Key Advantages of Chapter 12 Bankruptcy *for Struggling Family Farmers*

BY JAMES C. LANIK & JENNIFER B. LYDAY, PARTNERS, WALDREP WALL BABCOCK & BAILEY PLLC

American family farmers and family fishermen[1] are not immune to the effects of the current condition of the general economy. A recent industry analysis indicates that the three most pressing concerns of respondents surveyed in September 2022 were: 1) higher input costs; 2) rising interest rates; and 3) availability of inputs.[2] These factors are squeezing family farmers from all sides.

Needed inputs, such as fertilizer, feed, seed, etc., are becoming more expensive, if they can be had at all. At the same time, the capital needed to purchase those inputs is becoming more expensive to obtain. These trends, along with the ever-present issue of weather, may lead more farmers to seek out bankruptcy protection to maintain their livelihoods and, in some cases, to hold on to land that may have been in their families for generations.

Congress created a specialized chapter of bankruptcy—Chapter 12—in the 1980s to help struggling farmers reorganize their businesses and their debts.[3] A Chapter 12 bankruptcy has similarities to both a Chapter 11 reorganization and a Chapter 13 case, but significant and important differences exist between the chapters. This article provides a brief overview of some of the more material differences.

Eligibility

Chapter 12 was designed to provide farmers a structure to reorganize their business and continue to pay their debts. Thus, only certain individuals and entities can file under Chapter 12. Section 109 of the Bankruptcy Code[4] provides that only a farmer with regular annual income may be a debtor under Chapter 12. A farmer who exceeds the debt threshold or otherwise cannot meet the Chapter 12 requirements can still file under Chapter 11.

A "family farmer" is defined in Section 101(18) of the Bankruptcy Code as an

continued on page 14

continued from page 12

individual or individual and spouse engaged in a farming operation:

- With total debts (secured and unsecured) that do not exceed $11,097,350;
- With at least 50 percent of the total debts that are fixed in amount (exclusive of debt for the debtor's principal residence unless the debts arise out of a farming operation) arising out of a farming operation; and
- Receiving more than 50 percent of the gross income of the individual or the individual and spouse for the preceding tax year, and for each of the second and third prior tax years, from the farming operation.

A "family fisherman" is defined in Section 101 (19A) and Section 109 as an individual or individual and spouse engaged in a commercial fishing operation:

- With total debts (secured and unsecured) that do not exceed $2,268,500;
- With at least 80 percent of total debts that are in a fixed amount arising out of a commercial fishing operation; and
- Who receives more than 50 percent of the gross income of the individual or the individual and spouse for the preceding tax year from the operation.

A corporation may also qualify to be a Chapter 12 debtor. Section 101(18B) has the following requirements for a corporate Chapter 12 debtor:

- More than 50 percent the outstanding stock or equity in the corporation or partnership must be held by one family, or by one family and its relatives;
- The family must conduct the farming or commercial fishing operation;
- More than 80 percent of the value of the corporate or partnership assets consists of assets relating to the farming or fishing operation;
- Total debt of the corporation or partnership must not exceed $11,097,350 (farming operation) or $2,268,550 (commercial fishing operation);
- At least 50 percent for a farming operation or 80 percent for a fishing operation of the corporation's or partnership's total debts which are fixed in amount (exclusive of debt for a principal residence by a shareholder or partner unless such debt arises out of a farming or commercial fishing operation) must arise out of the farming or fishing operation; and
- If the corporation issues stock, the stock cannot be publicly traded.

Unlike in a Chapter 11 case, the automatic stay in a Chapter 12 also extends to co-debtors on consumer debts but not to debts incurred in the ordinary course of business; this stay is identical to the co-debtor stay in a Chapter 13 case.[5]

Lower Fees

Once the eligibility determination has been made, the first material difference for a Chapter 12 debtor is the lower fees. Filing fees are only $278 for a Chapter 12 compared to $1,738 for Chapter 11.[6] Also, the quarterly fees of 28 U.S.C. § 1930 do not apply in a Chapter 12 bankruptcy, and the standing trustee fees based on plan disbursements can be much lower for a Chapter 12 case than for a Chapter 11 case.[7]

The Trustee

In every Chapter 12 bankruptcy case, a disinterested trustee is appointed.[8] The trustee's duties are typically to provide additional oversight of the bankruptcy case. However, the trustee must be heard on matters pertaining to the value of property subject to a lien, confirmation of a plan, modification after confirmation, or the sale of the property of the estate.[9] The trustee is paid through the plan and is also paid a percentage of plan disbursements.[10] Periodic reports are also required in Chapter 12 plans.[11]

The Plan

Chapter 12 plans have many significant differences to plans under Chapter 11; some benefit the farmer, but others can be more onerous. A sampling of those differences includes:

- No exclusivity period exists under Chapter 12. The debtor is the only entity that can ever file a plan.[12]
- That exclusivity is offset by the quick deadlines for filing the plan. The debtor must file a plan within 90 days of the filing of the petition, while in a Chapter 11 case, no set deadline exists other than the exclusivity period. The 90-day deadline can be extended only for situations beyond the control of the debtor.[13]
- No disclosure statement is required, much like in Subchapter V cases.
- With respect to how much a farmer must pay, a Chapter 12 plan more closely resembles a Chapter 13 plan. A Chapter 12 plan must, among other things: provide future earnings/income to the trustee; pay in full all priority claims under Section 507; and if the plan classifies claims, treat all claims in a class the same.[14]
- A Chapter 12 plan may provide for some or all the following: designation of classes of claims; modification of the rights of secured creditors; cure of defaults; payments to unsecured creditors; assumption of unexpired leases and executory contracts; and sale or distribution of property; modification of home mortgages; and the vesting of property in the debtor at confirmation or some other time.[15]
- The plan can last up to three years, though the court can extend that period to no more than five years, for cause.

Plan Confirmation

Continuing with the expedited nature of a Chapter 12 case, the confirmation hearing must occur with 45 days after the debtor files the plan.[16] Creditors do not vote on the plan, but they do have the opportunity to object to the plan and be heard at the confirmation hearing.[17] At the confirmation hearing, the court must find that:[18]

- The plan complies with applicable law;
- The plan pays any expenses or fees required to be paid prior to confirmation;
- The debtor has proposed the plan in good faith;

- The debtor will pay more under the plan than would be paid in a Chapter 7;
- The plan treats secured claims by the consent of the creditor, allowing the creditor to retain its lien and paying the allowed amount of the claim, or surrendering the collateral;
- The debtor can make all payments under, and can comply with, the plan; and
- The debtor will pay any required domestic support obligations.

Many of these requirements also apply to Chapter 11 plan confirmation. Importantly, a Chapter 12 plan need not satisfy the absolute priority rule, as Chapter 12 does not have an analogue to Section 1129(b)(2)(B).

Tax Provisions

Many, if not most, distressed farming operations must sell property to survive. A unique and vitally important feature of Chapter 12 is the ability to reclassify what would otherwise be priority tax claims into general unsecured claims. These reclassified tax claims can be dealt with in the plan as unsecured claims[19] and can be discharged.[20]

The tax must arise from the sale or other disposition of any property used in the farming operation.[21] Such sale or disposition must occur only before the debtor receives a discharge, whether pre- or post-petition.[22]

Discharge

There are two types of discharges available to a Chapter 12 debtor. A debtor will receive a standard discharge if they complete all the plan payments, other than the payments to long-term secured creditors, and certify that all domestic support obligations during the case have been paid.[23]

A debtor may also be eligible for a "hardship discharge" regardless of whether they have completed all payments.[24] A hardship discharge is available only to a debtor whose failure to complete plan payments is due to circumstances beyond the debtor's control and through no fault of the debtor. In addition, creditors must have received at least as much as they would have received in a Chapter 7 liquidation case, and the debtor must be unable to modify the plan.[25]

James C. Lanik is a partner at Waldrep Wall Babcock & Bailey PLLC. He is board certified in Business Bankruptcy Law by the North Carolina State Bar and by the American Board of Certification. He has represented trustees, creditors, and debtors in all aspects of business bankruptcy and is currently on the panel of Chapter 7 Trustees for the Middle District of North Carolina. Lanik has also served as a receiver in state court matters and as a Chapter 11 trustee.

Jennifer B. Lyday is a partner at Waldrep Wall Babcock & Bailey PLLC and the firm's human resources partner. She has represented secured creditors, distressed businesses, unsecured creditors' committees, and trustees in business bankruptcy cases. She has also represented buyers and sellers of assets in bankruptcy and has counseled clients in complex civil litigation. Lyday is currently on the panel of Subchapter V Chapter 11 trustees for the Middle District of North Carolina.

Conclusion

Chapter 12 provides significant advantages over Chapter 11. The lack of a disclosure statement, plan voting, and the absolute priority rule, along with lower filing and other fees, would be enough to steer farmers to Chapter 12. Adding the ability to reclassify priority tax claims related to land sales as unsecured claims, and then to discharge those claims, makes Chapter 12 the clear choice for eligible farmers. J

The authors thank Diana Santos Johnson, their associate at Waldrep Wall Babcock & Bailey PLLC, for her research and drafting assistance

1 The U.S. Bankruptcy Code defines the terms "farmer" (11 U.S.C. § 101(20)), "family farmer" (11 U.S.C. § 101(18)), "commercial fishing operation" (11 U.S.C. § 101(7A), "family fisherman" (11 U.S.C. § 101(19A)), and other terms relating to the agriculture business. For brevity, clarity, and inclusiveness, the authors use the term "farmer" to include both those engaged in farming operations as well as those engaged in commercial fishing operations, unless otherwise noted.

2 See Purdue University/CME Group Ag Economy Barometer, Purdue University Center for Commercial Agriculture, (October 4, 2022), ag.purdue.edu/commercialag/ageconomybarometer/farmer-sentiment-drifts-lower-rising-interest-rates-contribute-to-uneasiness/.

3 The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 extended Chapter 12 to family fishermen.

4 11 U.S.C. § 101, et seq.

5 Compare 11 U.S.C. § 1201 with 11 U.S.C. § 1301.

6 28 U.S.C. § 1930(a).

7 28 U.S.C. § 586 (e)(1)(B) and 28 U.S.C. § 1930.

8 11 U.S.C. § 1202.

9 11 U.S.C. § 1202(b)(3).

10 See 11 U.S.C. § 1226(a)(2); 28 U.S.C. § 586(e)(1). The fees are 10% of the first $450,000 in disbursements, 3% of the disbursements above $450,000.

11 Fed. R. Bankr. P. 2015(b).

12 11 U.S.C. § 1221.

13 *Id.*

14 11 U.S.C. § 1222(a).

15 11 U.S.C. § 1222(b).

16 11 U.S.C. § 1224.

17 11 U.S.C. § 3015(f).

18 11 U.S.C. § 1225(a).

19 11 U.S.C. § 1222(a)(5).

20 11 U.S.C. § 1228(a).

21 11 U.S.C. § 1232(a).

22 *Id.*

23 11 U.S.C. § 1228(a).

24 11 U.S.C. § 1228(b).

25 *Id.*