien ($81,729.93), $1,700.00 owed to an electrical cooperative, and $4,327.00 in real estate taxes.

The Debtor filed this case on May 7, 1987. About six months later, on October 14, 1987, the Debtor filed an application for employment of an accountant, attorney and appraiser. In its

application, the Debtor states that it did not file the application with the petition because a petition had to be prepared hurriedly.

II. Standard of Review.

Rule 8013, Rules of Bankruptcy Procedure, provides as follows:

> On an appeal the district court . . . may affirm, modify or reverse the bankruptcy judge's judgment, order or decree or remand with instructions for further proceedings. Findings of fact, whether based on oral or documentary evidence, shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the bankruptcy court to judge the credibility of witnesses.

See Bankr. R. 8013. See also In re Hunter, 771 F.2d 1126, 1129 (8th Cir. 1985) (district court bound to uphold all factual findings of a bankruptcy judge unless they are found to be clearly erroneous.).

III. Discussion.

A. Priority of Liens.

Title 11, United States Code, section 1225(a)(5), requires that the plan must provide the secured creditor with property of a value equal to the allowed amount of the creditor's secured claim. The extent of a creditor's secured claim is analyzed pursuant to 11 U.S.C. 506(a), which provides that an allowed claim is a secured claim only "to the extent of the value of such creditor's interest and the estate's interest in such property." As a general rule, if there are liens against the property that are senior to the creditor's lien, the amount of debt secured by senior liens must be deducted in determining the extent to which

the creditor holds a secured claim. 3 Collier on Bankruptcy, 506.04 at 506-19 (15th ed. 1986).

The record indicates that the IRS has a lien on the real estate that is part of the bankruptcy estate (see Debtor's Brief, Attachment B). The lien was filed August 25, 1982 in the amount of $81,729.93. The record also indicates that the Bank's mortgage was not entered into until June 11, 1985, and was not filed of record until June 17, 1985. Therefore, the Debtor argues that the IRS's lien position is first in time and superior to the Bank's lien position. The Debtor further argues that the tax lien is in full force and effect. The Debtor relies on a letter addressed to its attorney from the supervisory attorney of the Nebraska District of the IRS (see Plaintiff's Brief Attachment B) wherein the IRS specifically indicates its intent to enforce its estate tax lien should (1) there be a cessation of qualified use or (2) disposition of the farmland to an unqualified person.

The Debtor points out that the special use valuation is a matter of express congressional intent. It is a right to be earned in the future. After fifteen years and only after fifteen years does the IRS lien abate. However, until the running of the full fifteen-year period, the lien is enforceable. Therefore, the Debtor fully anticipates the IRS tax lien to be enforced and has provided for such in its Chapter 12 bankruptcy plan.[1]

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[1] The Debtor's planned treatment of the IRS lien requires the Debtor to continue farming in order to fulfill the congressional requirement of fifteen years and thereby abate the estate tax lien.

The Bank argues that the IRS's federal estate-tax lien is subordinate to its lien. The Bank further argues that should the court determine that the Bank's lien does not have priority over the IRS lien, the Debtor should not be able to subtract the hypothetical IRS lien in determining the secured status of the Bank. The Bank argues that if the Debtor does as it proposes to do, it will continue farming and never pay so much as one cent to the IRS.

Regarding this issue, the Bankruptcy Court stated:

> The flaw in the debtor's analysis is that a senior lien used to reduce the secured claim of a junior lienholder somehow must be treated in the plan of reorganization. See In re Edwardson, 74 B.R. 831, 835, 836 (Bankr. D. N.D. 1987) (secured creditor's claim was reduced by the real estate taxes due but the debtors were directed to provide for the payment of those taxes in the plan). Although the IRS filed a proof of claim indicating a secured claim in the amount of $81,729.93, the debtor's plan does not provide for payment of that claim or a lien retention by the IRS. The IRS has not objected to the plan nor has the debtor objected to the proof of claim. Presumably both the IRS and the debtor anticipate that the lien will never be enforced. This presumption is reasonable in light of the debtor's articulated intention to continue farming and to carry through a plan of reorganization.
>
> Given the debtor's failure to treat the IRS estate tax lien in its plan and the unlikelihood at this point in time that the lien will be enforced, the debtor may not utilize the value of the tax lien to reduce the allowed secured claim of Citizens. In the event that enforcement of the lien is triggered, the relative positions of the interested parties could be reassessed accordingly by this court (if the three-year plan has not been completed) or by the appropriate nonbankruptcy court (if the case has been closed). Whereas the debtor in effect would gain $81,729.93 at Citizens' expense if the debtor reduced the secured claim of Citizens, received a discharge upon completion of the three-year plan and enforcement of the tax lien was not triggered.

This court finds that the ruling as set forth by the Bankruptcy Court provides the best solution to this issue. It is clear that the IRS lien is a "hypothetical lien" in that it will never be enforced should the Debtor continue farming and carry out its plan of reorganization. Therefore, the court finds that the Debtor cannot utilize the IRS tax lien to reduce the allowed secured claim of the Bank. The court is sure that if the IRS lien is triggered, the relative positions of the parties will be reassessed by the appropriate court under the circumstances that might exist at that time.

B. Application for Employment of Attorney, Accountant and Appraiser.

The Debtor requests late approval of expenditure of funds for employment of its attorney, accountant and appraiser. Employment of professionals is controlled by 11 U.S.C. 327 and Bankr. R. 2014(a). A nunc pro tunc appointment of professionals, retroactive to the date of filing of the bankruptcy petition, will only be granted upon a showing of "extraordinary circumstances." See Matter of Independent Sales Corp., 73 B.R. 772, 777-78 (Bankr. S.D. Iowa 1987). In denying the Debtor's application, the Bankruptcy Court identified five factors to be evaluated in determining whether extraordinary circumstances exist: (1) whether the applicant or some other person bore responsibility for applying for approval; (2) whether the applicant was under time pressure to begin service without approval; (3) the amount of delay after the applicant learned that the initial approval

had not been granted; (4) the extent to which compensation to the applicant will prejudice innocent third parties; and (5) other relevant factors.

Debtor argues that its attorney was under extreme time pressure to begin prior to approval in that: (1) Said Debtor originally had no intention or plan to file bankruptcy; (2) while the Debtor prepared for the 1987 planting season, its officers were advised by the ASCS office that the Commodity Credit Corporation, because of deteriorated corn discovered upon delivery, had exercised a setoff against the farm program payment which took away all working capital of the Debtor and the Debtor received no farm payments whatsoever in the spring of 1987; and (3) due to the emergency of the Debtor to be able to plant for

The 1987 corn crop, a Chapter 12 petition was hurriedly prepared

And filed just days before planting began.

The Bank argues that the Debtor's request to have said

appointment made effective as of the date of filing its petition should be denied herein. The Bank relies on In re Matter of Wilson, No. 87-1402-C (Bankr. S.D. Iowa Apr. 18, 1988), wherein the court held that "oversight, inadvertence or ignorance" is not an extraordinary circumstance so as to justify nunc pro tunc authorization of employment.

In the instant case, the Bankruptcy Court stated:

> Application of these standards to the instant case leads the court to conclude that the debtor has not shown "extraordinary circumstances" that merit nunc pro tunc appointment . . . Applications in most cases are filed with the petitions for relief and are approved by the court as a matter of course. If an emergency does arise where it is impossible to file an application with the petition, the court expects that an application will be filed soon after the petition filing. Here, more than five months elapsed between the filing

of the petition and the submission of the application.

> Finally, it is too early to tell whether third parties will be prejudiced by the untimely application. In the event the case proves unsuccessful, third parties such as creditors will be harmed by the delay caused by the filings.

(Emphasis added.)

The court agrees with the reasoning as set forth by the Bankruptcy Court above. The court specifically points out that this situation may have been viewed differently by the court had less time elapsed between the filing of the bankruptcy petition and the submission of the application for court approval for employment the accountant, attorney and appraiser. However, under the circumstances as they existed herein, the court finds that the Debtor failed to show that extraordinary circumstances existed.

C. The 1987 Bean Crop.

The record indicates that the Bank had a valid lien on the Debtor's 1986 bean crop. In 1987, the Debtor ended up with 104 acres of beans. Although these beans were all planted after filing of the Chapter 12 petition, 94 of the 104 total acres were planted with seed beans from the 1986 crop.

The Bank points out that as a rule, 11 U.SOC. 552(a) nullifies any pre-petition liens to the extent that they include after-acquired property of the Debtor. See 4 Collier on Bankruptcy, p. 552.01 (15th edo 1983); In re Albright Sign Services Co., Inc., 11 B.R. 409 (Bankr. W.D. Ky. 1981). However, if after-acquired property of the estate constitutes "proceeds, products, offspring, rents or profits" emanating from pre-

petition assets of the Debtor, then the lien established by the security agreement attaches to the extent allowed by applicable nonbankruptcy law. See In re Hugo, 50 B.R. 963, 967 (Bankr. E.D. Mich. 1985).

The Bank argues its security interest in 94 acres of the Debtor's 1987 bean crop falls within the aforesaid exception. The Bank contends that its security interest in the 94 acres stems from the fact that they are "identifiable non-cash proceeds" as set forth in the Iowa Code § 554.9306(4)(a). Iowa Code § 553.9306(i) defines proceeds as "whatever is received upon the sale, exchange, collection or other disposition of collateral or proceeds." The Debtor argues that the 1986 beans were not sold, exchanged or collected. Therefore, the Debtor further argues that it did not receive anything that would constitute proceeds. The Debtor relies on Farmers Coop. Elevator v. Union State Bank, 409 N.W.2d 178 (Iowa 1987), wherein the court decided that hogs which ate encumbered feed were not proceeds. In Farmers Coop., the Iowa Supreme Court interpreted the "other disposition of collateral" language as used in section 554.9306(l). In so doing, the court stated: "Biological transformation of feed is not a type of 'other disposition' within the contemplation of section 554.9306.11

In the instant case, the Bankruptcy Court found that the Debtor received nothing in terms of "proceeds" when it disposed of the 1986 beans by planting them. There was no sale, exchange or collection of the beans. The court also held that the biological transformation of beans into soybean plants is not an

"other disposition" for purposes of section 554.9306. Therefore, the Bankruptcy Court concluded that the mature soybean plants were not proceeds of the 1986 beans.

This court agrees and finds that the Bank does not have a valid lien on the 1987 bean crop. See Farmers Coop. Elevator v. Union State Bank, 409 N.W.2d 178 (Iowa 1987).

D. Bank's Motion to Marshal Assets.

For the reasons and authorities set forth in the preceding section of this order, the court finds that the Bankruptcy Court did not err in denying the Bank's motion.to marshal assets. Accordingly, the court will not further belabor its ruling herein.

IT IS THEREFORE ORDERED that the Debtor's appeal of the Bankruptcy Court's order of May 8, 1588 is hereby denied.

IT IS FURTHER ORDERED that the Bank's cross-appeal of the Bankruptcy Court's order of May 8, 1988 is hereby denied.

IT IS FURTHER ORDERED that the judgment of the Bankruptcy Court is hereby affirmed.

December 1988.

Donald E. O'Brien, Judge
UNITED STATES DISTRICT COURT