

The National Agricultural
Law Center



A research project from The National Center for Agricultural Law Research and Information of the
University of Arkansas • NatAgLaw@uark.edu • (479) 575-7646 • www.NationalAgLawCenter.org

An Agricultural Law Research Article

Bankruptcy Reform and Family Farmers

by

Susan A. Schneider

August 2005

www.NationalAgLawCenter.org

Bankruptcy Reform and Family Farmers

Susan A. Schneider

Associate Professor, University of Arkansas
Director, Graduate Program in Agricultural Law

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 passed the Senate on March 10; it passed the House of Representatives on April 11; and it was signed by the President on April 20, 2005. It became Public Law No.109-8, marking the conclusion of almost a decade of contentious debate. The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (to be codified in scattered sections of 11 U.S.C.). Most provisions of the bill will not be effective for six months from enactment. *Id.* at § 1501, 119 Stat. at 216.

Much of the new law is directed toward consumer bankruptcy reform, and some of the most controversial aspects of it, e.g., means testing for Chapter 7 relief, have been reported widely in the media. The important aspects of the law that will directly affect farmers, however, have received little attention. The main provisions are summarized as follows.

Chapter 12 becomes permanent. When Chapter 12 was first enacted in 1986, it was a temporary provision of the Bankruptcy Code. *Bankruptcy Judges, United States Trustees and Family Farmer Bankruptcy Act of 1986*, Pub. L. No. 99-554, tit. II, § 255, 100 Stat. 3088, 3105-3113 (1986) (codified at 11 U.S.C. §§ 1201 - 1231). It had a sunset provision that provided for repeal on October 1, 1993. *Id.* at tit. III, § 302(f), 100 Stat. at 3124. It has been renewed numerous times, each time as another temporary extension. Renewals, however, sometimes came months after Chapter 12 had sunset, creating frustrating gaps in its availability. Efforts to make Chapter 12 permanent were politically tied to the bankruptcy reform legislation, as proponents sought the votes of farm state representatives. Therefore, the various versions of bankruptcy reform over the years have generally included a provision that would make Chapter 12 a permanent part of the Bankruptcy Code. Section 1001 of the new law so provides. *Id.* at § 1001, 119 Stat. at 185-86. This amendment will take effect on July 1, 2005, the date upon which the current extension of Chapter 12 would have otherwise expired. *Id.*

Chapter 12 eligibility expanded. The new law amends Chapter 12 eligibility standards, expanding its availability. Four changes are made. First, the statutory maximum for debts is increased from \$1,500,000 to \$3,237,000. *Id.* at § 1004, 119 Stat. at 186. This maximum amount will now increase with the Consumer Price Index. *Id.* at § 1002, 119 Stat. at 18.

Second, the new law amends the requirement that at least eighty percent of debt come from farming. Under the new law, just fifty percent of the debt must arise out of the farming operation. *Id.* at § 1004, 119 Stat. at 186.

Third, the income requirement that provided that fifty percent of income from the preceding taxable year must come from farming is expanded to allow for a consideration of either the taxable year preceding the bankruptcy or each of the second and third years preceding. *Id.* at § 1005, 119 Stat. at 186-87.

Fourth, family fisherman are defined and afforded Chapter 12 eligibility, subject generally to the pre-reform income and debt standards. *Id.* at § 1007, 119 Stat. at 187-88. Although maximum aggregate debts are set at \$1,500,000.00, this amount will be indexed. *Id.* at § 1202, 119 Stat. at 193.

Priority of certain tax obligations modified. Under the new law, claims owed to any government unit as a result the disposition of a farm asset may no longer be afforded § 507 priority. Provided that the debtor receives a discharge, these claims can be treated as unsecured debt. *Id.* at § 1003, 119 Stat. at 186.; see, Neil E. Harl, Joseph E. Peiffer, and Roger McEowen, *Major Developments in Chapter 12 Bankruptcy*, 16 AGRICULTURAL LAW DIGEST 57 (Apr. 22, 2005). This provision took effect on the date of the enactment, but will not apply with respect to cases commenced before that date. *Id.* at § 1003(c), 119 Stat. at 186.

The retroactive assessment of disposable income is prohibited. In the past, courts have interpreted the Chapter 12 “projected disposable income” requirement as allowing an unsecured creditor or the trustee to object to discharge on the grounds that all “actual” disposable income had not been paid to unsecured creditors, even though the projected amount was paid. See, e.g., *Rowley v. Yarnall*, 22 F.3d 190 (8th Cir. 1994). This objection forced farm debtors to go back and account for all income and expenses throughout the plan term, running the risk of being assessed a final amount due in order to receive a discharge. Moreover, it frequently prohibited farmers from having liquid assets remaining that could be carried over to keep the farm operating after discharge.

Section 1006 of the new law, “Prohibition of retroactive assessment of disposable income,” reaffirms the requirement that a Chapter 12 plan can be confirmed based on “projected” disposable income. It then provides specific rules for how this obligation can be modified, providing that modification can only apply prospectively, i.e., it cannot increase the amount of payments that were due prior to the date of the order modifying the plan. Unless the debtor proposes modification, an increase may not require payments to unsecured creditors in any particular month that are greater than the debtor’s disposable income for that month. And, a modification of the plan in the last year of the plan cannot require payments that would leave the debtor with “insufficient funds to carry on the farming operation after the plan is completed.” *Id.* at § 1006, 119 Stat. at 187.

Summaries of the overall bankruptcy reform bill are available on the American Bankruptcy Institute website, <http://abiworld.net/bankbill/> and from Congress at its Thomas website, <http://thomas.loc.gov/>. Careful analysis of the entire bill will be required in order to determine how the general provisions such as means testing, homestead exemption limitations and required credit counseling will apply in the context of farm bankruptcy.