IN THE UNITED STATES BANKRUPTCY COURT FOR THE
SOUTHERN DISTRICT OF MISSISSIPPI
JACKSON DIVISION

IN RE:

WAYNE AND BENNIE BRYANT — CASE NO. 8702146JC

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FINDINGS OF FACT AND CONCLUSIONS OF LAW ON "MOTION FOR LEAVE OF COURT TO ALLOW SALE OF CERTAIN REAL ESTATE FREE AND CLEAR OF ALL LIENS" FILED BY THE DEBTORS AND ON "MOTION TO DISMISS" FILED BY THE BANK OF RALEIGH

THIS MATTER came before the Court on the Debtors' "Motion for Leave of Court to Allow Sale of Certain Real Estate Free and Clear of All Liens" and the "Objection of Bank of Raleigh to Debtors' Motion

to Sell Real Property"; Bank of Raleigh's "Motion to Dismiss"; and various Responses filed by both parties. A hearing was held on this matter, and after considering all evidence, testimony and briefs submitted by the parties, the Court finds that the Bank of Raleigh's "Motion to Dismiss" and "Objection to Motion for Leave of Court to Allow Sale of Certain Real Estate Free and Clear of All Liens" should be denied.

FINDINGS OF FACT

Wayne and Bennie B. Bryant filed a petition for relief under Chapter 12 of the Bankruptcy Code on September 18, 1987. Harold J. Barkley, Jr. was appointed the Chapter 12 Trustee.

The Debtors own approximately 234 acres of real property in Smith County, Mississippi. (Note: There appears to be a dispute over the exact acreage owned by the Debtors. Bank of Raleigh's (Bank) appraiser testified that the Debtors own 227.45 acres. FmHA's Assistant County Supervisor testified that the FmHA had a deed of trust on 238 acres.) At the hearing on this matter, Mr. Bryant testified that he farmed for a living. The Bank contends that the Debtors stated at the First Meeting of Creditors that they were getting out of the farming business. Therefore, the Bank argues that the Debtors are not eligible to file under

Chapter 12 of the Code because they are not "engaged in a farming operation."

Mr. Bryant contends that he is engaged in a farming operation. He stated that in past years he had a row-crop operation which was connected with his cattle business, but currently he was not in the row-crop business. Mr. Bryant further testified that he was a cattle farmer, but he currently did not own any cattle. Mr. Bryant stated that he had sold all of his cattle at auction in December, 1987. Mr. Bryant stated that it was his intention to purchase approximately 20-25 head of cattle in October or November of 1988. He indicated that he would run the cattle through the winter on his land, and in May of 1989, he would then sell the cattle. Mr. Bryant expected to realize approximately $3,000 as profit.

The Debtors' property is divided into two (2) tracts -- Tract I (approximately 152 acres) and Tract II (approximately 75 acres -- including the Debtors' homestead). The Farmers Home Administration (FmHA) has a deed of trust on both tracts of land plus security interests in Debtors' cattle and equipment. As of the hearing date of July 15, 1988, the Debtors' debt to FmHA totaled $132,816.93.

On May 20, 1986, the Debtors executed two (2) promissory notes and a deed of trust in favor of the

Bank of Raleigh. The Bank has a second deed of trust behind FmHA's first deed of trust on Tract I. The Bank does not have any type of security interest in Tract II. As of the hearing date of July 15, 1988, the Debtors owed the Bank $27,454.79.

The Debtors have entered into an agreement to sell 202 acres of their land to Eugene Tullos for a purchase price of $119,998.10 ($595.05 per acre). Mr. Tullos has deposited $5,000 earnest money with the Debtors' attorney. This sale would convey all of Tract I and all but approximately 25 acres and their home from Tract II. In the agreement, the parties agreed to a closing date of September 30, 1988. However, by letter dated April 19, 1989, Robert Murphree stated to the Court that the Debtors and Mr. Tullos "are both willing to go forward with a proposed sale if the Court allows the same."

The Debtors propose to apply the proceeds from the sale to FmHA's first deed of trust. After applying the $119,998.10 to the debt owed to FmHA, the Debtors will owe FmHA approximately $13,000. FmHA has agreed to finance this amount. The Bank will not receive any of the proceeds from the sale.

In its objection to the proposed sale, the Bank contends that it is a fully secured creditor. If

the Debtors are allowed to sell all of their collateral, with the exception of their homestead and 25-30 acres, the Bank states that the effect would be to extinquish the second mortgage lien of the Bank. The Bank argues that the Debtors and FmHA should be required to marshal the Debtors' assets. That is, the FmHA should be required to satisfy its debt out of Tract II before looking to Tract I.

CONCLUSIONS OF LAW

I. Motion to Dismiss

In 1986 the Bankruptcy Judges, United States Trustee, and Family Farmers Bankruptcy Act of 1986 (P.L. 99-554) was signed into law. This Act created Chapter 12 of the Bankruptcy Code. Chapter 12 was specifically limited to aid family farmers with regular annual income.

The Bank of Raleigh (Bank) filed a "Motion to Dismiss" the Debtors' Chapter 12 petition on the grounds that "the Debtors were not eligible for relief under Chapter 12 as they were not family farmers as

defined by Section 101(17), 101(18) and were not actively engaged in a farming operation as defined by Section 101(20)."

11 U.S.C. §109(f) defines who may be a debtor under Chapter 12:

> (f) Only a family farmer with regular annual income may be a debtor under Chapter 12 of this title.

11 U.S.C. §101(17, (18), and (20) state:

> (17) "family farmer means--
>
> (A) individual or 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 (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, 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 the taxable year preceding the taxable year in which the case concerning such individual or such individual and spouse was filed; or
>
> (18) "family farmer with regular annual income" means family farmer whose annual income is sufficiently stable and regular to enable such family farmer to make payments under a plan under chapter 12 of this title;

> (20) "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;

At the trial held on this matter, the Bank withdrew its claim that the Debtors did not meet the "income test" insofar as qualifying to file under Chapter 12. Rather, the Bank is objecting to the Debtors eligibility to file a Chapter 12 petition on the ground that the Debtors were not "engaged in a farming operation."

Mr. Bryant testified at the trial that he was a cattle farmer. He stated that in the past he would purchase calves in the fall, feed them across the winter and then sell them in the late spring. He stated that it was his intention to continue this same type of operation but on a smaller scale with fewer cattle and less acreage.

At the time of the hearing, the Debtors did not own any cattle due to the fact that in December of 1987 the Debtors sold all of their cattle at auction. The proceeds from this sale were tendered to the FmHA. The Bank argues that the Debtors' lack of cattle and a statement which the Bank contends Mr. Bryant made at the first meeting of creditors that he was getting out of the farming business all prove that the Debtors

were not "engaged in a farming operation" and were not eligible to file under Chapter 12.

In determining whether a debtor's activities constitute farming within the definition of §101(20), two lines of cases have evolved from the 7th Circuit's opinion in In re Armstrong, 812 F.2d 1024, (7th Cir. 1987), cert. denied, _____ U.S._____, 108 S.Ct. 287, 98 L.Ed.2d 248 (1987). One line of cases following the majority opinion in Armstrong looks to see if the debtor's activities are subject to the traditional risks associated with agricultural production. In re Paul, 83 B.R. 709, 712 (Bkrtcy.D.N.D. 1988). The second line of cases follows the dissenting opinion in Armstrong. The dissenting opinion adopted a "totality of the circumstances" test which evaluates the entire factual context surrounding the debtor's activities -- a case by case determination. In re Paul, 83 B.R. at 712. This "totality of the circumstances" test is the better reasoned approach, is more in keeping with the legislative intent of Chapter 12 and appears to be the majority view. See: In re Burke, 81 B.R. 971 (Bkrtcy. S.D.Iowa 1987); In re Mikkelsen Farms, Inc., 74 B.R. 280 (Bkrtcy.D.Or. 1987); In re Wolline, 74 B.R. 208 (Bkrtcy.E.D.Wisc. 1987); In re Welch, 74 B.R. 401 (Bkrtcy.S.D.Ohio 1987); In re Guinnane, 73 B.R. 129 (Bkrtcy.D.Mont. 1987); In re Rott, 73 B.R. 366 (Bkrtcy. D.N.D. 1987); In re Easton, 79 B.R. 836 (Bkrtcy. N.D. Iowa 1987).

In applying the "totality of the circumstances" test, the courts have considered such factors as "the debtor's past activities, the relationship between the questioned activity and activities traditionally associated with farming and the circumstances surrounding any cessation of farming activities." In re Burke, 81 B.R. 971, 976 (Bkrtcy.S.D. Iowa 1987).

In In re Mikkelsen Farms, Inc., 74 B.R. 280 (Bkrtcy.D.Or. 1987), the Federal Land Bank objected to confirmation of the debtor's plan on the grounds that the debtor was not engaged in a farming operation. The debtor had sold some of its equipment and at the time the petition was filed no farming was being done on any of the parcels. The debtor had also entered into leases on various parcels of land. The court examined the legislative history of Chapter 12 and concluded that "Congress was extremely concerned with the economic plight of families who had lived on the farm and had an established way of life in raising crops and livestock." In re Mikkelsen Farms, Inc., 74 B.R. at 284.

The court went on and refuted the FLB's argument that the debtor's scaled down operation was insufficient to qualify as engaged in farming. The court stated that §1222(a)(8) allows for a partial or complete liquidation of the debtor's estate. The court

found that "(t)his provision reflects a recognition by Congress that many family farm reorganizations, to be successful, will involve a scaling down of the farm operation. H.R. 5316, 99th Cong., 2d Sess., 132 Cong. Rec. at H8999 (daily ed. Oct. 2, 1986)." Id., at 284.

In Potmesil v. Alexandria Production Credit Association, 42 B.R. 731 (W.D.La. 1984), the District Court held that §101(17) speaks to the "preceding" taxable year. The court stated that it would look to the debtor's status at the time the statute calls for and not at the time the petition is filed. "If our legislators intended to investigate a person's status as to whether or not he was still a farmer at the time of the filing of the petition, they had the wherewithal to do so." Potmesil, 42 B.R. at 733.

Applying the "totality of the circumstances" test and the reasoning of the courts in Mikkelsen Farms and Potmesil to the case at bar, this court finds that the Debtors are engaged in a farming operation. Mr. Bryant testified that in the past he ran approximately 50 head of cattle on his property, grew corn and grew hay. Mr. Bryant further testified that he intended to continue raising cattle on his property, but on a much smaller scale. If the sale of his property is approved, Mr. Bryant testified that the approximately 25 acres of land which he is keeping will be sufficient

for him to raise a small number of cattle. He stated that he was not getting out of the farming business. Rather, Mr. Bryant did not have any cattle at the time of the July hearing because traditionally he has sold his cattle in late spring and purchased cattle in October.

Likewise, the Debtors are not proposing to totally liquidate their property, but rather they are proposing to partially liquidate their property and continue raising cattle but on a scaled down version.

Therefore, the Debtors are engaged in a farming operation and are eligible to file under Chapter 12.

II. Marshaling of Assets

The Bank requests the Court to require the Debtors and the FmHA to marshal the Debtors' assets. The Bank argues that if the Court allows the proposed sale to be consummated, the Bank's second deed of trust on Tract I will be extinguished and cut off while the Debtors retain their homestead and approximately 25 acres.

The doctrine of marshaling assets is founded upon equity. It is applied to promote fair dealing and justice. But it will be "applied only when it can be

equitably fashioned as to all of the parties." Meyer v. United States, 375 U.S. 233, 237, 11 L.Ed 2d 293, 297, 84 S.Ct. 318 (1963). "(T)he equitable doctrine of marshalling (sic) rests upon the principle that a creditor having two funds to satisfy his debt, may not by his application of them to his demand, defeat another creditor, who may resort to only one of the funds." Meyer, 375 U.S. at 236. See: Keaton v. Miller, 38 Miss. 630 (1860); First American National Bank of Iuka v. Alcorn, Inc., 361 So.2d 481, 492 (Miss. 1978); Farmers and Merchants Bank v. Gibson, 7 B.R. 437, 439 (Bkrtcy.N.D.Fla. 1980). The invokement of the doctrine rests within the sound discretion of the court, and it will not be invoked when it will cause an injustice to any party. Dilworth v. Federal Reserve Bank of St. Louis, Mo., 170 Miss. 373, 154 So. 535, 540 (Miss. 1934).

The doctrine of marshaling assets is generally defined as follows:

> [W]here two or more creditors seek satisfaction out of the assets of their debtor, and one of them can resort to two funds whereas another creditor has recourse to only one of the funds--for example where a senior or prior mortgagee has a lien on two parcels of land, and a junior mortgagee has a lien on but one of the parcels--the former may be required to seek satisfaction out of the fund which the latter creditor cannot touch, so that by this means of distribution both

> creditors may be paid, or the single fund creditor may, if possible, have his claim satisfied out of the fund which is subject to the claims of both creditors. [footnotes omitted]
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> 53 Am.Jur.2d Marshaling Assets §1 (1970).

A good explanation of the doctrine of marshaling assets is contained in In re Coors of North Mississippi, Inc., 66 B.R. 845 (Bkrtcy.N.D.Miss. 1986). Bankruptcy Judge David W. Houston, III summarized the elements required to invoke the doctrine as follows:

> 1) two persons that are creditors of a common or the same debtor;
> 2) that common debtor owns or is in control of at least two funds;
> 3) one creditor has the right to resort to at least two of the funds while the other creditor has the right to resort to only one of the funds. (citations omitted).
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> 66 B.R. at 866.

See: Peoples Bank of Tuscaloosa v. The Computer Room, Inc. (In re The Computer Room, Inc.), 24 B.R. 732 (Bkrtcy.N.D.Al. 1982).

A. Common debtor

The Debtors, Wayne and Bennie Bryant, granted the FmHA a security interest/deed of trust on their cattle, equipment and all of their real property. In 1986, the Debtors granted the Bank a second deed of trust on one tract of their land. Therefore, the requirement that there must be a common debtor has been satisfied.

B. Common debtor owns two funds

The requirement that the Debtors own or control two funds has been satisfied in the case at bar. The first "fund" is Tract I (approximately 152 acres) on which the FmHA has a first deed of trust and the Bank has a second deed of trust. The second "fund" is Tract II (approximately 75 acres) on which the FmHA has the only deed of trust.

C. Creditors rights against funds

In the case at bar, the FmHA has a first deed of trust on both tracts of real property which the Debtors own. Therefore, the FmHA has the right to proceed against both tracts in order to collect Debtors' debt.

The Bank has a deed of trust on only one of the tracts of land. Therefore, the Bank can only look to one tract in order to collect its debt. Consequently, the final element to invoke the doctrine of marshaling assets has been met--the FmHA may resort to two funds while the Bank may resort to only one of the funds.

The particular fact situation present in the case at bar is a classic case for invoking the doctrine of marshaling assets--all of the required elements are present.

D. Homestead Exemption

However, case law has carved out an

"exception" to the application of the doctrine. When the fund to which only one creditor may resort is the debtor's homestead, the courts have declined to invoke the doctrine of marshaling assets. This court must now determine if this "exception" should be applied in the case at bar.

The Debtors argue that if the court grants the Bank's request for marshaling assets and thereby requires the FmHA to collect against Tract II before collecting against Tract I, the net effect would be the destruction of the Debtors' homestead exemption. The Debtors argue that this would be a grave injustice to them.

The U. S. Supreme Court addressed the issue of exempt insurance proceeds in Meyer v. United States, 375 US 233, 84 S.Ct. 318, 11 L.Ed 2d 293 (1963). In Meyer, the court refused to extend the doctrine of marshaling assets when the result would be to impair the debtor's exemption in the insurance proceeds.

The general rule with regard to the debtor's exemption in his homestead is stated in 53 Am.Jur.2d, Marshaling Assets, §25:

> In determining the applicability of the marshaling doctrine, the courts have considered exemption statutues in weighing the equities between the parties. Where exempt property or property which is subject to the right of homestead is covered by the lien or claim of the senior creditor, it has been

> questioned whether the junior encumbrancer is entitled to have the senior lien satisfied out of the exempt property in order that he may have his demand paid by resort to the nonexempt property of the debtor. While the reports contain cases which have held that the senior claimant may be required to proceed first against the exempt or homestead property, the prevailing view. . .is that the principal of marshaling will not be applied to creditors who are thus situated.
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> To give effect to the doctrine in these circumstances would result in placing on the exempt property a greater burden than that which has been placed thereon by the debtor himself or by the law, thus causing a nullification of the protection which the law provides for the debtor and his family. In other words, the right of the homestead or other exemption claimant is superior, or at least equal, to the right of the junior lienor to have the assets marshaled; therefore, the claim of the junior lienor will not be recognized. Furthermore, the junior creditor is considered to have taken his encumbrance with knowledge of the equities which the homestead carries, among which is the important one requiring the senior creditor to have recourse first to lands other than the homestead. (footnotes omitted).

See: Farmers and Merchants Bank v. Gibson, 7 B.R. 437, 442 (Bkrtcy.N.D.Fla. 1980).

The case law in Mississippi has followed this general rule with regard to homestead exemption. In Biggs v. Roberts, 115 So.2d 151 (Miss. 1959), the Mississippi Supreme Court stated the objective of the

homestead exemption law "is to insure that. . .the residents of this state shall never by financial misfortune or stress of circumstances be deprived of their homesteads, and the desired end is sought to be secured by providing that no creditor shall be permitted to wrest from the family the dwelling place." Biggs, 115 So.2d at 153. See: Daily v. City of Gulfport, 54 So.2d 485, 488 (Miss. 1951).

In Koen v. Beill, 23 So. 481 (Miss. 1898), the Mississippi Supreme Court directly addressed the question of whether the doctrine of marshaling assets can be invoked against exempt homestead property. The court concluded that "(w)e cannot think that the rule of marshaling securities applies to homestead exemptions." Koen, 23 So. at 481.

A similar result was reached by the court in Hodges v. Hickey, 7 So. 404 (Miss. 1890) wherein the court stated that:

> (W)e could not assent to the right of the creditor to compel the mortgagee of the whole to subject, first, the homestead exemption to the payment of the mortgage debt, in order that the non-exempt portion might be exonerated in favor of other creditors. To do this would be to extend a mortgage given by the exemptionist upon the exempt property, as security for other debts for which he did not intend to bind it. The rule of marshaling securities is never enforced by courts of equity where to do so would be unjust to the debtor.
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> 7 So. at 407.

Applying this to the case at bar, this court will not require the FmHA to proceed against (Tract II) the homestead first in order to free-up the non-exempt property (Tract I) for the Bank. To do this would give the Bank rights for which it did not originally bargain. Therefore, to enforce the doctrine of marshaling assets against the Debtors' homestead would be unjust to the Debtors and would defeat the public policy of this state with regard to homestead exemption.

CONCLUSION

After considering the intent of Congress in passing Chapter 12 legislation and the case law which has evolved from Chapter 12, this Court concludes that the Bryants are engaged in a farming operation and qualify under §109(f) to be debtors under Chapter 12.

The facts before the Court present a classic case for invoking the doctrine of marshaling assets except for the fact that one of the two funds involves the Debtors' homestead. "When weighing the equities between parties to determine the applicability of the marshaling doctrine. . .the exemption policies of the states tilt the equities in favor of the exemption claimant." Farmers and Merchants Bank v. Gibson, 7 B.R. 437, 442 (Bkrtcy.N.D.Fla. 1980). Mississippi Law

on homestead exemption prohibits the application of the doctrine when the net effect would be the destruction of the Debtors' exemption in their homestead. Consequently, this Court will not order FmHA to marshal the Debtors' assets.

IT IS, THEREFORE, ORDERED AND ADJUDGED that the Bank of Raleigh's "Motion to Dismiss" is hereby denied.

IT IS FURTHER ORDERED that the Bank of Raleigh's Objection to the Debtors' "Motion for Leave of Court to Allow Sale of Certain Real Estate Free and Clear of All Liens" is hereby denied and that the motion to sell is hereby granted.

The attorney for the Debtors shall submit a written judgment consistent with this opinion and in accordance with Bankruptcy Rule 9021 and new Uniform Local Rule 17.

SO ORDERED this the 11th day of July, 1989.

U. S. BANKRUPTCY JUDGE