

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF ILLINOIS

IN RE:) In Proceedings
) Under Chapter 12
LLOYD J. FLOOD and)
LOIS L. FLOOD,) No. BK 87-30618
)
Debtors.)

O R D E R

This matter is before the Court on motion to dismiss filed by the First National Bank in Toledo ("Movant"). On November 3, 1987 the Court, after hearing the evidence presented by the parties, denied the motion as to all issues except the question of whether debtors qualify as family farmers under §101(17)(A) of the Bankruptcy Code. Specifically, the sole issue before the Court is whether debtors satisfy the requirement contained in §101(17)(A) that at least 80 percent of their aggregate noncontingent, liquidated debts, on the date the case was filed, arose out of their farming operation.

Debtors filed their Chapter 12 petition on June 26, 1987. On Schedule A-2 of the petition, they listed debts owed to movant totaling \$172,853.00. Movant filed four proofs of claim totaling \$359,984.25. The fourth claim is for \$177,821.00 allegedly owed by debtors on a 1979 Federal Land Bank note and mortgage that was subsequently assigned to movant. Debtors deny liability on this claim and have not included it on their bankruptcy schedules. If this claim is included as a non-farm related debt, debtors would not qualify as family farmers under §101(17)(A).

On July 9, 1979 debtors co-signed a promissory note and

mortgage with their son and daughter-in-law, Dan L. Flood and Tracy A. Flood, for a Federal Land Bank loan. The loan was solely for the benefit of Dan and Tracy Flood and they received all of the proceeds of the loan. Of the 210 acres of farmland securing the loan, 170 were owned by Dan and Tracy Flood with the remaining 40 acres owned by debtors.

In 1982, Dan and Tracy Flood granted movant a second mortgage on various parcels of real estate originally mortgaged in 1979 to Federal Land Bank. Also in 1982, judgment liens were obtained by Greenup National Bank and Greenup Grain Company against Dan L. Flood, which became liens upon his real estate.

On October 23, 1985 movant purchased the 1979 Federal Land Bank note and mortgage. Beginning in December 1985, movant, with the consent of Dan and Tracy Flood, sold a portion of Dan and Tracy Flood's real estate securing the previously described mortgages. The sale netted \$111,197.61 of which \$56,345.12 was applied to junior lienholders, i.e., movant's second mortgage and the two judgment liens on the property. Debtors did not authorize the sale of the real estate nor did they consent to the application of any of the proceeds to junior lienholders. Dan and Tracy Flood subsequently filed for and received a discharge in bankruptcy.

Movant claims that debtors still owe \$177,821.69 on the 1979 note and mortgage. Debtors argue that they signed the note and mortgage as accommodation parties and that they were discharged from any liability for the debt, pursuant to §3-606(1)(b) of the Uniform Commercial Code ("U.C.C."), when movant impaired the collateral by

applying some of the proceeds, from the sale of a portion of the collateral, to junior liens without their consent.

An "accommodation party" is defined in U.C.C. §3-415 as "one who signs the instrument in any capacity for the purpose of lending his name to another party to it." Whether a party is an accommodation party at the time of signing is a question of fact and intention. Godfrey State Bank v. Mundy, 412 N.E. 2d 1131, 1134, 45 Ill. Dec. 549, 552, 90 Ill. App. 3d 142 (1980); Wohlhuter v. St. Charles Lumber and Fuel, 323 N.E. 2d 134, 137, 25 Ill. App. 3d 812 (1975). When a person receives no direct benefit from the execution of a note he will likely be regarded as an accommodation party. Godfrey State Bank v. Mundy, supra, 412 N.E. 2d at 1136, 45 Ill. Dec. at 554. This is true even where the party assigns some of his own collateral for a loan but receives none of the loan proceeds. South Side Bank and Trust v. Yorke, 305 N.E. 2d 367, 369, 15 Ill.App. 3d 948 (1973).

Debtors claim that the testimony at the hearing established that they were accommodation parties to the 1979 note and mortgage because the loan was solely for the benefit of Dan and Tracy Flood and that Dan and Tracy Flood received all of the proceeds of the loan. Assuming that debtors were accommodation parties, the question is whether the debt was discharged under U.C.C. §3-606(1)(b) when movant applied the proceeds of the sale of a portion of the collateral securing the loan to junior liens. U.C.C. §3-606(1)(b) provides:

(1) The holder discharges any party to the instrument to the extent that without such parties' consent the holder

(b) unjustifiably impairs any collateral for

the instrument given by or on behalf of the party or any person against whom he has a right of recourse.

In the present case, the 1979 note and mortgage which debtors co-signed contained the following provisions:

Mortgagors...covenant and agree...(10) that mortgagee may extend and defer the maturity of and renew and reamortize said indebtedness, release from liability any party liable thereon, and release from the lien hereof portions of the priority covered hereby, without affecting the priority hereof or the liability of mortgagors or any other party for the payment to be secured, hereby.

By agreeing to this provision debtors waived any right to withhold consent to movant's application of sale proceeds to junior liens. Therefore, even assuming that movant's acts impaired the collateral, debtors were not discharged from liability for the debt under U.C.C. §3-606(1)(b). See, National Acceptance Company of America v. Deanes, 446 F.Supp. 388, 390 (N.D. Ill. 1977) (consent to an impairment of collateral under §3-606(1)(b) can be incorporated into the instrument and there does not need to be an explicit consent to a particular impairment immediately before such impairment.) See also, U.C.C. §3-606, official comment, ¶2.

Debtors argue in the alternative that if their liability for the 1979 note and mortgage was not discharged under U.C.C. §3-606(1)(b), it is still a debt which arose out of their farming operation and, therefore, can be counted as a farm related debt for purposes of the 80 percent requirement of §101(17)(A). Debtor Lloyd Flood testified at the hearing that he and his son had separate farming operations

but that they jointly owned and operated farm machinery and worked on each other's farms. He also testified that the purpose of the 1979 Federal Land Bank loan was to refinance Dan Flood's farming operation. As has previously been noted, all the proceeds of this loan went to Dan and Tracy Flood.

The relevant portion of §101(17)(A) defines a "family farmer" as an

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...(emphasis added).

In the present case, debtors admit that the only reason the debt on the 1979 note and mortgage was incurred was to help their son refinance the debt on his farming operation. There is no evidence that debtors either owned or operated their son's farming operation. The mere fact that debtors and their son worked on each other's farms and shared machinery does not transform a debt incurred on behalf of the son's farm to a debt incurred on behalf of debtor's farm.

Debtors appear to be arguing that any farm related debt can be counted as part of the "80 percent" necessary to qualify as a family farmer. No cases have been cited by debtors to support this proposition, nor has the Court been able to locate any such cases. Therefore, we are left with the plain language of §101(17)(A) which clearly requires the debt to arise out of a farming operation which the debtors own or operate. Since this debt of \$177,821.00 did not

arise out of a farm operation owned or operated by the debtors, it must be counted against debtors for the purpose of determining whether they are family farmers.

Since the \$177,821.69 debt owed to movant did not arise out of debtors' farming operation, less than 80 percent of debtors' noncontingent, liquidated debt is farm related under §101(17)(A). This remains true even if the debt owed by debtors to James and Marie Flood (the classification of which is contested by the parties and which amounts to somewhere between \$50,000.00 and \$62,000.00) is counted as farm related debt.

Therefore, debtors fail to qualify as family farmers under §101(17)(A) and, as a result, are ineligible for Chapter 12 relief. See, §109(f).

IT IS ORDERED that the motion to dismiss filed by First National Bank in Toledo is GRANTED and that debtors' Chapter 12 petition is DISMISSED.

/s/ Kenneth J. Meyers
U.S. BANKRUPTCY JUDGE

ENTERED: December 7, 1987