

UNITED STATES BANKRUPTCY COURT

DISTRICT OF SOUTH DAKOTA
ROOM 211
FEDERAL BUILDING AND U.S. POST OFFICE
225 SOUTH PIERRE STREET
PIERRE, SOUTH DAKOTA 57501-2463

IRVIN N. HOYT
BANKRUPTCY JUDGE

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June 1, 2004

Daniel J. Brown, Esq.
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Subject: *In re Cloverleaf Farmers' Cooperative, Inc.*,
Chapter 12; Bankr. No. 89-40531

Dear Mr. Brown:

The matter before the Court is Debtor's April 20, 2004, Motion to Avoid Lien. This is a core proceeding under 28 U.S.C. § 157(b)(2). This letter decision and accompanying order shall constitute the Court's findings and conclusions pursuant to Fed.Rs.Bankr.P. 7052 and 9014(c). As discussed below, Debtor's Motion will be granted.

Summary. Cloverleaf Farmer's Co-operative ("Debtor") filed a Chapter 12 petition in bankruptcy on November 9, 1989. Among its creditors, Debtor listed the Small Business Administration ("SBA") as holding a claim for \$95,000. Debtor's schedules stated the debt arose from a 1981 promissory note that was secured by a second mortgage on 1,920 acres of land. Debtor's schedules further stated that the market value of the collateral was zero, presumably because no equity existed in the subject real property to support the second mortgage.

SBA filed a proof of claim on November 19, 1989. SBA stated it had a claim for \$87,460.98 in principal and \$8,458.55 in interest for a total of \$95,919.53. SBA stated that its claim was secured by a right of setoff and mortgages on real property in Miner and Kingsbury counties in South Dakota.

On January 16, 1990, Debtor filed a motion seeking a determination of the SBA's secured interest in some Conservation Reserve Program ("CRP") payments from the government. SBA contested the motion and urged the Court to find that it had a right to offset its pre-petition claim against the government funds that Debtor was scheduled to receive. SBA also asked the Court, by a separate motion, to sequester the CRP payments as rent in which the SBA had received on assignment from Debtor based on a pre-petition default. SBA also moved for relief from the stay to

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effect the requested setoff.

Following a February 6, 1990, hearing, Debtor's motion to determine secured status was dismissed for procedural reasons. The Court¹ denied SBA's setoff motion on the grounds that the CRP payments did not constitute rent from the secured real property, and the Court denied SBA's rent sequestration motion on the grounds that SBA had not perfected a security interest in the CRP payments.

On November 26, 1990, the Farmers Home Administration ("FmHA") filed a motion seeking a valuation of its collateral. Debtor filed a plan on January 9, 1991. The plan stated FmHA, the first mortgage lien holder, was unsecured by nearly \$200,000. The plan listed SBA in the class of undersecured or unsecured creditors and stated SBA held a claim for \$95,919.53. The plan proposed to pay the undersecured and unsecured creditors, at most, any disposable income earned during the plan term.

Several objections to confirmation were filed. SBA was not one of the objectors. FmHA and Debtor eventually agreed that the value of FmHA's secured claim, and thus the value of Debtors' real property on which FmHA had a mortgage, was \$550,000, and that FmHA held an unsecured claim for \$100,985.19. Debtor obtained a confirmation order on April 19, 1991. A Restated Chapter 12 Plan, now known in this District as a Plan as Confirmed, was filed May 1, 1991. It classified the SBA as holding an unsecured claim for \$95,919.53. The Restated Plan did not propose any payments to the class of unsecured claim holders. Though the Restated Plan was unclear about whether Debtor had committed its disposable income to pay unsecured creditors, FmHA's and Debtor's agreement stated that Debtor had made that commitment.²

After navigating several post-confirmation roadblocks, Debtor filed its final report and account on May 27, 1994. Debtor received a Chapter 12 discharge on July 26, 1994. The case trustee filed his final report on July 28, 1994. He stated no payments were made to unsecured creditors. On Debtor's motion, to which no objections were filed, several judgments and judgment liens were

¹ The Hon. Peder K. Ecker, presiding.

² The undersigned conducted hearings in this case in May and early June 1991.

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discharged by Order entered September 21, 1994.³ The case was closed on October 4, 1994.

On April 20, 2004, Debtor filed a Motion to Avoid Lien under 11 U.S.C. § 506(d). Therein, Debtor asked the Court to avoid the mortgages that SBA had on Debtor's real property. Debtor based the motion on the lack of equity in the real property to support SBA's second mortgage at the time its petition had been filed and on the confirmed plan's treatment of SBA as an unsecured claim holder. SBA did not file an objection to Debtor's Motion to Avoid Lien.

While the Court could grant Debtor's Motion to Avoid Lien solely because no objection to it was filed, to do so would ignore current law on this issue and perhaps mislead parties in other cases. A discussion of the law is warranted.

Discussion. When a creditor files a proof of claim, the claim is "deemed allowed" unless someone objects to it. 11 U.S.C. § 502(a). To obtain confirmation, a Chapter 12 plan must provide for the surrender of the secured property to the creditor, 11 U.S.C. § 1225(a)(5)(C), or allow the lien to stand and pay the creditor that allowed amount of the claim, 11 U.S.C. § 1225(a)(5)(B), or the creditor must accept the plan treatment. 11 U.S.C. § 1225(a)(5)(A). As interpreted in this Circuit, that means a secured creditor can stand outside the confirmation process and still retain his lien. *JaKs Farm Custom Forage Harvesting, L.L.C. v. Anderson (In re Anderson)*, 305 B.R. 861 (B.A.P. 8th Cir. 2004) (citing, *inter alia*, *Harmon v. United States (In re Harmon)*, 101 F.3d 574 (8th Cir. 1996)). If the creditor files a proof of claim and the debtor does not challenge that "deemed allowed" claim outside the confirmation process, the creditor's secured interest remains, notwithstanding what the plan may provide. *Anderson*, 305 B.R. at 864-65. In other words, a Chapter 12 debtor cannot use just the confirmation process to avoid an encumbrance, including judgment liens. *Id.* at 865.

In this case, SBA filed a proof for a secured claim of \$95,919.53. Debtor did not file an objection to SBA's claim. Debtor also did not seek a determination of the value of SBA's

³ This procedure is no longer followed in this District. A motion to discharge judgments under S.D.C.L. § 15-16-20 has been separated from any motion to avoid liens under 11 U.S.C. § 522 since the reliefs sought are distinct. See Local Bankr. Rs. 4003-2 and 4072-1.

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security. Hence, under the Anderson analysis, SBA's mortgage lien passed safely through the confirmation process. Moreover, under 11 U.S.C. § 1228(a), a Chapter 12 discharge, entered upon completion of plan payments, discharges only those claims that were "provided for by the plan[.]" Debtors' confirmed plan did not address or otherwise provide treatment for SBA's second mortgage. The plan did not state under what circumstances or conditions SBA's mortgage would be released.

The Court, however, is acutely aware that the confirmation process followed in nearly all Chapter 12 cases to date in this District has not reflected the claim procedures discussed in Anderson. Valuation motions under § 506(d) to determine the extent a creditor's claim is secured have been rare. Rarer still have been objections to proofs of claims by a debtor or adversary proceedings between the debtor and a secured creditor to sort out the validity, priority, or extent of a lien. By consensus of all participants, the confirmation process in this District has instead been an umbrella proceeding that was understood by all to resolve many encumbrance and valuation issues.

That umbrella procedure undoubtedly is what was followed in this case. SBA did not object to Debtor's proposed plan treatment because SBA understood there was no equity to support its mortgage. It is also undoubtedly why SBA has not objected to Debtors' present motion to avoid its mortgages either. Therefore, Debtor's Motion to Avoid Lien will be granted.

The question of whether a particular encumbrance has been discharged or avoided in a Chapter 12 case likely will surface in other cases. There will be few cases in which the debtor took affirmative steps during the bankruptcy process, such as filing a valuation motion or objecting to the creditor's proof of claim, to insure that an encumbrance was removed from estate property when the debtor's equity in the property did not support the encumbrance. Accordingly, when presented with encumbrance removal actions in older Chapter 12 cases, like the Motion to Avoid Lien in this case, the Court will discern from the record what parties in interest understood and intended at confirmation. Where, as in this case, an encumbrance was not supported by any equity and the creditor was active in the case but did not object to the proposed plan, the Court will discharge the valueless lien or other encumbrance

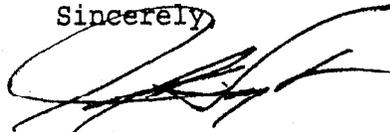
In pending and future cases, however, the requirements of the Bankruptcy Code and Federal Rules of Bankruptcy Procedure, as

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discussed in Anderson, need to be better followed. Counsel for debtors and the case trustee will need to insure that in every Chapter 12⁴ case the debtor files a specific objection to each proof of claim when the debtor does not agree with the value or the nature (secured, unsecured, priority) of the claim. The hearing on the objection to the proof of claim can be set for the same time as the confirmation hearing. When the deadline for filing a proof of claim expires after confirmation, the plan should state that objections to claims will be filed when necessary and the plan modified accordingly. Also, a debtor should either file a valuation motion under § 506(d) to determine the extent of a creditor's lien when there is no equity to support it or the debtor should commence an adversary proceeding when a secured creditor has not filed a proof of claim, when several encumbrances on the same secured property are at issue, or when the validity, priority, or extent of a lien (not just the value of the secured property) are at issue. Finally, each proposed plan should specifically state what will happen, upon confirmation or when plan payments are completed, to each and every encumbrance of record, including judgment liens on real property. When these guidelines are followed, all parties can be better assured that secured interests are adequately addressed as required by Harmon and Anderson.

An appropriate order will be entered granting Debtor's April 20, 2004, Motion to Avoid Lien.

Sincerely



Irvin N. Hoyt
Bankruptcy Judge



case file (docket original; serve parties in interest)
Assistant United States Trustee Bruce J. Gering
Trustee John S. Lovald
Trustee Dennis C. Whetzal
Trustee Dale A. Wein

NOTICE OF ENTRY
Under F.R.Bankr.P. 9022(a)
Entered

JUN 01 2004

Charles L. Nail, Jr., Clerk
U.S. Bankruptcy Court
District of South Dakota

⁴ Due to the similarity between Chapter 12 and Chapter 12 code sections, the case law set forth in *JaKs Farm Custom Forage Harvesting, L.L.C. v. Anderson (In re Anderson)*, 305 B.R. 861 (B.A.P. 8th Cir. 2004), is likely applicable to Chapter 13 cases, also.

I hereby certify that a copy of this document was electronically transmitted, mailed, hand delivered or faxed this date to the parties on the attached service list.

JUN 01 2004

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