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## PAYING CREDITORS DIRECTLY IN CHAPTER 12 BANKRUPTCY

— by Neil E. Harl\*

Recent cases in the Sixth<sup>1</sup> and Eighth<sup>2</sup> Circuit Courts of Appeal have allowed debtors under Chapter 12 bankruptcy to make payments directly to a creditor and avoid paying the trustee's fee.<sup>3</sup> An earlier Ninth Circuit Court of Appeal case had held that a Chapter 12 bankruptcy does not authorize a debtor to make payments directly to creditors for claims modified by the plan in order to avoid paying the trustee's fee.<sup>4</sup>

### The trustee's fee

A trustee is appointed in every Chapter 12 bankruptcy case.<sup>5</sup> The compensation to Chapter 12 trustees is not to exceed 10 percent of payments made for the first \$450,000 of payments under the plan.<sup>6</sup> After the aggregate amount of payments made under the plan exceeds \$450,000, the fee is not to exceed 3 percent.<sup>7</sup> Note that the percentage amounts are ceilings.

The statute specifies that the trustee is to ". . . collect such percentage fee from all payments received by such individual under plans in the cases under Chapter 12 . . . for which such individual serves as standing trustee."<sup>8</sup>

### Trustee's fee on fully secured claims

The courts have generally recognized that payments on fully secured claims that are not modified by the bankruptcy plan can be paid directly to the creditor.<sup>9</sup> Such payments are not "received by"<sup>10</sup> the trustee and thus are not subject to the trustee's fee.<sup>11</sup>

### Trustee's fee on impaired claims

For claims that are impaired, the courts have been divided.<sup>12</sup> A number of bankruptcy courts have required all payments made on impaired claims to be paid through the trustee and thus subject to the trustee's fee.<sup>13</sup> Other courts allowed debtors to make payments on impaired claims directly to creditors either with no trustee's fee<sup>14</sup> or a reduced trustee's fee.<sup>15</sup> The court held that transfers in kind are not payments under the plan and are not subject to the trustee's fee.<sup>16</sup>

Two United States Courts of Appeal have held that a Chapter 12 debtor may not bypass the trustee when making

payments on impaired claims.<sup>17</sup> In the Ninth Circuit case, *In re Fulkrod*,<sup>18</sup> the court affirmed per curiam a decision of the Bankruptcy Appellate Panel holding that payments could not be made directly to creditors to avoid the trustee's fee.<sup>19</sup> The court was influenced by the argument that "Congress clearly intended that the trustee in bankruptcy play a significant role in the administration of estates under Chapter 12" and found that allowing direct payments to creditors without payment of the trustee's fee "is hardly an outcome Congress would have intended."<sup>20</sup> The court even distanced itself from language in the lower court decision that "hinted that Chapter 12 might permit a debtor to make direct payments to impaired creditors without trustee compensation in certain limited circumstances."<sup>21</sup>

By contrast, the Eighth Circuit Court of Appeals in a 1994 case, *In re Wagner*,<sup>22</sup> approved payments to impaired secured creditors with no trustee's fees paid. The debtors' plan contained language that appeared to exclude the payments from trustee's fees where payments were made directly to the creditors.<sup>23</sup> The court agreed that the debtors' plans permitted them to make direct payments to their impaired secured creditors and held that such payments were not in conflict with the bankruptcy code.<sup>24</sup> Indeed, the court stated that trustee's fees are only required for payments "received by"<sup>25</sup> the trustee. The Eighth Circuit dismissed *In re Fulkrod*,<sup>26</sup> the Ninth Circuit decision, as "not based upon a close textual analysis of the Chapter 12 statutes but upon policy grounds."<sup>27</sup>

The latest Court of Appeals case, *In re Beard*,<sup>28</sup> decided by the Sixth Circuit Court of Appeals in early 1995, held that a Chapter 12 debtor may bypass the trustee and pay the secured portion of an undersecured debt to the creditor.<sup>29</sup> The court agreed with the Eighth Circuit in *In re Wagner*<sup>30</sup> that a direct payment is not "received by" the trustee and thus the trustee is not entitled to a percentage of the payment.<sup>31</sup> The court noted that, had Congress desired a different result, it could have worded the statute in terms of "payments received or that could have been received."<sup>32</sup>

Without much doubt, the U.S. Supreme Court will be asked to resolve the conflict in the circuits.

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**Note: The Agricultural Law Press office will be closed from April 28 through May 21, 1995 for vacation. The next issue of the Digest will be published June 2, 1995.**

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### Implications for Chapter 13

Because the statutory provision relating to payments "received by" the trustee<sup>33</sup> applies to Chapter 13 bankruptcies as well as those under Chapter 12, the controversy is important also to Chapter 13 filers. However, it should be noted that the provision allowing direct payment of secured claims for Chapter 12 filings<sup>34</sup> is not identical to the corresponding provision under Chapter 13.<sup>35</sup> The Chapter 13 statute omits the language in Chapter 12 that permits direct payments to the secured creditors "by the trustee or the debtor."<sup>36</sup>

#### FOOTNOTES

- <sup>1</sup> *In re Beard*, 45 F.3d 113 (6th Cir. 1995).
- <sup>2</sup> *In re Wagner*, 36 F.3d 723 (8th Cir. 1994).
- <sup>3</sup> See generally 13 Harl, *Agricultural Law* § 120.08[3] (1995); Harl, *Agricultural Law Manual* § 13.03[8][b] (1995).
- <sup>4</sup> *In re Fulkrod*, 973 F.2d 801 (9th Cir. 1992).
- <sup>5</sup> 11 U.S.C. § 1202(a).
- <sup>6</sup> 11 U.S.C. § 1202(d)(1)(B)(i).
- <sup>7</sup> 11 U.S.C. § 1202(d)(1)(B)(ii).
- <sup>8</sup> 28 U.S.C. § 586(e)(2) (emphasis added).
- <sup>9</sup> 11 U.S.C. § 1225(a)(5)(B)(ii) (allowing distribution "by the trustee or the debtor" of debtor property "with respect to each allowed secured claim"). See, e.g., *In re Erickson Partnership*, 77 B.R. 738 (Bankr. S.D. 1987), *appeal dismissed*, 871 F.2d 1092 (8th Cir. 1989). See also *In re Beard*, 45 F.3d 113, 119 (6th Cir. 1995) (dictum).
- <sup>10</sup> 28 U.S.C. § 586(e)(2).
- <sup>11</sup> See, e.g., *In re Erickson Partnership*, 77 B.R. 738 (Bankr. D. S.D. 1987), *appeal dismissed*, 871 F.2d 1092 (8th Cir. 1989) (payments made outside of plan for claims not modified by plan or modified by agreement of creditor not subject to trustee's fee).

- <sup>12</sup> See 13 Harl, *supra* n. 3, § 120.08[3]; Harl, *supra* n. 3, § 13.03[8][b].
- <sup>13</sup> E.g., *In re Rott*, 73 B.R. 366 (Bankr. D. N.D. 1987); *In re Hagensick*, 73 B.R. 710 (Bankr. N.D. Iowa 1987).
- <sup>14</sup> E.g., *In re Land*, 82 B.R. 572 (Bankr. D. Colo. 1988), *aff'd*, 96 B.R. 310 (D. Colo. 1988); *In re Crum*, 85 B.R. 878 (Bankr. N.D. Fla. 1988); *Matter of Pianowski*, 92 B.R. 225 (Bankr. W.D. Mich. 1988).
- <sup>15</sup> See *In re Cannon*, 93 B.R. 746 (Bankr. N.D. Fla. 1988) (trustee's fees for payments made directly to creditors set at one-half trustee's fee for payments made through trustee).
- <sup>16</sup> *In re Mikkelsen Farms, Inc.*, 74 B.R. 280 (Bankr. D. Or. 1987).
- <sup>17</sup> *In re Schollett*, 980 F.2d 639 (10th Cir. 1992); *In re Fulkrod*, 973 F.2d 801 (9th Cir. 1992).
- <sup>18</sup> Note 17 *supra*.
- <sup>19</sup> *Id.*
- <sup>20</sup> 973 F.2d 801, 802 (9th Cir. 1992).
- <sup>21</sup> 973 F.2d 801, 803 (9th Cir. 1992) (dictum).
- <sup>22</sup> 36 F.3d 724 (8th Cir. 1994).
- <sup>23</sup> 36 F.3d 723, 725 (8th Cir. 1994).
- <sup>24</sup> 36 F.3d 723, 727 (8th Cir. 1994).
- <sup>25</sup> See 28 U.S.C. § 586(e)(2).
- <sup>26</sup> Note 17 *supra*.
- <sup>27</sup> 36 F.3d 723, 726 (8th Cir. 1994).
- <sup>28</sup> 45 F.3d 113 (6th Cir. 1995).
- <sup>29</sup> *Id.*
- <sup>30</sup> Note 2 *supra*.
- <sup>31</sup> See 45 F.3d 113, 119 (6th Cir. 1995).
- <sup>32</sup> *Id.*
- <sup>33</sup> See 28 U.S.C. § 586(e)(2).
- <sup>34</sup> 11 U.S.C. § 1225(a)(5)(B)(ii).
- <sup>35</sup> 11 U.S.C. § 1325(a)(5)(B)(ii).
- <sup>36</sup> See 11 U.S.C. §§ 1225(a)(5)(B)(ii), 1325(a)(5)(B)(ii).

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## CASES, REGULATIONS AND STATUTES

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by Robert P. Achenbach, Jr.

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### BANKRUPTCY

#### GENERAL-ALM § 13.03.\*

**AUTOMATIC STAY.** The debtor was a grain storage facility. The debtor experienced financial difficulty and surrendered its state license but filed for bankruptcy before the Illinois Department of Agriculture (IDA) began to liquidate the debtor's grain assets. The IDA sought relief from the automatic stay in order to liquidate the debtor's grain assets. The Bankruptcy Court had granted the relief, holding that the debtor's chance of a successful reorganization was not good; therefore, the creditors would be better served if the IDA liquidated the debtor's assets. The debtor argued that IDA lost its right to liquidate the assets once the debtor filed for bankruptcy. The appellate court affirmed, holding that although the IDA's right to liquidate was subject to bankruptcy law, the relief was granted for sufficient cause because of the perishability of the grain and the debtor's poor chances of a successful reorganization which would restore its license. **Matter of C & S Grain Co., Inc.**, 47 F.3d 233 (7th Cir. 1995).

#### EXEMPTIONS

**AVOIDABLE LIENS.** The debtor sought to avoid a judicial lien on the debtor's homestead which was claimed

as an exemption under N.Y. C.P.L.R. § 5206(a). The court held that the state exemption provided that in the event of a sale of the homestead, the debtor would receive the exemption amount before payment of any judicial liens; therefore, the judicial lien could not impair the homestead exemption and was not avoidable. **In re Giordano**, 177 B.R. 451 (Bankr. E.D. N.Y. 1995).

**TOOLS OF THE TRADE.** The debtors, husband and wife, claimed an exemption for a feed truck as a tool of their farming business. A creditor objected to the exemption, arguing that the wife did not have an ownership interest in the truck and was not in the business of farming; therefore, the truck was not eligible for a tool of the trade exemption as to the wife. The wife's name was on the title for the truck and she provided a substantial amount of help with the farm operation. The wife did work two days a week as a beautician but her income from that job was far less than half of the farm income. The court held that the wife owned an interest in the truck as a spouse and that the wife's business was farming for the purposes of the exemption; therefore, the wife was qualified to claim an exemption for the truck as a tool of the trade. **In re Zink**, 177 B.R. 713 (Bankr. D. Kan. 1995).