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The Effects of the Chapter 12 Legislation on Informal Resolution of Farm Debt Problems

by

Mark Bromley

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THE EFFECTS OF THE CHAPTER 12 LEGISLATION ON INFORMAL RESOLUTION OF FARM DEBT PROBLEMS*

*Mark Bromley***

I. INTRODUCTION

Since the passage of Chapter 12, the terms of informal resolutions of farm debt problems have generally been more favorable to debtors than they were prior to its passage. This change is part of a shift in the balance of power between creditors and debtors. It has occurred largely because of creditors' perceptions that the legislation greatly strengthens the debtor's hand in the bankruptcy proceedings which might follow failure to achieve informal resolution of farm debt problems.

II. PERCEIVED SOURCES OF DEBTOR LEVERAGE

In the creditors' view, debtors obtain greater negotiating strength through Chapter 12 in four respects: (1) the higher debt limit in Chapter 12, by comparison with Chapter 13, makes Chapter 12 available to more farmers than could use Chapter 13; (2) the possibility of confirmation without a meaningful creditor vote or veto in Chapter 12, as contrasted to Chapter 11, causes creditors to believe their influence on the contents of plans and on the eventual confirmation of plans is reduced; (3) the reduced adequate protection standard in Chapter 12 for farm land, which allows courts to use rental value as a standard, makes the pre-confirmation period more onerous for creditors, as their return on investment is diminished compared to the returns expected during a Chapter 11 before confirmation; and (4) the right of the debtor to surrender property in satisfaction of debt presents creditors with the prospect of having unmarketable assets transferred into their acquired property inventory, and being required to credit the debtor's account for property value which the creditor may not realize upon the eventual disposition of the asset.

III. CREDITORS REACT

Faced with the shift in power between themselves and their borrowers, lenders have been more willing to consider alternatives to the foreclosure/

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** Mr. Bromley practices with Kinney, Urban, Schrader, Bromley & Kussmaul, of Lancaster, Wisconsin.

replevin approach to resolution of debt problems. Creditors relying on real estate security are now accepting shared-appreciation agreements under which the debt being serviced is reduced to the value of the real estate and the debtor and the creditor share in any increase in the value of the real estate after the date of the agreement. Creditors are also more willing to accept interest rate reductions which are necessary to permit the farmer to meet his operating expenses and continue to make payments to the creditor.

Creditors are also accepting surrender of real estate which is surplus to the farm operation and crediting the debtor's account for the value of the property.

IV. The Consequences of the Creditor Reaction

Since the passage of Chapter 12, large numbers of informal settlements have been made. Under these settlements debtors with secured debt exceeding total asset value have received write-downs to the asset's value, in exchange for a share of future appreciation. These settlements have often involved reductions in the interest rate charged on the remaining obligation.

The problems of debtors whose real estate debt exceeds real estate value, but who hold substantial equity in other property, continue to be intractable, as creditors continue to look beyond their security to the value of the other assets available to satisfy the over-leveraged debt. Debtors are reluctant to deal away any additional security to achieve a compromise, and often cannot afford the higher payments creditors seek under these circumstances.

V. Causes of Debtor Preference for Informal Resolution

Debtors prefer compromise over bankruptcy proceedings for several reasons. Informal resolution generally is far less costly than Chapter 12 resolution. Informal resolution leaves the Chapter 12 option available for later use. Informal resolutions, since the passage of Chapter 12, have been close to the predicted result of an actual Chapter 12. This is considerably different from the experience under prior law, in which the informal resolution was seldom close to the predicted result of a Chapter 11 proceeding.

Debtors also know that many Chapter 12 reorganization efforts will ultimately be futile; the effort to reorganize a heavily leveraged farm enterprise will be doomed to failure in many cases, as illustrated by the following examples. These examples use a model farm based on dairy farms in southwestern Wisconsin, using the production characteristics and costs associated with dairy farming there.[1]

1. Luening, Klemme, & Howard, Farm Enterprise Budgets (1987).

VI. Model Farms

All of the examples are based on a farm with ownership of 450 total acres, of which 300 acres are tillable. The total value of the real estate with improvements is $360,000. The model farm has personal property consisting of 100 cows with raised replacements and a machinery line which has a value of $90,000.

The model assumes that the owned real estate produces all hay and corn required for the dairy herd, but does not produce a cash crop surplus.

Milk production varies in the examples from 13,500 pounds/cow/lactation to 16,500 pounds and 19,500 pounds.

These assumed production levels reflect, respectively, an average Wisconsin dairy herd, a herd in the top 20% of Wisconsin's dairy herds, and a herd in the top 5% of Wisconsin's dairy herds.

Costs of production are adjusted to reflect levels of production assumed, and in the case of the top-producing herd, the milk price is increased to reflect quality premiums which are assumed to be received by that operator.

The percentage of secured debt to total assets varies from 0% to 100%.

Personal property values vary to reflect the higher value of higher-producing herds.

The summary for each of the model farms consists of two columns, with the operating income and expense in the left column. The right column shows the debt service requirements at the assumed values, interest rates, and amortization periods for the real and personal property. An entry for the trustee's fee demonstrates the increased cost of debt service on the secured claims which results from the Chapter 12 proceeding. Beneath the calculation of required payment on secured debt, the required payment on unsecured debt appears. The required payment on the unsecured debt is the lesser of two figures: annual disposable income, or the amortized Chapter 7 dividend. Chapter 12 requires that a plan pay unsecured creditors no less than they would receive if the enterprise were liquidated under Chapter 7. Chapter 12 also requires, assuming a proper motion is made, that the debtor devote all disposable income to the plan during the plan's term. If payment of the hypothetical dividend absorbs all disposable income, then the disposable income test becomes irrelevant. If the dividend does not absorb all disposable income, then the disposable income figure must be paid to the unsecured creditors.

The hypothetical Chapter 7 dividend is calculated in the lower third of the left column of each summary, and the resulting figure is carried into the right column under the "Unsecured Creditors" heading. The disposable income figure under that heading is obtained, in the left column, by deducting family living expense and payments to secured claims from net operating income.

The annual payment, which includes the trustee's fee for administering the payment to unsecured creditors, is then subtracted, in the left column,

from the disposable income. In order for the plan to be feasible, the balance must not be less than zero: if it is less than zero, some required payment cannot be made, and the plan fails. If the balance is greater than zero, the requirement that all disposable income be paid to unsecured creditors is violated, and confirmation will be denied. The rule is, therefore, that the balance must be zero if the plan is to be confirmed.

FARM A

Secured Debt Leverage: 100%

Income and Expense	
Number Milk Cows	100
Herd Average	13,500
Price/CWT	$11.50
Income	
Milk Income	$155,250
Cull Cows	$11,700
Bull Calves	$3,600
Total Income	$170,550
Operating Expense	$103,250
Net Operating Income	$67,300
Family Living Expense	$12,000
Debt Service Funds	$55,300
Total Payments	$85,185
Disposable Income	($29,885)

Chapter 7 Dividend Calculation	
Total Assets	$628,000
Total Secured Claims	$628,000
Assets to Administer	$0
Cost of Administration	$0
Tax Consequences of Administration Exemptions	
Hypothetical Dividend	$0
Amortization of Dividend	
Period	5 years
Interest	10%
Annual Payment	$0

Debt Service Required	
Real Estate:	
Value	$360,000
Interest	10.50%
Amortization	25 years
Annual Payment	$41,195
Personal Property:	
Value	$268,000
Interest	10.50%
Amortization	15 years
Annual Payment	$36,246
Secured Debt Service	$77,441
10% Trustee's Fee	$7,744
Total	$85,185
Unsecured Creditors:	
*Disposable Income	$0
*Chapter 7 Dividend	$0
Annual Payment	$0
Total All Payments	$85,185

*Creditors receive the larger amount.

Farm A demonstrates that a dairy farm on which the secured debt equals the value of the assets, with average production and average expenses, cannot support itself, let alone support the costs of bankruptcy administration under Chapter 12. The debt service on the real estate and per-

sonal property requires an annual payment of $77,441 at the assumed 10.5% interest rate. The funds available for debt service are only $55,300, leaving an operating deficit of $22,141. The cost of bankruptcy and administration merely inflates the deficit further.

FARM B

Secured Debt Leverage: 100%

Income and Expense	
Number Milk Cows	100
Herd Average	16,500
Price/CWT	$11.75
Income	
Milk Income	$193,875
Cull Cows	$11,700
Bull Calves	$3,600
Total Income	$209,175
Operating Expense	$117,250
Net Operating Income	$91,925
Family Living Expense	$12,000
Debt Service Funds	$79,925
Total Payments	$88,235
Disposable Income	($8,310)

Chapter 7 Dividend Calculation	
Total Assets	$648,500
Total Secured Claims	$648,500
Assets to Administer	$0
Cost of Administration	$0
Tax Consequences of Administration Exemptions	
Hypothetical Dividend	$0
Amortization of Dividend	
Period	5 years
Interest	10%
Annual Payment	$0

Debt Service Required	
Real Estate:	
Value	$360,000
Interest	10.50%
Amortization	25 years
Annual Payment	$41,195
Personal Property:	
Value	$288,500
Interest	10.50%
Amortization	15 years
Annual Payment	$39,019
Secured Debt Service	$80,214
10% Trustee's Fee	$8,021
Total	$88,235
Unsecured Creditors:	
*Disposable Income	$0
*Chapter 7 Dividend	$0
Annual Payment	$0
Total All Payments	$88,235

*Creditors receive the larger amount.

Farm B has above-average production and has expenses increased modestly to reflect the increased cost of the higher level of production. The value of the personal property is raised $20,500 to account for the higher value of the dairy herd. This farm generates enough income to support itself

and its debts, even though those debts equal the value of the assets, so long as a Chapter 12 reorganization is not required. Once reorganization becomes necessary, the farm faces the additional expense of supporting the trustee's office, and a deficit of $8,000 results.

FARM C

Secured Debt Leverage: 100%

Income and Expense	
Number Milk Cows	100
Herd Average	19,500
Price/CWT	$11.75
Income	
Milk Income	$219,125
Cull Cows	$11,700
Bull Calves	$3,600
Total Income	$244,425
Operating Expense	$125,250
Net Operating Income	$119,175
Family Living Expense	$12,000
Debt Service Funds	$107,175
Total Payments	$94,186
Disposable Income	$12,989

Chapter 7 Dividend Calculation	
Total Assets	$688,500
Total Secured Claims	$688,500
Assets to Administer	$0
Cost of Administration	$0
Tax Consequences of Administration Exemptions	
Hypothetical Dividend	$0
Amortization of Dividend	
Period	5 years
Interest	10%
Annual Payment	$0

Debt Service Required	
Real Estate:	
Value	$360,000
Interest	10.50%
Amortization	25 years
Annual Payment	$41,195
Personal Property:	
Value	$328,500
Interest	10.50%
Amortization	15 years
Annual Payment	$44,429
Secured Debt Service	$85,624
10% Trustee's Fee	$8,562
Total	$94,186
Unsecured Creditors:	
*Disposable Income	$12,989
*Chapter 7 Dividend	$0
Annual Payment	$12,989
Total All Payments	$107,175

*Creditors receive the larger amount.

Farm C demonstrates that even with 100% leverage on the secured debt, a farmer whose herd is in the top 5% of all Wisconsin dairy herds can generate enough income to support the Chapter 12 proceeding and still have almost $13,000 left over. This is true despite the fact that the value of the personal property is set $60,500 higher than the value of farm personal property in Farm A, to reflect the increased value of the milking herd. The

question with Farm C is not whether the farm could afford a Chapter 12 proceeding, but rather why it would be forced into one. It is our experience with these farms that their lenders will work with the farmer and avoid a Chapter 12 proceeding.

FARM D

Overall Debt Leverage: 100%
Secured Debt Leverage: 60%
No Tax Consequences

Income and Expense	
Number Milk Cows	100
Herd Average	19,500
Price/CWT	$11.75
Income	
Milk Income	$229,125
Cull Cows	$11,700
Bull Calves	$3,600
Total Income	$244,425
Operating Expense	$125,250
Net Operating Income	$119,175
Family Living Expense	$12,000
Debt Service Funds	$107,175
To Secured Claims	$56,512
Disposable Income	$50,663
Required for Unsecured	$53,648
Balance	($2,985)

Chapter 7 Dividend Calculation	
Total Assets	$688,500
Total Secured Claims	$413,100
Assets to Administer	$275,400
Cost of Administration	$22,032
Tax Consequences of Administration	$0
Exemptions	$50,000
Hypothetical Dividend	$203,368
Period	5 years
Interest	10%
Annual Payment	$53,648

Debt Service Required	
Real Estate:	
Value	$360,000
Interest	10.50%
Amortization	25 years
Annual Payment	$24,717
Personal Property:	
Value	$328,500
Interest	10.50%
Amortization	15 years
Annual Payment	$26,657
Secured Debt Service	$51,374
10% Trustee's Fee	$5,137
Total	$56,512
Unsecured Creditors:	
*Disposable Income	$50,663
*Chapter 7 Dividend	$53,648
Annual Payment	$53,648
Total All Payments	$110,160

*Creditors receive the larger amount.

Farm D reflects secured debt equal to 60% of the asset value and total debt which equals the total value of assets used in the farm enterprise. This and all succeeding examples use the highest assumed level of production, 19,500 pounds per cow, for the purpose of illustrating other factors affecting feasibility of reorganization. This example demonstrates that the necessity of making payments to unsecured debts makes reorganization more difficult. This is because Chapter 12 requires that unsecured debt be fully amortized under the plan, to the extent it would have been paid in a Chapter 7 liqui-

dation.[2] Plans cannot be confirmed for terms exceeding five years, which effectively limits the amortization period for payments to unsecured creditors to five years. In this case, because net operating losses from prior years are assumed to eliminate any tax consequence, the only deduction from the total assets available to pay secured claims is the debtor's claim of exemptions. This leaves $132,574 for unsecured creditors, which is required to be amortized over five years at an assumed interest rate of 10%. This burden leaves even this otherwise-profitable farm enterprise insolvent on a cash flow basis. Interest payments could be limited to those due in the last four years, on the theory that a Chapter 7 liquidation would place no funds in the creditors' hands during the first year, but that would not solve the solvency problem.

FARM E

Overall Debt Leverage: 100%
Secured Debt Leverage: 60%
With Tax Consequences

Income and Expense	
Number Milk Cows	100
Herd Average	19,500
Price/CWT	$11.75
Income	
Milk Income	$229,125
Cull Cows	$11,700
Bull Calves	$3,600
Total Income	$244,425
Operating Expense	$125,250
Net Operating Income	$119,175
Family Living Expense	$12,000
Debt Service Funds	$107,175
To Secured Claims	$56,512
Disposable Income	$50,663
Required for Unsecured	$50,663
Balance	0

Chapter 7 Dividend Calculation	
Total Assets	$688,500
Total Secured Claims	$413,100
Assets to Administer	$275,400
Cost of Administration	$22,032
Tax Consequences of Administration	$45,000
Exemptions	$50,000
Hypothetical Dividend	$158,368
Period	5 years
Interest	10%
Annual Payment	$41,777

Debt Service Required	
Real Estate:	
Value	$360,000
Interest	10.50%
Amortization	25 years
Annual Payment	$24,717
Personal Property:	
Value	$328,500
Interest	10.50%
Amortization	15 years
Annual Payment	$26,657
Secured Debt Service	$51,374
10% Trustee's Fee	$5,137
Total	$56,512
Unsecured Creditors:	
*Disposable Income	$50,663
*Chapter 7 Dividend	$41,777
Annual Payment	$50,663
Total All Payments	$107,175

*Creditors receive the larger amount.

2. 11 U.S.C. § 1225(a)(4).

Farm E is identical to Farm D, except that Farm E is assumed to be carrying an unrecognized tax gain, which would be realized in a liquidation under Chapter 7. Realization of the gain would require the Chapter 7 trustee to use a portion of the liquidation proceeds to pay taxes, and therefore reduces the hypothetical Chapter 7 dividend. This tax impact is taken into account under "Tax Consequences" in the lower left column of the summary. The tax cost of liquidation is assumed to be $45,000, which reduces the fund available in the hypothetical Chapter 7 case to an amount which can be amortized for less than the debtor's disposable income, and makes Chapter 12 reorganization feasible. The amortization of required payments to unsecured debt is reduced to $41,777 per year, which is less than the annual disposable income of $50,663: the balance in the left column of the summary returns to zero, and feasibility appears to be present.

The necessity of operating with a zero balance presents a problem of strategy for debtor's counsel where the "disposable income rule" mandates payments the "Chapter 7 dividend rule" would not require. Payments made to unsecured creditors do not benefit the debtor, and so debtor's counsel prefers to present a budget showing no disposable income available for distribution beyond that necessary to amortize the hypothetical Chapter 7 dividend. When the plan is presented, however, values for the farm assets and financing terms for those assets may be undetermined. If secured creditors oppose confirmation of the plan and persuade the court to set higher values, higher interest rates, or shorter amortization periods, then the debtor needs to be able to propose an amendment to his plan which will increase the payment to the prevailing secured creditor. The problem facing debtor's counsel is how to place money in the budget to make that amendment feasible. If the fund appears under "Disposable Income" and the debtor's plan is confirmed as drafted, that money will be paid to the unsecured creditors, which as noted earlier, does not benefit the debtor. If the debtor projects his expenses higher than necessary, believing that he can revise the expenses to obtain any additional funds needed to pay off secured debt, he risks taking the awkward step of attacking his own budget before the court, if amendment becomes necessary. The same disadvantage is inherent in a low income projection.

Some attorneys advocate requesting a court valuation of assets before the plan is filed, as a way of addressing the budget problem. This method would be more effective if the time constraints of Chapter 12 were less stringent, but even then, interest rates and amortization periods would remain undetermined. In addition, this procedure may provoke opposition from secured creditors which a simple plan filing might avoid.

The preferred place to cache excess income is in the proposed payments to secured creditors. This is accomplished by shortening amortization periods to require higher payments, which then absorb the excess cash flow. If asset values or interest rates are set higher than anticipated, the debtor can amend the plan to accommodate the change and obtain the necessary cash

flow by lengthening the amortization period. Assuming the maximum period generally used for such assets is not exceeded, the debtor will probably be able to accommodate the higher required payment. The debtor who places excess cash flow in the secured creditor's hands also obtains an ally in the confirmation battle, as the secured creditor is likely to support the plan.

FARM F

Overall Debt Leverage: 80%
Secured Debt Leverage: 40%
No Tax Consequences

Income and Expense	
Number Milk Cows	100
Herd Average	19,500
Price/CWT	$11.75
Income	
Milk Income	$229,125
Cull Cows	$11,700
Bull Calves	$3,600
Total Income	$244,425
Operating Expense	$125,250
Net Operating Income	$119,175
Family Living Expense	$12,000
Debt Service Funds	$107,175
To Secured Claims	$37,674
Disposable Income	$69,501
Required for Unsecured	$72,650
Balance	($3,149)

Chapter 7 Dividend Calculation	
Total Assets	$688,500
Total Secured Claims	$275,400
Assets to Administer	$413,100
Cost of Administration	$33,048
Tax Consequences of Administration	$0
Exemptions	$50,000
Hypothetical Dividend	$275,400**
Period	5 years
Interest	10%
Annual Payment	$72,650

Debt Service Required	
Real Estate:	
Value	$360,000
Secured Claims	$144,000
Interest	10.50%
Amortization	25 years
Annual Payment	$16,478
Personal Property:	
Value	$328,500
Secured Claims	$131,400
Interest	10.50%
Amortization	15 years
Annual Payment	$17,772
Secured Debt Service	$34,249
10% Trustee's Fee	$3,425
Total	$37,674
Unsecured Creditors:	
*Disposable Income	$69,501
*Chapter 7 Dividend	$72,650
Annual Payment	$72,650
Total All Payments	$110,324

*Creditors receive the larger amount.

**Dividend equals lesser of full payment of claims or net administered assets.

Farm F has equity above the total of all claims, including both secured and unsecured debt. This example demonstrates that even a farmer with equity may not be a good subject for Chapter 12 reorganization, given the

requirement that unsecured debt receive its Chapter 7 dividend with interest over a period not longer than five years. In the case of Farm F, this requirement results in a cash flow projection which will not permit reorganization: the payment of $72,650 to unsecured creditors leaves a budget deficit of $3,149. A reorganization under these circumstances would require that

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FARM G

Overall Debt Leverage: 80%
Secured Debt Leverage: 40%
No Tax Consequences

Income and Expense	
Number Milk Cows	100
Herd Average	19,500
Price/CWT	$11.75
Income	
Milk Income	$229,125
Cull Cows	$11,700
Bull Calves	$3,600
Total Income	$244,425
Operating Expense	$125,250
Net Operating Income	$119,175
Family Living Expense	$12,000
Debt Service Funds	$107,175
To Secured Claims	$37,674
Disposable Income	$69,501
Required for Unsecured	$69,501
Balance	0

Chapter 7 Dividend Calculation	
Total Assets	$688,500
Total Secured Claims	$275,400
Assets to Administer	$413,100
Cost of Administration	$33,048
Tax Consequences of Administration	$70,000
Exemptions	$50,000
Hypothetical Dividend	$260,052**
Period	5 years
Interest	10%
Annual Payment	$68,601

Debt Service Required	
Real Estate:	
Value	$360,000
Secured Claims	$144,000
Interest	10.50%
Amortization	25 years
Annual Payment	$16,478
Personal Property:	
Value	$328,500
Secured Claims	$131,400
Interest	10.50%
Amortization	15 years
Annual Payment	$17,772
Secured Debt Service	$34,249
10% Trustee's Fee	$3,425
Total	$37,674
Unsecured Creditors:	
*Disposable Income	$69,501
*Chapter 7 Dividend	$68,601
Annual Payment	$69,501
Total All Payments	$107,175

*Creditors receive the larger amount.

**Dividend equals lesser of full payment of claims or net administered assets.

some of the unsecured debt be converted to secured debt. That secured debt could then be amortized over a longer period than five years, and reorganization would then be feasible.

Farm G demonstrates that Farm F might be a suitable subject for Chapter 12 reorganization if it were carrying sufficient unrecognized taxable income to offset the otherwise-required payments to unsecured creditors. When a $70,000 unrecognized tax liability is available, the required payment to unsecured creditors is reduced from $72,650 to $69,501. This payment is still excessive, and some conversion of debt from unsecured to secured is still desirable.

FARM H

Overall Debt Leverage: 70%
Secured Debt Leverage: 0%
With Tax Consequences

Income and Expense	
Number Milk Cows	100
Herd Average	19,500
Price/CWT	$11.75
Income	
Milk Income	$229,125
Cull Cows	$11,700
Bull Calves	$3,600
Total Income	$244,425
Operating Expense	$125,250
Net Operating Income	$119,175
Family Living Expense	$12,000
Debt Service Funds	$107,175
To Secured Claims	$0
Disposable Income	$107,175
Required for Unsecured	$127,137
Balance	($19,962)

Chapter 7 Dividend Calculation	
Total Assets	$688,500
Total Secured Claims	$0
Assets to Administer	$688,500
Cost of Administration	$55,080
Tax Consequences of Administration	$45,000
Exemptions	$50,000
Hypothetical Dividend	$481,950**
Period	5 years
Interest	10%
Annual Payment	$127,137

Debt Service Required	
Real Estate:	
Value	$360,000
Interest	10.50%
Amortization	25 years
Annual Payment	$0
Personal Property:	
Value	$328,500
Interest	10.50%
Amortization	15 years
Annual Payment	$0
Secured Debt Service	$0
10% Trustee's Fee	$0
Total	$0
Unsecured Creditors:	
*Disposable Income	$107,175
*Chapter 7 Dividend	$127,137
Annual Payment	$127,137
Total All Payments	$127,137

*Creditors receive the larger amount.

**This figure is the lesser of two numbers: total unsecured claims, or the sum of the column above.

Farm H represents an actual, though unusual, debt situation in which one of my clients was the debtor. This is the case of a farmer with no se-

cured debt, but a total debt equaling 70% of asset values. In this situation most of the debt should be converted to secured debt (from a debt-management point of view), and Chapter 12 penalizes the failure to make that conversion to secured debt by requiring amortization of the Chapter 7 liquidation value over five years. This farm cannot be reorganized with all of the debts unsecured because the cash flow from the operation will not carry the required debt service. Here again, the answer to the problem is to convert unsecured debt to secured debt and thereby lengthen the available amortization period.

VII. Conclusion

In practice, Chapter 12 will have its greatest impact outside bankruptcy court, as creditor-debtor settlements are reached through informal negotiations in which the Chapter 12 remedy provides both the incentive to negotiate, and the gauge by which potential agreements are measured. When actually invoked, the remedy will be less successful. The very invocation testifies that at least one creditor has concluded that the terms on which the debtor proposes to proceed are either not feasible, or not confirmable. As the number of creditors reaching that conclusion increases, the likelihood of confirmation declines. In addition, confirmed plans will depend on optimum operating conditions for their feasibility. Optimal circumstances are rare, and in their absence, confirmed plans will fail.

The negotiation process will select out most of the cases in which reorganization would have a strong likelihood of success. Since a large proportion of the best reorganization candidates will avoid the process, the failure rate among the remainder will be high, as only the more difficult cases reach the formal process.

The case in which a plan is confirmed and completed will represent a miscalculation by one of the parties, though not necessarily by a creditor. The debtor's decision to proceed formally, and the creditor's decision to force formal proceedings, represent conclusions by both parties that the formal outcome, even with its costs, will be more favorable to them than the available informal solution. This conclusion will seldom be correct as to both parties.

Chapter 12 permits more certain prediction of the outcome of formal proceedings than was possible in farm cases under Chapter 11. This enhanced predictability facilitates informal settlement of creditor-debtor disputes, and should reduce the number of erroneous decisions to initiate, or force initiation of, formal proceedings. In addition, it will enable debtors to make more accurate choices between Chapter 12 proceedings and Chapter 7 liquidations.