

INTRODUCTION TO CHAPTER 12 PRACTICE

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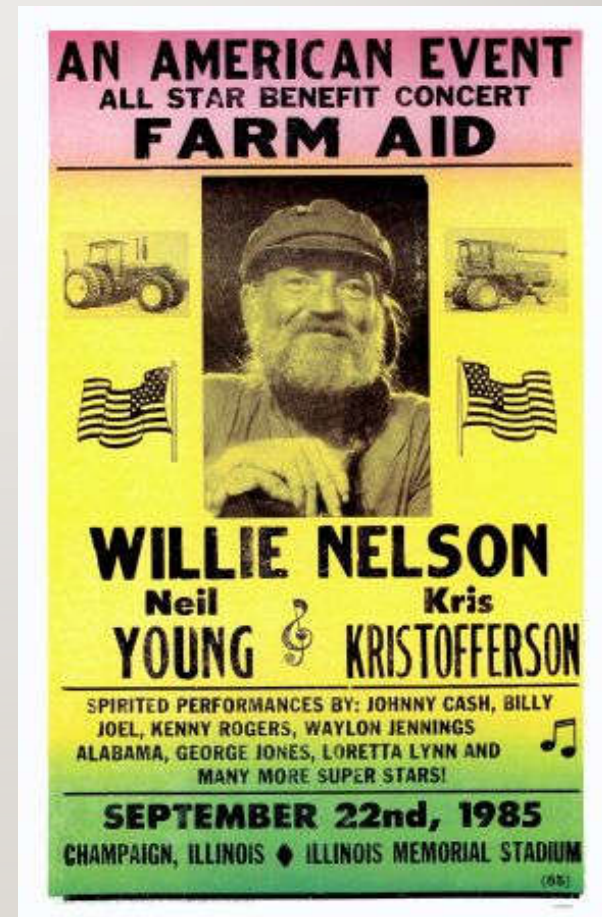
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HISTORY OF CHAPTER 12 BANKRUPTCY

- The farm crisis of the late 1980s gave birth to chapter 12 of the Bankruptcy Code.
- Falling land values and grain prices combined with soaring interest rates and tightening credit gave rise to one of the worst farm crises of the 20th century.
- Farmers responded by driving their tractors to Washington, D.C.
- Congress responded in 1986 by giving farmers a reorganization tool of unprecedented power and efficiency, and in 2005 made chapter 12 a permanent part of the Bankruptcy Code



THE NEW FARM CRISIS

DOWNWARD CYCLE IN FARMING

- Farming income reached high levels in 2010-2011.
- But from 2012-2016 farming income fell 34 percent, more than \$50 billion, after adjusting for inflation.
- Farm-sector debt has reached levels near the peak levels of the late 1970s and early 1980s.
- Rising interest rates coupled with reduced income and increased debt suggests that some farmers might not be able to repay debt in future years.



THE NEW FARM CRISIS

FEDERAL RESERVE WARNING



- In November 2018 the Federal Reserve Bank of Minneapolis warned of rising Chapter 12 bankruptcies, used by family farmers to restructure debt.
 - “Over the 12 months ending in June 2018, 84 farm operations in Ninth District states had filed for chapter 12 bankruptcy protection—more than twice the level seen in June 2014.”
 - The Fed said that the strain of low commodity prices compounded by recent tariffs “is starting to show up not just in bottom-line profitability, but in simple viability.”
 - Obtained at <https://www.minneapolisfed.org/publications/fedgazette/chapter-12-bankruptcies-on-the-rise-in-the-ninth-district>.



CHAPTER 12: SIMPLER AND MORE POWERFUL THAN EITHER CHAPTER 11 OR 13

- Chapter 12 and 13 similarities
 - ✓ Usually administered by standing trustee.
 - ✓ Proceeds under trustee supervision until completion of the plan.
 - ✓ Can restructure secured debts using the *In re Till* interest rate.
 - ✓ Debtor receives a discharge upon completion of the plan.



CHAPTER 12: SIMPLER AND MORE POWERFUL THAN EITHER CHAPTER 11 OR 13

- Chapter 12 Advantages over chapter 13

- ✓ Tax advantages: § 1232 allows a deprioritization of taxes due on the sale of assets as part of a confirmed plan, allowing farmers to “right-size” their operations and avoid large capital gains taxes that would otherwise be due.
- ✓ Can modify mortgages on principal residences by bifurcating undersecured claims under § 506 of the Bankruptcy Code, adjusting interest rates, and even re-amortizing mortgage loans beyond a 30-year period.
 - Compare 1222(b)(2) to 1322(b)(2):
 - 1222(b)(2) “the plan may--modify the rights of holders of secured claims, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims.”
 - 1322(b)(2) “the plan may--modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor’s principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims;



CHAPTER 12: SIMPLER AND MORE POWERFUL THAN EITHER CHAPTER 11 OR 13

- Chapter 12 Advantages over chapter 13
 - ✓ Can modify secured debts with much greater flexibility. Compare 1225(a)(5) to 1325(a)(5):

REQUIREMENTS	CHAPTER 12	CHAPTER 13
Secured creditor options: accepts plan, cram down or surrender	Yes	Yes
Hanging paragraph with 910 and 365 day restrictions on cram down	No	Yes
Distributed through plan via equal monthly amounts	No	Yes
Monthly amounts must be enough to provide adequate protection	No	Yes
Lienholder retains lien until PMT in full or discharge	No	Yes



CHAPTER 12: SIMPLER AND MORE POWERFUL THAN EITHER CHAPTER 11 OR 13

- Chapter 12 Advantages over chapter 13
 - ✓ Plan is not due until 90 days after the case is filed.
 - ✓ Plan payments not due until after confirmation.
 - ✓ Plan payments can be structured around farm's cash flow cycles.
 - ✓ Confirmation must occur within a specific time frame.
 - ✓ Concluded no later than 45 days after the filing of the plan. See 11 U.S. Code § 1224.



CHAPTER 12: SIMPLER AND MORE POWERFUL THAN EITHER CHAPTER 11 OR 13

- Chapter 12 Advantages over chapter 13 BIG POINTS SUMMARY
 - Chapter 12 allows the repayment of secured creditors, if appropriate, over a period longer than the life of the chapter 12 plan even though the original indebtedness is not so amortized.
 - See 11 U.S.C. § 1222(b)(9)
 - Chapter 12 allows modification of the rights of holders of security interests in all real and personal property without regard to its residential nature, so that secured creditors collateralized by the farmstead can be reamortized without the need for cure of default.



ELIGIBILITY



- Pursuant to § 109 (f), “Only a family farmer or family fisherman with regular annual income may be a debtor under chapter 12 of this title.”
- Farming: Activities involving the tillage of soil and raising of crops, raising of livestock or poultry, or livestock products in an unmanufactured state



TESTS FOR ELIGIBILITY

FAMILY FARMER (INDIVIDUAL)

- Debts are not over \$4,153,150 (as of 2018);
- At least 50 percent of debt is farm-related debt (not including home mortgage, unless the mortgage is a farm mortgage); and
- More than 50 percent of the debtor's income is from farming (measured by the previous tax year or the two tax years before the previous tax year)

FAMILY FARMER (CORPORATION)

- At least 50 percent of shares owned by one family or by one family and farming relatives;
- More than 80 percent of the value of the corporate assets consists of assets related to farming;
- Debts are not over \$4,153,150 (as of 2018);
- At least 50 percent of debt is farm-related debt; and
- Corporation is not publicly traded;



TESTS FOR ELIGIBILITY

FAMILY FISHERMAN

- Debts are not over \$1,924,550.00 (as of 2018);
- Must consist of commercial fishing operation.
- Similar to requirements for Family Farmers.



ELIGIBILITY



- Definitions found at:
 - “Family farmer” in § 101(18),
 - “Family fisherman” in § 101(19A),
 - “Family farmer with regular annual income” in § 101(19),
 - “Family fisherman with regular annual income” in § 101(19B),
 - “Farming operation” in § 101(21).



DIFFERENT TYPES OF CHAPTER 12 PLANS

- Traditional reorganization

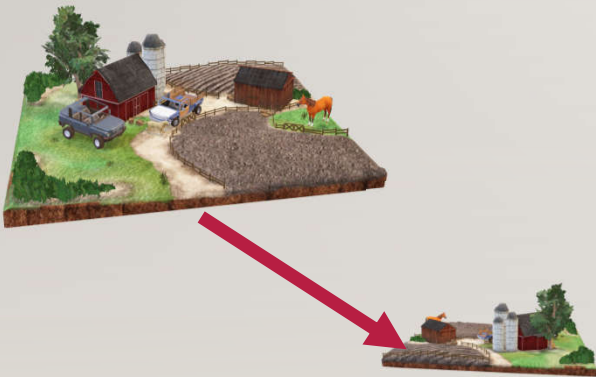


- Goals:
 - Preserve farm's nature and scale
 - Reduce debt service
 - Increase efficiency
 - Return to profitability
- Need stems from a specific event that disrupts finances
- Questions
 - Is the farm still viable with reorganization?
 - What is production cost vs market price?



DIFFERENT TYPES OF CHAPTER 12 PLANS

- Downsizing and conversion



- Goals:
 - Reduce scale of operation
 - Converting to a different or more diverse production base
 - E.g. Dairy farm to a crop farm
 - Return to profitability
- Carefully assess resources of the farm and what changes can reduce debt and increase profitability.
- Questions
 - Will the surrender of unnecessary equipment, land or livestock increase profitability?
 - Will changing from a strictly wholesale market (like milk) to a more diversified market (like a farmer's market) be effective?

DIFFERENT TYPES OF CHAPTER 12 PLANS

- Sale



- Goals:
 - Save the home but sell farmland, property, livestock
 - Debtor maintains control over marketing and sale
 - Take advantage of special tax rules on capital gains
- Debtor no longer wishes to work the farm
- Question
 - Will the plan be better than a liquidation in a chapter 7?

THE MOST POWERFUL — YET MOST UNDERUTILIZED — CHAPTER OF THE CODE

- According to the 2012 census of agriculture, there were approximately 2 million farms in the U.S., yet for the 12-month period ending Sept. 30, 2018, only 468 chapter 12 cases were filed.
- Why?
 - Many farmers and fisherman don't know chapter 12 exists.
 - Most bankruptcy attorneys tend to avoid chapter 12 and try to shoehorn the case into a 7 or 13.



THE MOST POWERFUL — YET MOST UNDERUTILIZED — CHAPTER OF THE CODE

- If you can do a chapter 13 you can also file a chapter 12.
- Discuss chapter 12 options with local FFA or other groups to get the word out that there are options for farmers and fishermen.
- Attorneys fees may be significantly higher than found in chapter 7 or 13 cases.

