

MEMORANDUM

To: John Doe, Esq.

From: Lawfinders Associates, Inc.

Re: *Smith*

Date: January 1, 200x

I. INTRODUCTION

Pursuant to your request, we have researched whether lease payments from a debtor to an insider are voidable as preferences. We have also gathered information regarding Missouri statutory landlord's liens. Based on our research, it is unclear whether the family members will be able to keep their rent payments if challenged in a bankruptcy proceeding.

I. BANKRUPTCY CONSIDERATIONS

The lease payments made to family members will not be voidable as preferences unless the transactions meet all of the elements of 11 U.S.C. § 547(b). To qualify as a preference, the payment must be made to or for the benefit of a creditor, on account of an antecedent debt, while the debtor was insolvent, within the preference period, and provide the creditor more than the creditor would have received under a Chapter 7 bankruptcy. *See* 11 U.S.C. § 547. The trustee must prove all the elements of a voidable preference by a preponderance of the evidence. *See Farmers Bank of Clinton v. Julian*, 383 F.2d 314, 324 (8th Cir. 1967). The trustee may have difficulty demonstrating that the lease payments to the lessors meet all of the criteria, and were therefore, voidable preferences.

A. The Trustee Will Likely Have Difficulty Proving All of The Elements of Section 547(b).

The trustee could potentially challenge any payments to insiders that were made within one year prior to the filing of the bankruptcy petition. If the debtor is an individual, a relative is an insider of the debtor. *See* 11 U.S.C. § 101(31). The farmer made payments to his father and sons within the one-year period that would precede the bankruptcy proceeding. Thus, any of the transfers to his relatives within the preference period are subject to scrutiny.

1. *There is no presumption of insolvency outside of the 90-day pre-petition period.*

Initially, depending on the potential debtor's circumstances, the trustee may have difficulty proving that the transfers were made while the potential debtor was insolvent. The information provided to us indicates that the potential debtor was an individual farmer. Provided that the potential debtor is not a partnership, the farmer was insolvent if the value of his debts was greater than the value of his property. *See* 11 U.S.C. § 101(32). Usually, there is also a presumption of insolvency for transactions that occur within the preference period. However, there is no presumption of insolvency where an alleged preferential transfer is made outside the 90-day period, even if that transfer is to an insider. *See In re Huizar*, 71 B.R. 826 (Bankr. W.D. Tex. 1987). If the farmer waits more than 90 days from the date of the lease payments to file bankruptcy, the trustee will be required to prove, by a preponderance of the evidence, that the farmer was insolvent at the time of the transfers. The payments are not voidable preferences if the trustee cannot prove the farmer was insolvent.

2. *The transfers were arguably not made on account of antecedent debt.*

Furthermore, the trustee may have difficulty showing that the transfers were made on account of antecedent debts. The debt is antecedent only if it was incurred before the purported preferential transfer. *In re Armstrong*, 291 F.3d 517, 522 (8th Cir. 2002). A debt is incurred when the debtor legally becomes bound to pay. *Id.* *See also, In re Upstairs Gallery*, 167 B.R. 915, 918 (9th Cir. 1994). The trustee will not be able to avoid the payments as preferences if they were not made on account of antecedent debts.

The potential debtor may be able to defeat any claim of preference under Section 547 because rental payments are not incurred until they become due. Although the issue is not well settled, some courts have determined that rent payments to landlords made within the preference period are not preferences because the lease obligation is incurred when it becomes due, not when the parties enter into the lease. *In re Coco*, 67 B.R. 365, 370 (S.D. N.Y. 1986); *cf. In re Iowa Premium Service Co., Inc.*, 695 F.2d 1109, 1111, n.7 (8th Cir. 1982). In *Iowa Premium*, the court evaluated when a party's obligation to pay interest payments accrued. *Id.* It determined that Iowa Premium was not required to pay interest payments under the note until it used the money. *Id.* Therefore, the court decided, the legal obligation to pay interest did not accrue until Iowa Premium used the funds from the loan. *Id.* In its analysis, the court said that Iowa Premium's situation was analogous to a rental contract where a tenant was paying for continued use of the land. *Id.* Here, as long as the lease payments were made on account of a prospective rental period, the trustee may have difficulty establishing that the lease payments were on account of antecedent debt. In that instance, the payments would not be considered avoidable preferences.

B. The Landlords May Not Qualify for the Exceptions Enumerated in Section 547(c).

If the trustee is successful in convincing the court that the payments are preferences, the relatives will likely have difficulty retaining the payments. The trustee may not recover preferences that qualify for an exception under Sections 547(c)(2)(A)-(B). A preference is not avoidable if it was a contemporaneous exchange for new value or if it was made in the ordinary course of business. 11 U.S.C. § 547 547(c)(2)(A)-(B). Although any landlord who received a timely payment, may qualify for the ordinary course of business exception, the landlords who received early payments will have difficulty demonstrating that they meet the requirements of either section.

1. *Early rent payments are arguably not contemporaneous exchanges for new value.*

The early rent payment to the father is probably not a contemporaneous exchange for new value. Payments made prior to the due date are not made contemporaneously in exchange for new value. *See In re R.M. Taylor, Inc.*, 245 B.R. 629 (Bankr. W.D. Mo. 2000). The court, in *Taylor*, decided that payments for worker's compensation coverage made prior to the due date could not be considered a contemporaneous exchange for new value. *Id.* at 635. To the extent that the farmer prepaid the rental amounts, those payments are arguably not subject to the exception enumerated in 547(c)(1)(A)-(B).

2. *Although some of the landlords may be able to demonstrate that the rental payments were made in the ordinary course of business, those who received early payments will likely have difficulty.*

The farmer's sons may be able to demonstrate that the payments occurred in the ordinary course of business, provided that there was nothing unusual about the transactions. To qualify for the exception, the party who received the payment must show that the debt was incurred in the ordinary course of business for the debtor and lessor, that the payment was made in the ordinary course of business, and was made according to ordinary business terms. 11 U.S.C. § 547(c). As long as the sons can present evidence that there was nothing out of the ordinary about these lease payments, the fact that the payments were made to insiders will not necessarily make the payments voidable.

These landlords must demonstrate that there was nothing unusual about the land rental payments before they can demonstrate that the payments were made in the ordinary course of business. As long as there is nothing abnormal about the rental transactions, it should be easy to demonstrate that the transactions occurred in the ordinary course of business. *See e.g. In re Haaland*, 1990 W.L. 1239793, *6 (Bankr. D. N.D. 1990). In *Haaland*, a nephew made

cash lease payments for farm land to his uncle. Even though the payments were made within the preference period, the court determined that it was normal for the nephew to pay his uncle for rent and for an equipment lease in January. Therefore, the payment made in January, while the debtor was insolvent, was not voidable as a preference.

It appears from the facts presented here that the farmer's payment to his father was not made in the ordinary course of business. The father received his rental payment two months early. Payments made early are not made within the ordinary course of business. *In re R.M. Taylor, Inc.*, 245 B.R. 629 (Bankr. W.D. Mo. 2000). In *Taylor*, the debtor argued that it had made two separate payments two days early, and thus, several large pre-petition early payments were made within the ordinary course of business. *Id.* at 637. The Court rejected this argument, holding that the other payments were 11 days, 39 days, and 60 days early. *Id.* The Court, addressing the dearth of case law on the subject concluded that without evidence that the payments were regularly made as early as 60 days prior to the due date, the early payments were not in the ordinary course of business and could be avoided by the trustee. *Id.* Thus, the farmer's payment to his father, and any other early payments, would likely be subject to a similar analysis.

C. The Farmer May Consider Filing a Chapter 12 Bankruptcy.

The farmer may want to explore the possibility of seeking relief under Chapter 12. Additional research would be required to evaluate whether the trustee's power to avoid preferences extends to debtors who file bankruptcy petitions pursuant to Chapter 12 of the Bankruptcy Code. It appears that a Chapter 12 trustee may be required to obtain the bankruptcy court's permission before conducting an investigation into the debtor's financial condition. *See In re Graven*, 84 B.R. 630, 630 (Bankr. W.D. Mo. 1988). It may benefit the debtor to take advantage of some of the protections afforded to farmers in Chapter 12. The debtor should, therefore, explore that possibility as well.

III. MISSOURI LANDLORD'S LIENS

Pursuant to your request, we have also researched landlord's liens created by R.S. Mo. § 441.280. The landlord's lien on crops grown on rented land is created by statute and expires eight months after the rent becomes due. R.S. Mo. § 441.280. Most of the cases interpreting the landlord lien statute date back to the late nineteenth and early twentieth centuries. *See* R.S. Mo. § 441.280, annotations.

It appears that the landlord must attach the crops to perfect his or her security interest. Where the landlord has a lien against the crops, that landlord may sell the crops to satisfy rent without resorting to legal proceedings. *Auxvasse Milling Co. v. Cornet*, (1900) 85 Mo.App.

251. The landlord has a lien on the crops for rent, but the lien is not enforceable until the tenant is late paying the rent. *Plano Mfg. Co. v. Cunningham*, (1898) 73 Mo.App. 376. But, the landlord must attach the crops to perfect the lien. *Fries v. First Community State Bank*, (1983) 661 S.W.2d 664, 666; *see also, Beck v. Wisely*, (1893) 52 Mo.App. 242. Additionally, R.S. Mo. § 441.300 indicates that the landlord may enforce the lien by distress or attachment.

The statutory lien exists against crops that are grown in the year the rent accrues. The lien attaches at the commencement of the crop's growth. *Jenkins v. Missouri Farmers Ass'n, Inc.*, (1993) 851 S.W.2d 542, 546. In *Jenkins*, the landlords claimed a lien on crops that were planted in 1989, were harvested in 1990, and were delivered in 1990. *Id.* at 543. The Court determined that the Jenkinsees had a statutory lien for 1989 rent on the crops that sprouted in 1989, even though those crops were harvested in 1990. *Id.* at 546. While the court did not directly address whether the Jenkinsees would have had a lien on the crops that sprouted in 1989 for the 1990 rent, the court did suggest that the Jenkinsees would have had a lien on any crops growing during the year that the rent became due. *Id.* Therefore, any unpaid landlords may be able to claim valid landlord liens, provided that the rent is late.

Even if the landlords could demonstrate statutory landlord liens against the crops, bankruptcy may displace some of the landlords' rights. A landlord's valid, statutory lien, usually has priority over other creditor's liens, even those creditors with a perfected security interest in the crops. *See Lane v. Pollard*, (1901) 88 Mo.App. 326; *see also In re Eddingfield*, 67 B.R. 1000 (Bankr. C.D. Ill. 1986) (Article 9 does not apply to statutory liens and landlords have priority over secured creditors R.S. Mo. § 441.280). However, the bankruptcy trustee in a Chapter 11 proceeding can avoid a statutory lien that is for rent or for the distress of rent. 11 U.S.C. § 545(3)-(4). *See In re Wedemeier*, 237 F.3d 938, 941 (8th Cir. 2001). Therefore, to the extent that the landlords were going to try to gain strategic advantage prior to bankruptcy by perfecting landlord liens, the landlords should be aware that their interests will likely have priority over other secured creditors, but are subject to avoidance by the bankruptcy trustee.

IV. CONCLUSION

The family members who received rental payments will likely be required to convince the court that the payments were not on account of antecedent debt or were not made while the farmer was insolvent. If the farmer waits more than 90 days after the payments were made to file bankruptcy, there will be a better likelihood of success on the insolvency issue, because there is no presumption of insolvency with regard to the insider transactions. It will be much more difficult for the landlords to show they qualify for exceptions to the preference statute than it will be for the trustee to prove that the preferences were avoidable. Finally, Chapter 12 may offer more favorable relief for the farmer and the relatives.

The Missouri landlord lien arises automatically by operation of law when the rent becomes past due, but is not perfected until the landlord attaches the crops. Article 9 does not apply to statutory liens. However, the lien statute will not likely assist any of the creditors in a dispute with the trustee, as the trustee can avoid statutory liens for rent.

Please let us know if we can assist you further in this, or any other, matter.