

Farm Bankruptcy Considerations

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A. Common Misunderstandings About Bankruptcy

Some people think that filing bankruptcy means that you have done something wrong. This is incorrect.

Filing bankruptcy is a business decision. It may be the best way for you to resolve problems with your farm business. It is likely that these problems occurred because of factors that were beyond your control, such as the economy and the weather. The fact that you file for relief in bankruptcy does not mean anything about your personality or your character.

Some people think that you can file bankruptcy against just one or two creditors, leaving other creditors out of the bankruptcy. This is also incorrect.

Bankruptcy is designed to cover your overall financial situation, and all of your debts and assets must be included.

Some people think that if you file bankruptcy, you will get to keep all of your exempt property. This may not be true.

Although you may be able to keep some of your exempt property, mortgages or security interests on that property may remain. In bankruptcy, when an asset is "exempt," this means only that it is pulled out of the bankruptcy estate. It does not, by itself, remove any lien or mortgage on the property. There are some "lien avoidance" powers in bankruptcy, however, that you should discuss with your lawyer. Similarly, you should find out from your lawyer whether you can reschedule your mortgage payments in bankruptcy.

Some people think that anyone who is a lawyer will be competent to file an agricultural bankruptcy. Unfortunately, this is not true.

Bankruptcy law is a very specialized practice. Agricultural law is also a very special area of practice. A farm bankruptcy may involve many complex issues relating to both bankruptcy law and agricultural law. There are many lawyers who may be very

competent in other areas who are not familiar enough with either bankruptcy law or agricultural law to tackle a farm bankruptcy. You should always discuss your lawyer's skills and experience with him or her.

Some people think that all bankruptcies are alike. In fact, the opposite is true— every bankruptcy is different.

There are different types of bankruptcy that you can choose. These types are called different "chapters," referencing the chapter of the Bankruptcy Code that applies to them. For example, there is a Chapter 7 Bankruptcy, which provides for the liquidation of non-exempt assets and the discharge of most of your debts, and there is Chapter 12 Bankruptcy, which provides for the reorganization of the debts of a family farm.

Even within one chapter, however, no two bankruptcies are the same. Who your creditors are, what your debts are, what type of operation you have, and many other factors make each case unique. It will be important for you to consider your situation and all of your options carefully to make the decisions that are best for you.

B. Questions About Farm Bankruptcy

When should I consider my bankruptcy options?

It is a good idea to consider your bankruptcy options long before you may need to file. The following factors should let you know that it is time for you to consider bankruptcy:

- 1) You are not able to keep up with your regular debt payments.
- 2) You have missed significant debt payments and are being contacted by your creditors.
- 3) You have an unusual, large expense that you are not able to meet.

Remember that just because you consider filing bankruptcy does not mean that you will necessarily choose to file bankruptcy. You are just considering all of your business and financial options.

How do I consider filing bankruptcy?

There are many steps that you should take in order to consider your bankruptcy options. These steps will help you to make a good decision. The most important steps are listed as follows:

- 1) Get all of your financial records together and organize them.
- 2) Locate copies of all of your loan documents, especially all papers that you have signed. This will include any loan agreements, security agreements, and mortgages. If you cannot find your copies, you can go to your lender and get copies of the agreements that you have signed.

- 3) Check to see what documents might have been filed against you in your county recorder's office. Ask if there is also a central state filing system that you should check. There may be mortgages, liens, judgments, financing statements, or other legal documents. Make sure that you have a copy of each document.
- 4) Make a list of:
 - *Your debts* (list each creditor by name, address, amount owed, default amount, if any, and any security interest or mortgage that they hold; include all of your debts, even debts to friends and relatives).
 - *Your property or assets* (include a short description and a value for each item of property).
 - *Any money or property that is owed to you* (include a short description and a value for each).
 - *Anticipated farm income* (estimate realistically what you think you will earn this year from your farm operations).
 - *Anticipated farm expenses* (estimate all of your farm expenses for this year).
 - *Anticipated non-farm income* (include all non-farm income that you or your spouse expect to earn this year).
 - *Anticipated non-farm expenses* (list all non-farm expenses, including family living expenses).
- 5) Try to find someone that you can trust to help you. You may be able to get help from your local county extension agent. You should also contact area farmers' organizations for advice on what other help may be available.
- 6) Based on the information that you have pulled together, prepare a cash flow for your operation.

Do I need to see a lawyer?

Yes. Because bankruptcy law is so complex, it is very important that you see a lawyer to discuss your legal rights.

How can I find a good bankruptcy lawyer?

There are many different ways to get good legal advice. Here are some suggestions that may be helpful.

- 1) Talk to people about lawyers. Ask a lot of questions about the quality of service, the fees, and the accessibility of the lawyer.
- 2) Contact the state bar association to see what information may be available about the lawyers in your state. This association will have different "sections" set up according to the various areas of practice. Find out if there is an agricultural law

section. If so, get a list of the membership. Is there a bankruptcy law section? If so, get a list of these members as well.

3) Call law offices. Ask questions:

- Do they practice agricultural law?
- How many farmers do they represent?
- Do they practice bankruptcy law? How much of their practice involves bankruptcy?
- What do they charge? How much would an initial visit cost? If you do need to file a bankruptcy, how much money will you have to pay before filing? They may call this a "retainer fee," and it will probably be different for each type of bankruptcy.

4) Contact your local legal services office to see if you may be eligible for reduced-fee legal services.

What questions should I ask the lawyer?

You should schedule a first appointment, called an "initial visit," with a lawyer. The purpose of this visit is to see whether you would like to hire the lawyer and whether he or she will accept your case. Here are some suggestions for questions you should ask:

- 1) Ask if he or she represents any of your creditors. If so, you should probably find another lawyer, unless there is a very good explanation for why this would not present a conflict of interest.
- 2) Ask how much experience he or she has with farm bankruptcy.
- 3) Discuss the full range of bankruptcy and non-bankruptcy options. The lawyer should be able to estimate what is likely to happen if you file each of the available bankruptcy chapters. He or she should be able to compare this to what will happen if you do not file bankruptcy. This will help you to understand your options, and it will help you find out how knowledgeable the lawyer is.
- 4) Ask how the fees are handled. Is there a retainer fee? If so, is it a flat sum for the whole bankruptcy, or is the fee based on an hourly charge subtracted from the retainer? If it is a flat sum, what exactly is covered? If there is an hourly charge, what is the hourly rate?

When you do hire a lawyer, be sure that you fully understand the agreement that you have. If there is a written fee agreement, be sure that you understand it before you sign it.

What else should I do if I am planning to file bankruptcy?

Although each case is different, here are some tips that should be helpful:

- 1) **Do not** try to pay off any of your creditors before you file. These payments may be considered *preferences* under the Bankruptcy Code. If they are preferences and you do eventually file bankruptcy, the bankruptcy court may take the payments back from your creditor. 11 U.S.C. § 547.
- 2) **Do not** transfer your property to a family member, a friend, or a trust in an attempt to avoid your creditors. This is likely to be overturned by the bankruptcy court as a *fraudulent transfer*. 11 U.S.C. § 548.
- 3) **Do** talk to your lawyer about acceptable bankruptcy planning. This planning should be done well in advance of filing. It should be done very carefully so as to be fully legal, and it should be done even before you are certain that you will file, just so that you will be ready if you do file. Good planning may make a very big difference as to how your bankruptcy turns out.
- 4) **Do** continue to negotiate with your creditors to try to achieve a non-bankruptcy settlement. If such a settlement can be reached, both you and your creditors are likely to save the legal costs of the bankruptcy filing. Sometimes, the threat of bankruptcy can be helpful in your negotiations.
- 5) **Do** try to talk with your family and friends about your situation. It will usually be helpful to you to get your feelings out in the open and to let them provide you with understanding and support. It will also be helpful to others who may be in a similar situation someday.

C. Introduction to Chapter 12 Bankruptcy

What is Chapter 12 bankruptcy?

Chapter 12 bankruptcy is a special type of bankruptcy designed specifically for the reorganization of family farms. It is called "Chapter 12" because the law that authorizes it is set forth in chapter 12 of the Bankruptcy Code.¹

Who is eligible for Chapter 12 bankruptcy?

Only a "family farmer" who has "regular annual income" is eligible for Chapter 12 relief.² If you farm as an individual, in order to be a "family farmer," you must meet the following requirements:³

¹ 11 U.S.C. §§ 1201-1231.

² 11 U.S.C. § 109(f).

³ 11 U.S.C. § 101(17)(A).

- 1) You must be engaged in farming.
- 2) Your total debts must not be more than \$1,500,000.
- 3) At least 80 percent of your debts must arise from your farming operation. In computing this percentage, you must include all "noncontingent, liquidated debts," but you may exclude the debt on your home, unless this debt arose from the farming operation.
- 4) More than 50 percent of your gross income from last year must have come from your farming operation. This requirement refers to the taxable year that precedes the year in which you file for bankruptcy.

If you farm as part of a partnership or corporation, the partnership or corporation must meet the following requirements:⁴

- 1) One family (or the relatives of that family) must own more than 50 percent of the stock or equity in the corporation or partnership.
- 2) This family (or the relatives) must conduct the farming operation.
- 3) More than 80 percent of the assets of the corporation or partnership must be related to the farming operation.
- 4) The total debts of the corporation or partnership must not be more than \$1,500,000.
- 5) At least 80 percent of the total corporate or partnership debts must arise from the farming operation. In computing this percentage, you may exclude the debt on one home owned by the corporation or partnership if it is used as a home for a shareholder or partner, unless the debt arises out of the farming operation.
- 6) If the corporation issues stock, it must not be publicly traded.

Whether you file as an individual or a corporation or partnership, you must also have "regular annual income." This means that you must have income that is "sufficiently stable and regular" to allow you to make payments under a plan.⁵

How might Chapter 12 help me?

If you cannot afford to make your current payments on your debts, you may be able to reorganize these payments in a Chapter 12 bankruptcy. In some cases, Chapter 12 will allow you to alter your secured debt by reducing the amount you owe, reducing the interest rate you are paying, or extending the payment period on your debt. Also, you may be allowed to pay only a portion of your unsecured debt. What you can and cannot do, however, will be based on the specific requirements for "plan confirmation" set forth in the law.

⁴ 11 U.S.C. § 101(17)(B).

⁵ 11 U.S.C. § 101(18).

What is plan confirmation?

In order to reorganize under Chapter 12, you must present a plan to the bankruptcy court. The court must approve or *confirm* your plan. Some of the most important requirements for confirmation are as follows:

- 1) You must have proposed your plan in good faith; that is, you must be sincere in your intention to reorganize your operation according to the plan. You cannot use Chapter 12 just to delay your creditors.
- 2) Unless the creditor agrees otherwise, the plan must allow each secured creditor to keep whatever lien it held on your property. It must also provide that each secured creditor receive the present value of its secured claim. In general terms, this means that you must pay them an amount equal to the fair market value of the collateral. If you pay this over time, you must pay interest on this amount. As an alternative, however, Chapter 12 allows you to turn over the collateral as full payment of the secured debt.⁶
- 3) The plan must provide that unsecured creditors be paid at least as much as they would receive if you liquidated your property in a Chapter 7 bankruptcy. This means the value of your unsecured assets, less the exempt property. The plan must also provide that these creditors receive whatever extra income you have each year after paying your secured creditors and your normal expenses.⁷
- 4) Although you will usually be able to continue to manage your farm yourself, a trustee will be appointed to handle the payments made under your plan. Your plan must provide for the payment of the trustee for his or her services.⁸ This payment may be up to 10 percent of the total of all of your other payments under the plan.
- 5) You must be able to show the court that you can afford to make all of the payments that are required under the plan.⁹

How do I file a Chapter 12 bankruptcy?

Getting a Chapter 12 started is easy. You just need to file a form called a "petition for relief in bankruptcy" with the bankruptcy court.¹⁰ For several reasons, however, you should not do this without being well prepared.

First, the filing of the petition starts the bankruptcy. Many rights and values are fixed as of this time, regardless of what happens later.

Second, you must file your plan within 90 days from the filing of the petition.¹¹ It may be very difficult to get an extension of this 90-day period. Considering how complicated it

⁶ 11 U.S.C. § 1225(a)(5).

⁷ 11 U.S.C. § 1225(a)(4).

⁸ 11 U.S.C. § 1226.

⁹ 11 U.S.C. § 1225(a)(6).

¹⁰ 11 U.S.C. § 301.

can be to come up with an acceptable plan, this is a very short period of time. Therefore, it is best if you can do much of your planning before you file.

Third, after filing, you will have to get court approval for many of your actions. You should consider the timing of your farming operations before you file.

What income and assets will have to be considered in the Chapter 12 bankruptcy?

All of your assets will have to be included in the bankruptcy.¹² This includes everything that you own. In addition, all of the income that you earn, even if it is non-farm income, will be included.

What will my creditors do if I file a Chapter 12 bankruptcy?

As soon as you file the petition for relief in bankruptcy, an "automatic stay" becomes effective.¹³ This means that your creditors cannot take any action against you, such as foreclosure, garnishment, or attachment, without the permission of the court.

Your creditors may, however, ask the court for relief from the stay or for an order requiring you to make payments to them. They may also challenge your right to file a Chapter 12 bankruptcy. Before you file, you should discuss with your lawyer what actions your creditors may take.

How long will the Chapter 12 last?

The bankruptcy court's involvement in your case may only last several months, up until you get the court to confirm your plan. The terms of the plan and the involvement of the trustee will last from three to five years. After that time, your unsecured debt will be discharged, the trustee will be dismissed, and you will simply make your scheduled payments directly to your secured creditors.

What if I am unable to make the payments under my confirmed plan?

If you fail to make the payments that you promised in your plan, your creditors can ask the court to dismiss your case. For this reason, you should always try to anticipate problems and build some cushion into your plan. All of your expenses should be covered by your plan. If something unexpected happens, however, you can ask the court to modify your plan.

Do I need a lawyer to file a Chapter 12 bankruptcy?

Although there is no law that requires you to have a lawyer, bankruptcy procedures and requirements are very complicated. Without the assistance of a competent bankruptcy lawyer, it will be difficult for you to know what your rights are. Your creditors will have

¹¹ 11 U.S.C. § 1221.

¹² 11 U.S.C. § 541(a).

¹³ 11 U.S.C. § 362.

lawyers, often experienced bankruptcy specialists, and they may take advantage of you if you do not have your own legal counsel.

How expensive is it to file a Chapter 12 bankruptcy?

One of the main problems with Chapter 12 is that it is often expensive. Many lawyers will require the payment of an initial fee, called a "retainer fee." This fee may be several thousand dollars. Cost will vary a lot from region to region, however, and from lawyer to lawyer. Therefore, you should talk to others to find out what the going rate may be in your area. You should also find out if there are any legal service offices that offer a reduced fee.

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