

A LOOK AT CHAPTER 12: BANKRUPTCY HELP FOR THE FARMER

I. Background.

A. Reorganization chapters: Chapters 11, 12, and 13.

B. Reorganization vs. liquidation under Chapter 7.

C. 1986 Bankruptcy Code addition of Chapter 12 due to existing farm crisis.

1. Based largely on Chapter 13.

2. Included some Chapter 11 concepts including reorganization of long-term debt beyond the maximum length of the plan (Section 122(a)(7)).

3. Can modify rights of holders of secured claims, including claims secured by the debtor's homestead, which neither Chapters 11 nor 13 can do.

4. Included "sunsetting" provisions which were to go into effect in 1993, but which have been extended three times, with the chapter to sunset on July 1, 2000. Only chapter in the code which sunsets.

D. Family farmer definitions:

1. Under 11 U.S.C. Section 101(18), "Family farmer" means --

(A) an individual or individual and spouse engaged in farming operations whose aggregate debts do not exceed \$1,500,000.00 and not less than 80 per cent of whose aggregate noncontingent, liquidated debts (excluding a debt for a principal residence of such individual or such individual and spouse unless such debt arises out of a family farming operation), on the date the case is filed, arising 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 per cent 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

(B) corporation or partnership in which more than 50 per cent of the outstanding stock or equity is held by one family, or by one family and

relatives of the members of such family, and such family or such relatives conduct the farming operation, and

(i) more than 80 per cent of the value of its assets consists of assets related to the farming operation;

(ii) its aggregate debts do not exceed \$1,500,000.00 and not less than 80 per cent of its aggregate noncontingent, liquidated debts (excluding a debt for one dwelling which is owned by such corporation or partnership and which a shareholder or partner maintains as a principal residence, unless such debt arises out of a family farming operation), on the date the case is filed, arising out of a farming operation owned or operated by such corporation or partnership; and

(iii) if such corporation issues stock, such stock is not publicly traded.

II. Commencement of case.

A. Filing of a voluntary petition; involuntary only available in Chapter 11 or 7 (Section 303).

B. Filing of petition results in automatic stay (Section 362), which is essentially a very broad injunction against further creditor collection activities.

C. Filing of petition results in the appointment of a trustee, as in Chapter 13, and in contrast to Chapter 11 where no trustee (other than the U.S. Trustee) is appointed (in Chapter 11, the debtor-in-possession has essentially all of the powers and duties of the trustee, subject to monitoring by the U.S. Trustee).

D. Powers of the debtor more closely resemble those of a Chapter 11 debtor, rather than a Chapter 13 debtor. See Section 1203. Reference is made to the debtor powers found in 1106, rather than those found in 1303. Chapter 13 debtors essentially have the power to sell property free and clear of liens, to continue to operate a business if already in business, and generally are in possession of property of the estate.

Chapter 12 debtors have all the powers and duties of a Chapter 7 trustee, except for the obvious of investigating the conduct of the debtor and filing a report concerning any such investigation, and eligibility for compensation as a trustee under Section 330.

E. No provision for creditors' committee to represent interests of unsecured creditors as in Chapter 11. Purpose of a creditors' committee is to allow for negotiation between the Chapter 11 debtor-in-possession and the committee concerning plan contents relative to unsecured creditors. In Chapter 11, creditors can propose a plan after the initial 120 day "exclusive period" given to Chapter 11 debtors-in-possession. See Section 1121(b). In Chapter 12, only the debtor may propose a plan under Section 1221.

F. Filing of a Chapter 12 petition operates as a stay against collection activities against a co-debtor, in the case of consumer debts only, which is identical to the Chapter 13 provision. No similar section is found in Chapter 11.

G. Commencement of the case will cause the meeting of creditors under Section 341 to be scheduled by the Chapter 12 trustee, which usually occurs within 30 days after the filing of the petition. The trustee presides over the meeting. The 341 meeting is essentially an administrative hearing rather than a court proceeding, since under Section 341, the bankruptcy court does not preside over the meeting, and may not even attend. The debtor must appear and be examined under oath by the trustee. Creditors may attend but are not required to do so. The basic purpose of the 341 meeting is to allow the trustee to insure that all the required schedules have been

filed and that the information contained thereon is correct. Bankruptcy Rule 2003 describes the specific procedures to be utilized at the 341 meeting. The meeting may be continued from time to time, although in the routine case, the 341 meeting is concluded at the end of the first meeting. Generally, if more detailed information from the debtor is desired by the trustee or any interested party, an examination under Bankruptcy Rule 2004 will be requested. The so-called “Rule 2004 exam” can be obtained only after the filing of a motion with the court and an entry of an order for the examination. It is similar to a deposition in civil cases.

III. Plan Development and Filing.

A. Debtor has 90 after filing of the case to file a plan. This can be extended on motion on showing of good cause. Compare this to 120 days (exclusive plan filing period) in Chapter 11 and 15 days in Chapter 13. The plan can, of course, be filed earlier, or even with the filing of the Chapter 12 petition.

B. Required plan contents:

1. Must provide for submission of all or a portion of future income to the trustee to fund the plan.
2. Must provide for full payment of all claims entitled to priority under 11 U.S.C. Section 507. These usually involved tax claims, but there are other types of priority claims, including past due child support.
3. If the plan creates classes of creditors, the creditors within each such class must receive identical treatment.

C. Permissive plan contents:

1. Designate classes of unsecured creditors within the plan. Generally recognized classes include student loans, co-signed debts, insufficient funds checks, and criminal restitution obligations. Other classifications may or may not pass muster.
2. Modify rights of holders of secured or unsecured claims. This could include “cram down” of secured debt to provide for payment of the value of the security only with the balance to be treated as an unsecured claim. Interest on unsecured claims could be deemed waived. Interest rate on secured claims could be reduced to a “market” rate. Payment period could be lengthened from that described in the contract with the creditor. The plan could propose no payment to unsecured creditors if the so-called “liquidation” test is met. This essentially requires that a Chapter 12 unsecured creditor can do no worse than that creditors would do in a Chapter 7 liquidation. See 11 U.S.C. 1225(a)(4). This requires the debtor to show that in a hypothetical Chapter 7, there would be no dividends available to general unsecured creditors. For example, if there are significant priority claims which would “eat up” available assets in Chapter 7 resulting in nothing left for general unsecured creditors, then a Chapter 12 plan can propose that unsecured creditors receive nothing.
3. Provide for the curing or waiving of any defaults.
4. Designate how payments are to be apportioned as between secured, priority and unsecured creditors.

5. Provide for curing of defaults as to “long term” debts, i.e., debts which have a repayment period in excess of five years, the maximum allowed for payment “through the plan.” These creditors can generally be paid directly rather than through the trustee.
6. Provide for the assumption or rejection of executory contracts (i.e., leases or other similar obligations).
7. Provide that a debt is paid by the sale of property rather than through plan payments.
8. Allow for property to be surrendered to secured creditors in satisfaction of the secured debt.
9. Provide for vesting of estate property in the debtor or any other entity upon plan completion.

D. Disclosure statements. Chapter 11 requires the debtor to file what is known as disclosure statement and provide a copy to creditors in order that they may have “adequate information” in order to decide whether to vote in favor or against a Chapter 11 plan. Recall that Chapter 12 does not have voting requirements. Thus, there is no specific provision for a disclosure statement in Chapter 12. Recalling also that Chapter 12 was patterned after Chapter 13, there is no disclosure statement requirement in Chapter 13 practice. Having said that, a practitioner before the local bankruptcy judges knows that a disclosure of information similar to that required by a Chapter 11 disclosure statement is expected to be filed as part of any Chapter 12 plan. This statement usually would give creditors a synopsis of the debtor’s farming

operations, the causes for the Chapter 12 filing, pre-bankruptcy financial information including cash flow and profit/loss statements, and the expected financial results if the Chapter 12 plan is confirmed.

IV. Confirmation procedure.

A. Creditors receive a copy of the plan when filed.

B. Creditors or the trustee, or both, may object to the plan.

C. Plan confirmation procedure is governed by Bankruptcy Rule 3015. Objections are treated as “contested matters” under Rule 9004.

D. Filing of the plan will establish the date of the confirmation hearing. The hearing must be no later than 45 days after plan filing. 11 U.S.C. 1224.

E. Confirmation hearing.

1. Any objections to confirmation will be considered.

2. Evidence in support of or opposition to the plan may be presented.

3. The court must find that the plan is proposed in good faith.

4. The court must find that the value to be received by unsecured creditors is no less than what they would get under Chapter 7 (liquidation test).

5. Secured creditors must either accept the plan, receive the value of their collateral, or have the collateral surrendered to them.

6. The debtor must be able to make all payments called for under the plan, i.e., the plan must be feasible. The further requirement here is that the debtor must devote all of his or her disposable income to the plan for at least three years, and for as long as five years.

7. Failure of confirmation does not automatically result in dismissal of the case. The debtor may be given another chance at formulating a plan. However, the likely result is that the trustee would file a motion to dismiss on denial of confirmation. A case cannot be converted to Chapter 7 on request of the trustee or a creditor, unless there is a showing that the debtor has committed fraud in connection with the case. This is a special provision applicable to farmers only, and a parallel provision for farmers exists in Chapter 13. 11 U.S.C. 1307(e).

V. Post-confirmation issues.

- A. Debtor must commence making payments to the trustee on debts being paid “through the plan” and to long-term creditors directly.
- B. Either the debtor or the trustee should request a “claims bar date” from the court whereby a final date for the filing of claims will be fixed by the court. Claims filed after that date would most likely be subordinated to timely filed claims, meaning that such late filed claims would be paid after timely filed claims. A second option would be disallowance of the untimely filed claim completely.
- C. Both debtor and the trustee are entitled to examine filed claims and to object to any claim. Common objections include a request that as to secured claims they be paid only to the extent of the value of the collateral, to improper classification by the creditor as to the type of claim (i.e., an unsecured creditor who claims priority status), and late filing or duplicate filing of claims.
- D. A proper order of confirmation, prepared by the debtor and approved by the

trustee, is submitted to the court.

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