

UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In the Matter of

JOHNNIE E. FERRARI and
MARY JANE FERRARI,

Debtors.

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Case No. 87-2841-C H
Chapter 12

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ORDER - OBJECTION TO CONFIRMATION OF PLAN

On December 20, 1988, a hearing was held on confirmation of Debtors' first amended Chapter 12 plan. The following attorneys appeared on behalf of their respective clients: Jim P. Robbins for Boone State Bank (hereinafter "Bank"); and Dan Childers for Debtors.

The Chapter 12 Trustee, Anita L. Shodeen, also appeared. At the conclusion of said hearing the Court took the matter under advisement with a briefing deadline. Briefs were timely filed and the Court considers the matter fully submitted.

This is a core proceeding pursuant to 28 U.S.C. §157(b)(2)(L). The Court, upon review of the file, evidence and briefs, now enters its findings and conclusions pursuant to Rule 7052, Fed.R.Bankr.P.

FINDINGS OF FACT

1. Debtors filed a Chapter 12 petition on November 17, 1987.
2. Debtors are farmers residing at R.R. 1, Box 115, Pilot Mound, Boone County, Iowa. Mr. and Mrs. Ferrari are 63 and 62 years of age, respectively. They have been farming since 1941. They purchased the original 160 acres and moved into an old school house which they remodeled into their home. The neighborhood includes timbered land along the Des Moines River in the northern part of

Boone County.

3. Debtors are the owners of four parcels of real estate, all located in Boone County. These parcels are designated and described as follows:

Parcel 1: Northwest Quarter (NW 1/4) Southwest quarter (SW 1/4) of Section 22, Township Eighty-five (85) North, Range Twenty-seven (27) West of the 5th P.M.

Parcel 2: North East quarter (NE 1/4) Southwest quarter (SW 1/4) and South half (S 1/2) Southwest quarter (SW 1/4) Section 22, Township eighty five (85) North Range twenty seven (27) West of the 5th P.M., except one and half (1 1/2) acres in the Southwest quarter (SW 1/4).

Parcel 3: Southeast Quarter (SE 1/4) of Southeast Quarter (SE 1/4) of Section Nine (9), Township Eighty-five (85) North, Range Twenty-seven (27) West of the 5th P.M.

Parcel 4: East half (E 1/2) of South East Quarter (SE 1/4) of Section Twenty-one (21), Township eight-five (85) North, Range twenty-seven (27), West of the 5th P.M.

4. Parcel 1 is a 40-acre tract which includes Debtors' homestead. This parcel is not encumbered by Bank. A dead-end county road serves this parcel.

5. Parcel 2 contains 120 acres and is adjacent to parcel 1; they combine to form the original 160 acres. Access to Parcel 2 is through Parcel 1. There are approximately 50 tillable acres in this tract. The balance is timber with limited agricultural value. This is a bare 120 acres with irregular fields and lighter soils which reduce the yields.

6. Parcel 3 is a 40-acre tract located 1.5 miles north of Parcels 1, 2 and 4. There are county gravel roads on the north and east of this parcel. There are approximately 35 tillable acres in this tract. This land is highly erodeable. However, the quality of land in this parcel is significantly higher as compared to the land in Parcels 2 and 4. There is a building site in the northeast portion of this tract. There are no interior fences except around the building site.

7. Parcel 4 is an 80-acre tract with approximately 10 acres of cropland, and the balance is rough timber. The dead-end road serving parcel 1 also serves this tract. The fields in this tract are irregular in shape with limited access.

8. Both Debtors and Bank have had the real estate appraised for purposes of determining Bank's interest in the real estate. Bank has a first mortgage on Parcel 3 and a second mortgage on Parcels 2 and 4.

9. Bank's original appraisal, as of September 7, 1988, attributed the following values to the respective tracts:

Parcel 2	\$38,400.00
Parcel 3	\$42,000.00
Parcel 4	<u>\$17,600.00</u>
Total	\$98,000.00

10. Bank's appraiser adjusted the appraised value of Parcel 3

at the time of hearing, December 20, 1988, and gave Parcel 3 a value of \$44,000.00 at that time.

11. Debtors' appraisal, adjusted to the time of hearing, attributes the following values to the respective tracts:

Parcel 2	\$30,744.00
Parcel 3	\$24,472.00
Parcel 4	<u>\$22,000.00</u>
TOTAL	\$77,216.00

12. SBA has a first mortgage on Parcel 4 in the amount of \$9,847.00.

13. The Iowa Chapter Realtors Land Institute's survey for the period between September 1, 1987, and April 1, 1988, reveals that there has been a 20% increase in real estate values on a cash basis for bare, unimproved land located in that area of the state. However, the greatest increase has been in the better quality land in Boone County. Both appraisers described Debtors' real estate as below average for that area.

14. Debtors, by Agricultural Security Agreements dated June 4, 1985, and April 2, 1986, granted Bank a security interest in:

All of Debtor's interest in equipment, vehicles, machinery, farm products [including all crops (annual or perennial, of every kind, both harvested, growing, or to be grown in the future, and all negotiable or non-negotiable Warehouse Receipts or other documents evidencing title or an interest in said crops), livestock

(all substitutes, additions, issue, products or proceeds thereof), all supplies used or produced in Debtor's farming operations, seed, chemicals, feed and products of crops and livestock], fixtures, accounts and accounts receivable, documents, contract rights, inventory, and general intangibles, whether now owned or hereafter acquired and wherever located, and all products of, proceeds of, additions to, replacements of, and returns and repossessions of such collateral, and all accessories, accessions, parts and equipment now or hereafter affixed to such collateral; all types of government program payments, including but not limited to benefits to be received under reduced acreage or payment in kind program; and all insurance proceeds pertaining to the above described collateral. In claiming proceeds, the secured party does not consent to sale or disposal of the collateral.

15. Debtors have machinery and equipment with a value of \$20,075.00. However, Debtors omitted a cultivator, auger, picker and harrow, all old equipment, from their machinery inventory. The omitted items of machinery have a combined value of \$260.00.

16. Debtors have livestock with a value of \$3,790.00.

17. Debtors have crops on hand with a value of \$1,410.00.

18. Debtors have sold 1987 crops with net receipts of \$28,944.00. In addition, Debtors have 2,500 bushels of ear corn which has a value of \$2.40 per bushel. It will cost 7 cents a bushel to shell and transport this ear corn.

19. Debtors have PIK Certificates from the 1986 crop year in the amount of \$1,699.00.

20. Bank financed the 1986 crop but not the 1987 crop.

21. Debtors received post-petition payments under the 1987 government program totaling \$3,576.00. Of this total, \$2,572.83 was

received in cash and \$1,003.17 was received in PIK certificates.

22. By Order of May 6, 1988, Debtors avoided Bank's lien which impaired a properly claimed exemption on machinery and equipment. This value reduction amounted to \$20,000.00.

23. Boone County, Iowa, has a statutory lien on the real estate in the amount of \$2,040.00 for real estate taxes.

DISCUSSION

Bankruptcy Code §1225(a) sets out six requirements that must be met before the court can confirm a Chapter 12 plan. Bank has objected to the treatment of its secured claim on two grounds: 1) valuation of real estate, crops and equipment; and 2) length of plan.

The Court will separately address each of these grounds.

A. Valuation of Collateral

In the post-hearing briefs, Bank argued the total amount of its allowed secured claim is \$133,936.00 while Debtors argued Bank's total allowed secured claim is \$107,345.00. The discrepancy is due to the parties' disagreement on the following values: 1) real estate; 2) PIK certificates and payments; 3) additional equipment; and 4) 1987 corn.

1. Real Estate

Both parties obtained appraisals for the three parcels of real estate in question. Bank's appraisal on all three totaled \$98,000.00 while Debtors' appraisal totaled \$77,216.00. There is a discrepancy between Debtors' appraiser's report as of May 27, 1987, and his

testimony at the hearing. Debtors used the appraised figure on Parcel 3 in their schedules while the appraiser's testimony at the hearing disclosed a lower appraised value than the value listed on his May 27, 1987 report. This discrepancy has not been explained. Consequently, the Court cannot give as much weight to Debtors' appraisal.

Bank's appraisal is more thorough. However, the land on Parcel 3 is below average for that area of the state and Bank's original appraisal fee of \$42,000.00 or \$1,050.00 per acre, considering the comparable sales, appears to be more reasonable than the appraiser's final appraised value of \$44,000.00. Bank's appraiser testified there has not been a significant increase in value in Parcels 2 and 4 since his written appraisal. There is insufficient showing of an increase in value in Parcel 3 since the original appraisal, which was as of September 7, 1988. As a result, the Court concludes the real estate values in Bank's secured claim are as follows:

1st mortgage	Parcel 3	\$42,000.00
2nd mortgage	Parcel 2	\$38,400.00
2nd mortgage	Parcel 4	\$17,600.00
less SBA 1st mortgage	Parcel 4	<u>(\$ 9,847.00)</u>
		\$88,153.00

2. PIK Certificates and Payments

The issue concerning the farm program payments is whether Bank has a valid security interest in the 1986 PIK certificates and the 1987 PIK certificates and cash. Although the parties' security

agreements of June 4, 1985, and April 2, 1986, granted Bank a security interest in PIK benefits, Debtors rely on the holding in Matter of Halls, 79 B.R. 417 (Bankr. S.D. Iowa 1987) to deny Bank's security interest in any of the PIK benefits.

The starting point in addressing this issue is 16 U.S.C. §590h(g) which sets out the general guidelines for assignment of farm program payments. Said section allows assignments as security "for cash or advances to finance making a crop" but precludes assignments to "pay or secure any preexisting indebtedness." Various regulations including 7 CFR §709 also regulate assignments and provide for the same treatment as found in 16 U.S.C. §590h(g), i.e., may assign as security to finance making a crop but may not assign to secure preexisting indebtedness. 7 CFR §709.3(a).

Individual farm programs and their accompanying regulations may modify the general assignment provisions of 16 U.S.C. §590 and 7 CFR §709. CRP regulations allow assignments complying with 16 U.S.C. §590, and said assignments may pay or secure preexisting indebtedness. See 7 CFR §704.18. PIK regulations, on the other hand, prohibit any assignment in spite of §590h(g), including one to finance a crop. See 7 CFR §§770.4(b)(2), 770.6. These PIK regulations state:

Commodity certificates shall not be subject to any lien, encumbrance, or other claim or security interest except that of an agency of the United States Government arising specifically under Federal statute.

7 CFR §770.4(b)(2).

[N]otwithstanding any other provision of this chapter, a payment made under this part may not be the subject of an assignment, except as determined and announced by the CCC.

7 CFR §770.6.

There is a split of authority concerning the impact of 7 CFR §§770.4(b)(2) and 770.6 on the assignability of a PIK certificate as security. In Matter of Halls, 79 B.R. 417, 420 (Bankr. S.D. Iowa 1987), the court reviewed the above regulations and concluded PIK certificates cannot be encumbered because 7 CFR §770.6 precludes assignment of payments to creditors for planting, cultivating and harvesting a crop, and because 7 CFR §770.4(b) states that commodity certificates shall not be subject to any encumbrance. In addition, the court held the supremacy clause dictates that state law on secured transactions must yield to these regulations to the extent a conflict exists. Id. at 421.

In In re Arnold, 88 B.R. 917, 921 (Bankr. N.D. Iowa 1988), the court also reviewed 7 CFR §§770.4(b)(2) and 770.6 but held they did not validly preempt state law on secured transactions because the necessary authorization by Congress to CCC to preempt state law was absent. The court also relied upon In re Sunberg, 729 F.2d 561 (8th Cir. 1984) in concluding that "antiassignment" clauses such as 7 CFR §770.6 are not intended to preempt state law between third parties but rather were created to insulate the government as benefit provider from conflicting claims over payments. Id. at 921-22. Finally, the court determined that PIK certificates could be assigned

as security but only to the extent the security interest conforms with the requirements of 16 U.S.C. §590h(g), i.e., for cash or advances to finance making the crop and not to secure any preexisting indebtedness. Id. at 922.

Upon review of these two lines of authority, the Court agrees with the Arnold approach. Applying this to the case at bar, the Court finds Bank has a valid security interest in Debtors' two 1986 PIK certificates, valued at \$1,699.00, because Bank financed Debtors' 1986 crop. Since Bank did not finance Debtors' 1987 crop, 16 U.S.C. §590h(g) and 7 CFR §709.3(a) prevent Bank from acquiring a valid security interest in Debtors' 1987 PIK certificates and payments totaling \$3,576.00. As a result, the Court concludes Bank's secured claim only includes Debtors' 1986 PIK certificates valued at \$1,699.00.

3. Additional Machinery and 1987 Crop

The parties have minor value disagreements on additional machinery and equipment and the 1987 crop. Concerning machinery and equipment, the Court agrees with Bank that Debtors omitted a cultivator, auger, picker, and harrow from their machinery inventory and that said machinery has a combined total value of \$260.00. Adding this to the listed machinery and equipment valued at \$20,075.00, the value of Debtors' machinery totals \$20,335.00.

The second minor disagreement goes to 1987 corn. Both parties agree there are 2,500 bushels with a cash price of \$2.40 per bushel but disagree concerning the cost of shelling and transportation. The

Court previously found 7 cents per bushel is a reasonable figure to shell and transport the corn. As a result, the Court concludes the value of Debtors' unsold 1987 corn crop of 2,500 bushels at \$2.33 per bushel equals \$5,825.00. Combined with the \$28,944.00 of net proceeds from the previously sold 1987 crop, Debtors' 1987 crops have a total value of \$34,769.00.

4. Total Value of Bank's Secured Claim

Based on the above discussion, the Court concludes Bank's allowed secured claim equals \$128,320.00 and is broken down as follows:

1st mortgage	Parcel 3	\$42,000.00
2nd mortgage	Parcels 2 & 4	46,153.00
(SBA's mortgage deducted)		
Machinery and equipment		20,075.00
Additional equipment		260.00
Livestock		3,790.00
Crops on hand		1,410.00
1987 crop		
(Sold)		28,944.00
2500 bu. of corn @ \$2.33 bu.		5,825.00
Uncashed check		204.00
1986 PIK certificates		<u>1,699.00</u>
Total		\$150,360.00
Minus - §522(f) lien avoidance on		
machinery and equipment		<u>20,000.00</u>
		\$130,360.00
Minus - real estate taxes		<u><u>2,040.00</u></u>
Bank's total secured value		<u><u>\$128,320.00</u></u>

B. Length of Plan

Bank challenges Debtors' proposal to extend the term of repayment of Bank's claim for 25 years. Under §§1222(b)(9) and (c), the Court for cause can allow Debtors to make payments over a period longer than 3-5 years provided Bank retains its lien and receives its property with a present value equal to its allowed secured claim. See Matter of Simmons, 86 B.R. 160, 162 (Bankr. S.D. Iowa 1988). In Simmons, Chief Judge Jackwig discusses lengths of plans and notes the court has permitted a debtor to pay claim secured by real estate over a period of 30 years and claims secured by machinery and livestock for no more than 7 years. Id. Simmons demonstrates the Court's discretion to set what it believes is a reasonable repayment period.

In the case at bar, Bank's claim is secured by real estate,

machinery, livestock and crops, with real estate making up approximately two-thirds of the collateral value. Debtors' plan does provide Bank with a continuing lien. The fact Debtors are in their sixties does not persuade the Court that 25 years is an unreasonable repayment term. It is common practice for financial institutions to refinance farmers in this age group with loans of that length. At retirement and/or death, the land is sold and debt paid, or another person assumes the debt and takes over the operation. Given these facts and the Court's discretion under Simmons, the Court concludes Debtors' 25 year repayment term is reasonable.

C. Feasibility--§1225(a)(6)

Section 1225(a)(6) requires that a debtor will be able to make all payments under and comply with the plan. In the case sub judice Debtor filed a cash flow with their original plan but did not file the same with their first amended plan. The issues of the value of Bank's allowed secured claim and length of plan are now resolved. The remaining issue is the feasibility of the first amended plan. Based upon the above ruling, and without waiving any objections thereto, Debtors must file a cash flow addressing all their commitments under the first amended plan in order for the Court to determine whether the first amended plan is feasible.

CONCLUSION AND ORDER

WHEREFORE, based on the foregoing analysis, the Court concludes the allowed amount of Bank's secured claim is \$128,320.00 and that Debtors' 25 year repayment term for this claim is reasonable.

IT IS ACCORDINGLY ORDERED, as follows:

(1) Boone State Bank's allowed secured claim is set in the amount of \$128,320.00;

(2) the amortization of Boone State Bank's allowed secured claim is approved for twenty-five (25) years; and

(3) Debtors shall file a cash flow within twenty (20) days of the filing of this Order. Within ten (10) days thereafter, Boone State Bank shall file objections, if any, to Debtors' cash flow under their first amended plan. Further hearing, if any is required, shall be set upon further order of the Court.

Dated this 8th day of May, 1989.

RUSSELL J. HILL
U.S. BANKRUPTCY JUDGE