

AG BANKRUPTCIES

JOHN MASSOUH

Sprouse Shrader Smith PLLC

701 S. Taylor, Suite 500

Amarillo, Texas 79101

(806) 468-3337

State Bar of Texas

10th ANNUAL

JOHN HUFFAKER AGRICULTURAL LAW COURSE

May 26-27, 2016

Lubbock

CHAPTER 12

John F. Massouh

SPROUSE SHRADER SMITH, PLLC
MEMBER

Contact:

(806) 468-3337

john.massouh@sprouselaw.com

Practice Areas:

- Agricultural Law
- Business and Commercial Litigation
- Business Bankruptcy Law

John's practice focuses on business and commercial litigation, agricultural law, business bankruptcy law, creditor's rights, and collections. He represents a wide range of corporate clients and individuals with challenging litigation and bankruptcy matters. He has built a solid reputation representing a variety of business clients in disputes, bankruptcies, and litigation, including nationally known business failures in the cattle and agricultural industries.

John also has extensive experience handling all types of bankruptcy-related matters and litigation, representing many clients, including leading financial institutions and large publicly traded companies, in complex bankruptcy cases under Chapters 7, 11, 12, and 13 of the Bankruptcy Code.

John has significant experience in the agricultural industry, representing feed yards, livestock producers, livestock dealers, farmers, ranchers, agricultural vendors, and financial institutions in a variety of disputes and bankruptcy matters involving debt collection, cattle care and feeding, lien disputes, grazing issues, fraudulent transactions, and all aspects of agricultural lending.

Education:

Texas Tech University School of Law, J.D., 2000

University of Texas, B.B.A., Finance, 1997

Publications and Presentations:

- "Recent Revisions to the UCC" (June 2013)
- "Feedyard Lending and Marketing" (April 2013)
- "Bankruptcy Basics" (December 2012)
- "Overview of Common Livestock Issues," West Texas Bankruptcy Institute (October 2011)
- "Where's the Beef? A Workshop on Cattle Lending" (July 2011)
- "Recovering Attorney and Paralegal Fees," Strategies for Damages and Attorney Fees 2010, State Bar of Texas (February 2010)

TABLE OF CONTENTS

BANKRUPTCY BASICS OUTLINE 1

INTRODUCTION 5

SECTION 503(B)(9) ADMINISTRATIVE PRIORITY CLAIMS 5

CHAPTER 12: BASICS AND ELIGIBILITY 5

 Background..... 5

ELIGIBILITY FOR CHAPTER 12: "REGULAR ANNUAL INCOME" 6

ELIGIBILITY: "FAMILY FARMERS" AND "FAMILY FISHERMEN" 6

HOW CHAPTER 12 WORKS..... 7

THE CHAPTER 12 PLAN AND CONFIRMATION HEARING 8

MAKING THE PLAN WORK..... 9

THE CHAPTER 12 DISCHARGE..... 9

CHAPTER 12 HARDSHIP DISCHARGE..... 10

BANKRUPTCY BASICS OUTLINE

I. BANKRUPTCY - WHAT IS IT?

- A. Creature of Federal Law:
 - 1. Code: 11 U.S.C. et seq
 - 2. Rules: Generally incorporates Federal Rules of Civil Procedure
 - 3. Local Rules: Differ from district to district and court to court

- B. Mechanism for obtaining protection from creditors:
 - 1. No insolvency requirement
 - 2. Voluntary v. Involuntary Petitions
 Involuntary Test: "Generally not paying debts as such debts become due"
 --Need more than one creditor to put a Debtor into an involuntary bankruptcy
 - 3. Main Types of Bankruptcies:
 - a. Chapter 7 - Liquidation
 - b. Chapter 11 - Reorganization
 - c. Chapter 13 - Wage earners
 - d. Chapter 12 - Farmers

II. WHO ARE THE PLAYERS?

- A. Bankruptcy Judge - Article III Judge
 - 1. Technically - District Judge refers cases to Bankruptcy Court. There is a standing order referring cases.
 - 2. Importance:
 - a. Jury Trials - Often "withdraw reference" to get case to District Court. (Some bankruptcy judges, including Judge Jones, will hold jury trials.)
 - b. Appeals - Go first to District Court. (Some districts have BAP's.)

- B. Debtor
 - 1. Chapter 7 - Seeking discharge
 - 2. Chapter 11 - Seeking plan
 - 3. Chapters 12 and 13 - Seeking both

- C. Trustee
 - 1. Chapter 7 - Gathers and liquidates assets
 - 2. Chapter 11 - Not appointed, unless for cause
 - 3. Chapters 12 and 13 - Monitors cases

- D. Debtor-in-Possession - Chapter 11 - Has duties of Chapter 7 Trustee (including fiduciary duty to creditors)
 --Must file Monthly Operating Reports apprising creditors of the current financial situation
- E. United States Trustee - Oversight function all cases
- F. Committees
 - 1. Generally only seen in large Chapter 11 cases
 - 2. Can have multiple committees: creditors' committees, equity securities committees, ad hoc committees, etc.
- G. Creditors - File claims
- H. Equity Security Holders - Usually get wiped out
- I. Debtor's attorney (Trustee's attorney) - Paid from estate (lives in a fishbowl, court must approve fees)

III. WHAT HAPPENS IN THE CASE?

- A. Filing of Petition:
 - 1. Two-page, simple document
 - 2. Sets important dates:
 - a. Fraudulent transfers
 - b. Preference periods

- c. Exclusivity period
 - d. Time to assume or reject leases
 3. Invokes automatic stay
- B. Filing of Schedules: Debtor has 15 days from filing Petition
- C. Creditors Meeting (341 Meeting):
 1. Debtor is under oath
 2. Free discovery
 3. Sets additional dates:
 - a. Objections to exemptions
 - b. Filing proof of claim
 - c. Deadline for filing adversary on some dischargeability proceedings
- D. Chapters diverge from here

IV. CHAPTER 7

- A. Trustee will:
 1. Gather assets (if any). Assets include:
 - a. Preference actions, fraudulent transfer actions, other "Chapter 5" actions
 - b. Debtor's pre-petition causes of action
 2. Reduce assets to cash
 3. Distribute assets to creditors
 4. Object to claims
- B. Debtor must:
 1. Reaffirm
 2. Redeem or
 3. Surrender property to secured creditors
- C. Debtor ultimately is discharged from debts, unless:
 1. Specific debt excepted from discharge
 - a. Automatically, or
 - b. By filing Adversary Proceeding

Note: Chapter 13 eliminates a lot of the exceptions
 2. Denial of Discharge (bad faith, etc.)
- D. Creditor Actions:
 1. Lift stay
 2. Object to exemptions
 3. Dischargeability proceedings
 4. Defend preferences

V. CHAPTER 11

- A. Debtor-in-Possession (DIP) - proposes plan
 1. Exclusivity period (generally 120 days)
 2. Negotiation with creditors and other parties
 3. Approval of plan (or cramdown)
- B. Continued operation of business:
 1. Post-petition financing
 2. Cash collateral issues
 3. Lift stay issues
 4. Files monthly operating reports (pays fees)
- C. Duty to prosecute for creditors:
 1. Preferences
 2. Fraudulent transfers
- D. Assuming and rejecting leases/executory contracts
- E. Object to claims

VI. TYPES OF PROCEEDINGS

- A. Adversary Proceedings (lawsuit within the bankruptcy)
 - 1. Removal
 - 2. Abstention
- B. Contested matters - More informal process

VII. STRATEGIES TO THINK ABOUT

- A. Your creditor's property rights:
 - 1. Secured creditor - you are probably okay, if your collateral has value
 - 2. Unsecured creditor - watch out
 - 3. Bifurcated claims:
 - a. valuation issues
 - b. interest rate issues
 - 4. Pre-petition versus post-petition claims
- B. Use of the automatic stay
 - 1. Stopping foreclosure
 - 2. Stopping litigation
 - 3. Stay does not stop action started by debtor
 - 4. Lifting the stay
- C. Recovery of preferences:
 - 1. Use involuntary to capture assets
 - 2. Prior to bankruptcy, always take the preference
- D. Discovery available:
 - 1. Rule 2004 exams - authorized fishing expeditions
 - 2. Trustee owns the attorney-client privilege
- E. Res judicata/collateral estoppel effect of orders:
 - 1. Confirmation orders - this is federal court
 - 2. Other orders
- F. Rejecting contracts and leases
- G. Cash collateral hearings:
 - 1. Stopping the process before it gets started, or
 - 2. Using other people's money without their permission
- H. Protecting the discharge (or non-discharge) in other forums
 - 1. Wording the judgment
 - 2. Allegations in petition
- I. Other strategies:
 - 1. Protection from indemnity claims
 - 2. Collecting debts - let the trustee do the work
 - 3. Reclamation claims (act quickly)
 - 4. Setoff claims (accorded secured status)

AG BANKRUPTCIES

INTRODUCTION

When one thinks of agriculture bankruptcies, usually Chapter 12 of the Bankruptcy Code comes to mind. Although, Chapter 12 is important, and will be discussed in detail, ag related issues transcend all aspects of the Bankruptcy Code and pop up frequently in Chapter 11 and Chapter 7 bankruptcy filings. This article is intended to touch on some of the common ag related issues in a bankruptcy context and will focus on bankruptcies filed under Chapter 12 of the Bankruptcy Code, otherwise known as "family farmer" bankruptcy.

SECTION 503(B)(9) ADMINISTRATIVE PRIORITY CLAIMS

Many times you might find yourselves representing a trade vendor who is owed money from a bankrupt farmer, dairyman, or cattleman for feed or other supplies delivered to the Debtor, but not paid for. In this instance, your client would typically fall into the class of unsecured creditors who are generally unlikely to get paid in full, or at all. The Bankruptcy Code, however, provides some relief for your client. Section 503(b)(9) of the Code provides:

After notice and a hearing, there shall be allowed administrative expenses, other than claims allowed under section 502(f) of this title, including—

(9) the value of any goods received by the debtor within 20 days before the commencement of a case under this title in which the goods have been sold to the debtor in the ordinary course of such debtor's business.

11 U.S.C. §503(b)(9).

Therefore, your client can be entitled to administrative priority claim with respect to the amount of goods sold to the debtor in the 20 days prior to the filing of the bankruptcy petition. What this means is that your client will jump from the bottom of the list of creditors to get paid to the top. See 11 U.S.C. §507 (other than claims for domestic support obligations, allowed administrative claims are paid first).

The priority nature of the claim is not automatic. In order to avail yourself with priority status, an application for the allowance of an administrative expense claim must be filed with the court, with supporting invoices and documentation to prove that the goods were sold in the ordinary course of business and within the appropriate 20 day time period. Then, if you are successful after notice and hearing, the judge

will enter an order allowing the claim as an administrative priority expense claim.

That seems fine and dandy, but what about getting paid on the claim? Some case law exists that support the finding that an allowed administrative priority expense claim should be paid immediately. Absent a showing of substantial doubt that there will be sufficient funds available to pay all administrative claimants, the Court may compel the Debtor to make immediate payment on the claimant's administrative expense claim. *In re: Four Star Pizza, Inc.*, 135 B.R. 498, 499 (Bankr. W.D. Pa. 1992). The time of the administrative expense payment rests with the discretion of the Bankruptcy Court. *In re: Isis Foods, Inc.*, 27 B.R. 156, 157-58 (W.D. Mo. 1982); see also *In re NE Opco, Inc.*, 501 B.R. 233, 259 (Bankr. D. Del. 2013) ("courts have discretion to determine when an administrative expense claim will be paid [and] consider prejudice to the debtor, hardship to the claimant, and potential detriment to the other creditors' in making such determination).

If the judge declines to allow immediate payment of the administrative expense claim, then typically the claim will be paid when all other administrative expense claims are paid under the plan of reorganization in a Chapter 11 or 12, or upon a trustee's distribution under Chapter 7.

CHAPTER 12: BASICS AND ELIGIBILITY

Background

Chapter 12 is designed for "family farmers" or "family fishermen" with "regular annual income." It enables financially distressed family farmers and fishermen to propose and carry out a plan to repay all or part of their debts. Under chapter 12, debtors propose a repayment plan to make installments to creditors over three to five years. Generally, the plan must provide for payments over three years unless the court approves a longer period "for cause." But unless the plan proposes to pay 100% of domestic support claims (i.e., child support and alimony) if any exist, it must be for five years and must include all of the debtor's disposable income. In no case may a plan provide for payments over a period longer than five years. 11 U.S.C. § 1222(b)-(c).

Congress enacted Chapter 12, which is modeled after Chapter 13, "in response to the agricultural debt crisis of the mid-1980s," *Traders State Bank v. Mann Farms, Inc. (In re Mann Farms, Inc.)*, 917 F.2d 1210, 1214 (9th Cir. 1990), and in order "to enable family farmers to retain their farms while reorganizing their financial affairs." *In re Lockard*, 234 B.R. 484, 490 (Bankr. W.D. Mo. 1999). "Chapter 12 is intended to 'give family farmers facing bankruptcy a fighting chance to reorganize their debts and keep their land.'"

In re Buchanan, 2006 U.S. Dist. LEXIS 50968 at *9, 2006 WL 2090213, at *3 (M.D. Tenn. July 25, 2006) (quoting *In re Pianowski*, 92 B.R. 225, 232 (W.D. Mich. 1988)).

Many "family" farms operate much like an unincorporated business, with high revenue and high debt-loads. Previously, family farmers often had too much debt to qualify as a chapter 13 debtor. However, those farmers also often had too little income to fund a chapter 11 bankruptcy case, making chapter 7 liquidations the only option for debt-ridden farmers.

Chapter 12 operates very much like chapters 11 or 13 of the bankruptcy code, in that it allows the debtor to file a reorganization plan that allows the debtor to retain its assets while repaying creditors all or a portion of their debts over a set period of time. However, chapter 12 of the Bankruptcy Code provides for a middle ground between the short time frame and limited powers of chapter 13 and the longer time frame and broader powers provided in chapter 11. For example, chapter 12 is more streamlined, less complicated, and less expensive than chapter 11, which is better suited to large corporate reorganizations. In addition, few family farmers or fishermen find chapter 13 to be advantageous because it is designed for wage earners who have smaller debts than those facing family farmers. In chapter 12, Congress sought to combine the features of the Bankruptcy Code which can provide a framework for successful family farmer and fisherman reorganizations.

ELIGIBILITY FOR CHAPTER 12: "REGULAR ANNUAL INCOME"

The Bankruptcy Code provides that only a family farmer or family fisherman with "regular annual income" may file a petition for relief under chapter 12. 11 U.S.C. §§ 101(18), 101(19A), 109(f). A debtor cannot be considered a chapter 12 debtor unless the debtor is a "family farmer" with regular annual income. "Regular annual income" is a defined term in the Bankruptcy Code and means annual income sufficiently stable and regular to enable the farmer to make payments under a chapter 12 plan.

The purpose of this requirement is to ensure that the debtor's annual income is sufficiently stable and regular to permit the debtor to make payments under a chapter 12 plan. But chapter 12 makes allowance for situations in which family farmers or fishermen have income that is seasonal in nature.

ELIGIBILITY: "FAMILY FARMERS" AND "FAMILY FISHERMEN"

Under the Bankruptcy Code, "family farmers" and "family fishermen" fall into two categories: (1) an individual or individual and spouse and (2) a corporation or partnership. Farmers or fishermen falling into the first category must meet each of the

following four criteria as of the date the petition is filed in order to qualify for relief under chapter 12:

1. The individual or husband and wife must be engaged in a farming operation or a commercial fishing operation.
2. The total debts (secured and unsecured) of the operation must not exceed \$4,031,575 (if a farming operation) or \$1,868,200 (if a commercial fishing operation).
3. If a family farmer, at least 50%, and if family fisherman at least 80%, of the total debts that are fixed in amount (exclusive of debt for the debtor's home) must be related to the farming or commercial fishing operation.
4. More than 50% of the gross income of the individual or the husband and wife for the preceding tax year (or, for family farmers only, for each of the 2nd and 3rd prior tax years) must have come from the farming or commercial fishing operation.

In order for a corporation or partnership to fall within the second category of debtors eligible to file as family farmers or family fishermen, the corporation or partnership must meet each of the following criteria as of the date of the filing of the petition:

1. More than one-half the outstanding stock or equity in the corporation or partnership must be owned by one family or by one family and its relatives.
2. The family or the family and its relatives must conduct the farming or commercial fishing operation.
3. More than 80% of the value of the corporate or partnership assets must be related to the farming or fishing operation.
4. The total indebtedness of the corporation or partnership must not exceed \$4,031,575 (if a farming operation) or \$1,868,200 (if a commercial fishing operation).
5. At least 50% for a farming operation or 80% for a fishing operation of the corporation's or partnership's total debts which are fixed in amount (exclusive of debt for one home occupied by a shareholder) must be related to the farming or fishing operation.
6. If the corporation issues stock, the stock cannot be publicly traded.

A "farming operation" includes "farming, tillage of the soil, dairy farming, ranching, production or raising of crops, poultry, or livestock, and production of poultry or livestock products in an unmanufactured state." § 101(21). The definition of "farming operation" does not provide an exclusive list of all farming activities

and is not limited to the specific activities delineated in the statute. *In re Armstrong*, 812 F.2d 1024, 1026 (7th Cir. 1987); *Watford v. Fed. Land Bank of Columbia (In re Watford)*, 898 F.2d 1525, 1527 (11th Cir. 1990). "This definition is to be construed liberally in order to further Congress' purpose of helping family farmers to continue farming." *Watford*, 898 F.2d at 1527.

Two tests have been employed by bankruptcy courts when examining debtor's income for the purpose of determining what percentage of that income is from farming. The first test looks at the extent to which the income in question bears a relationship to the debtor's farming activities prescribed by the words of the statute. *Armstrong*, 812 F.2d at 1027-29. Under this test, courts use the definition of gross income found in the Tax Code at 26 U.S.C. § 62(a) and then determine what percentage of that gross income is derived from farming operations (hereinafter, "Tax Code test"). *In re Wagner*, 808 F.2d 542, 549 (7th Cir. 1986). Other courts have found the definition of "gross income" in the Tax Code too rigid for use in bankruptcy cases and have employed a more flexible approach. See *Cadle Co. v. King (In re King)*, 272 B.R. 281, 292-93 (Bankr. N.D. Okla. 2002) (discussing the two approaches). The second test examines the circumstances around the debtor's income in order to achieve an equitable result. *Watford*, 898 F.2d at 1528-29.

HOW CHAPTER 12 WORKS

A chapter 12 case begins by filing a petition with the bankruptcy court serving the area where the individual lives or where the corporation or partnership debtor has its principal place of business or principal assets. Unless the court orders otherwise, the debtor also shall file with the court (1) schedules of assets and liabilities, (2) a schedule of current income and expenditures, (3) a schedule of executory contracts and unexpired leases, and (4) a statement of financial affairs. Fed. R. Bankr. P. 1007(b). A husband and wife may file a joint petition or individual petitions. 11 U.S.C. § 302(a).

When a chapter 12 petition is filed, an impartial trustee is appointed to administer the case. 11 U.S.C. § 1202. In some districts, the U.S. trustee appoints a standing trustee to serve in all chapter 12 cases. 28 U.S.C. § 586(b). As in chapter 13, the trustee both evaluates the case and serves as a disbursing agent, collecting payments from the debtor and making distributions to creditors. 11 U.S.C. § 1202.

Similar to a chapter 11 debtor-in-possession, a chapter 12 debtor continues in possession of its assets and continues to operate its business. As in chapter 11, a chapter 12 debtor has a fiduciary duty while in bankruptcy to act for the benefit of its creditors and not in the debtor's own self-interests. However, in a chapter 12 case a trustee is appointed from the outset of the case to oversee the debtor's conduct and, most

importantly, to collect the debtor's plan payments and make distributions to creditors.

Filing the petition under chapter 12 "automatically stays" (stops) most collection actions against the debtor or the debtor's property. 11 U.S.C. § 362. Filing the petition does not, however, stay certain types of actions listed under 11 U.S.C. § 362(b). The stay arises by operation of law and requires no judicial action. As long as the stay is in effect, creditors generally cannot initiate or continue any lawsuits, wage garnishments, or even telephone calls demanding payments.

Chapter 12 also contains a special automatic stay provision that protects co-debtors. Unless the bankruptcy court authorizes otherwise, a creditor may not seek to collect a "consumer debt" from any individual who is liable with the debtor. 11 U.S.C. § 1201(a). Consumer debts are those incurred by an individual primarily for a personal, family, or household purpose. 11 U.S.C. § 101(8).

Between 21 to 35 days after the petition is filed, the chapter 12 trustee will hold a "meeting of creditors." During the meeting the trustee puts the debtor under oath and both the trustee and creditors may ask questions. The debtor must attend the meeting and answer questions regarding the debtor's financial affairs and the proposed terms of the debtor's repayment plan. 11 U.S.C. § 343; Fed. R. Bankr. P. 4002. If a husband and wife have filed a joint petition, they both must attend the creditors' meeting. In order to preserve their independent judgment, bankruptcy judges are prohibited from attending. 11 U.S.C. § 341(c). The parties typically resolve problems with the plan either during or shortly after the creditors' meeting.

In a chapter 12 case, to participate in distributions from the bankruptcy estate, unsecured creditors must file their claims with the court within 90 days after the first date set for the meeting of creditors. Fed. R. Bankr. P. 3002(c). A governmental unit, however, has 180 days from the date the case is filed file a proof of claim. 11 U.S.C. § 502(b)(9).

After the meeting of creditors, the debtor, the chapter 12 trustee, and interested creditors will attend a hearing on confirmation of the debtor's chapter 12 repayment plan.

Pre-Confirmation Issues

The most important issue occurring in chapter 12 are use of "cash collateral" and whether a secured creditor is receiving adequate protection for its claims. With respect to the former, "cash collateral" is defined as any cash proceeds stemming from a secured creditors' collateral. The most obvious example of cash collateral in a chapter 12 case are proceeds stemming from the sale of livestock, milk or crops that act as security for a creditors' claims. In those instances, when a secured creditor has a lien on livestock, milk

production or crops “and the proceeds thereof,” the debtor has the right to sell its livestock, milk and/or crops to fund its business, but must “adequately protect” the secured creditors’ claims. In chapters 7, 11, or 13, “adequate protection” typically means the “indubitable equivalent” of the value of the property on the date the debtor entered bankruptcy. For example, if the debtor’s crops were worth \$100,000 on the petition date and debtor seeks to sell all of the crops, the debtor must ensure that the creditor receives at least \$100,000 from the sale. However, chapter 12 has a special provision regarding adequate protection which defines “adequate protection” as, among other things, periodic cash payments, additional or replacement liens, or, with respect to farmland, payment for the use of the land of the “reasonable rent customary in the community in which the property is located.” This provision allows the debtor to sell crops, pay a portion of the secured proceeds to its secured creditor, and retain the remainder of the proceeds to fund new crops. The same can be said of milk production and livestock production.

THE CHAPTER 12 PLAN AND CONFIRMATION HEARING

Just like in chapters 11 and 13, the goal of the bankruptcy case for the family farmer debtor is to emerge from the case by filing a chapter 12 plan. The reorganization plan is central to a Chapter 12 bankruptcy. The plan provides the bankruptcy court with a detailed description of how the farm intends to continue operating while in bankruptcy and after being successfully discharged from bankruptcy. In essence, the reorganization plan is a short term and long term business plan for the farm. Creditors do not need to approve the plan but do get an opportunity to object to the plan. The typical objections are that payments offered under the plan are less than creditors would receive if the debtor's assets were liquidated, or that the plan does not commit all of the debtor's disposable income for the three-to-five-year period of the plan.

The plan term is typically 3 to 5 years and acts as a new contract between the debtor and its creditors regarding how debts are repaid. Like in chapter 11 or chapter 13, generally speaking, secured creditors are paid the lesser of the “present day value” the collateral securing their claims or their total claim. For a plan to be confirmable by the court, the plan must provide unsecured creditors with more than they would have received had the debtor’s assets been liquidated for the benefit of creditors and must include all of the debtor’s “disposable income.” Unfortunately, with the increasing rise in secured debts that would be paid upon liquidation, unsecured creditors often receive less than 50% of their claims over 5 years through a chapter 12 plan. Chapter 12 also allows a debtor to pay its secured claims over a period of time greater than 5

years. This applies to both long-term and short-term secured debt and can even apply to debt that has fully matured prior to the bankruptcy case being filed. In many instances, a family farmer has limited income with which to pay its creditors and is forced to stretch a secured creditor’s debt repayment over many years. This often results in litigation regarding whether a plan is proposed in “good faith” and whether the plan is “feasible.”

Unless the court grants an extension, the debtor must file a plan of repayment with the petition or within 90 days after filing the petition. 11 U.S.C. § 1221. The plan, which must be submitted to the court for approval, provides for payments of fixed amounts to the trustee on a regular basis. The trustee then distributes the funds to creditors according to the terms of the plan, which typically offers creditors less than full payment on their claims.

There are three types of claims: priority, secured, and unsecured. Priority claims are those granted special status by the bankruptcy law, such as most taxes and the costs of bankruptcy proceeding. Secured claims are those for which the creditor has the right to liquidate certain property if the debtor does not pay the underlying debt. In contrast to secured claims, unsecured claims are generally those for which the creditor has no special rights to collect against particular property owned by the debtor.

A chapter 12 plan must provide for full payment of all priority claims, unless a priority creditor agrees to different treatment of the claim or, in the case of a domestic support obligation, unless the debtor contributes all “disposable income” - discussed below - to a five-year plan. 11 U.S.C. § 1222(a)(2), (4).

Secured creditors must be paid at least as much as the value of the collateral pledged for the debt. One of the features of Chapter 12 is that payments to secured creditors can sometimes continue longer than the three-to-five-year period of the plan. For example, if the debtor's underlying debt obligation was scheduled to be paid over more than five years (i.e., an equipment loan or a mortgage), the debtor may be able to pay the loan off over the original loan repayment schedule as long as any arrearage is made up during the plan.

The plan does not have to pay unsecured claims in full, as long as it commits all of the debtor's projected “disposable income” (or property of equivalent value) to plan payments over a 3 to 5 year period, and as long as the unsecured creditors are to receive at least as much as they would receive if the debtor's nonexempt assets were liquidated under chapter 7. 11 U.S.C. § 1225. “Disposable income” is defined as income not reasonably necessary for the maintenance or support of the debtor or dependents or for making payments needed to continue, preserve, and operate the debtor's business. 11 U.S.C. § 1225(b)(2).

Perhaps the most beneficial aspect of a Chapter 12 bankruptcy is the ability of the farmer to “cram down” the secured debt. The farmer is able to reduce secured debt to the value of the collateral securing the debt. For example, Farmer borrowed \$300,000 to purchase dairy cows and the cows provide the collateral for the loan. The cows now have a value of \$200,000. If the Farmer were to file a Chapter 12 bankruptcy, the secured debt on the cows would be reduced to \$200,000 and the other \$100,000 of the cow loan would be converted to unsecured debt. Farmer would be required to continue to make payments on the cow loan but at the lower debt level of \$200,000.

Within 45 days after filing the plan, the presiding bankruptcy judge decides at a "confirmation hearing" whether the plan is feasible and meets the standards for confirmation under the Bankruptcy Code. 11 U.S.C. §§ 1224, 1225. Creditors, who receive 21 days' notice, may appear at the hearing and object to confirmation. Fed. R. Bankr. P. 2002(a)(8). While a variety of objections may be made, the typical arguments are that payments offered under the plan are less than creditors would receive if the debtor's assets were liquidated, or that the plan does not commit all of the debtor's disposable income for the three-to-five-year period of the plan.

If the court confirms the plan, the chapter 12 trustee will distribute funds received in accordance with the terms of the plan. 11 U.S.C. § 1226(a). If the court does not confirm the plan, the debtor may file a modified plan. 11 U.S.C. § 1223. The debtor may also convert the case to a liquidation under chapter 7. 11 U.S.C. § 1208(a). If the debtor fails to confirm a plan and the case is dismissed, the court may authorize the trustee to keep some of the funds for costs, but the trustee must return all remaining funds to the debtor (other than funds already disbursed to creditors). 11 U.S.C. § 1226(a).

For a Chapter 12 plan to be confirmed, the following criteria must be met:

1. The plan must be submitted in good faith. That is, the farmer must file the Chapter 12 bankruptcy with true intentions of continuing the family farming operation. The filing cannot be done to simply delay actions by creditors.
2. The plan must address how secured debt will be repaid. Chapter 12 provides for three possible means of modifying debt:
 - a. Negotiating mutually agreeable modified terms with the creditor.
 - b. “Cramming down” the secured debt to the present value of the collateral securing the debt.
 - c. The collateral is turned over to the creditor in satisfaction of the debt.
3. The plan must provide for the full payment of all priority claims. Priority claims include tax liability, child support payments, and alimony.

The plan will require the farmer to stay on a strict budget for both the farm and personal living expenses. Farmers in Chapter 12 bankruptcy often find the strict budgeting the most difficult aspect of the plan. Farmers, being autonomous, independent, and self-reliant, can find the transition to adhering to a pre-established budget challenging. For example, the farmer cannot finance a new piece of equipment or spend more than his allotted personal funds without permission from the trustee. Therefore, it is extremely important to develop a plan that the farmer can live within.

On occasion, changed circumstances will affect the debtor's ability to make plan payments. A creditor may object or threaten to object to a plan, or the debtor may inadvertently have failed to list all creditors. In such instances, the plan may be modified either before or after confirmation. 11 U.S.C. §§ 1223, 1229. Modification after confirmation is not limited to an initiative by the debtor, but may also be made at the request of the trustee or an unsecured creditor. 11 U.S.C. § 1229(a).

MAKING THE PLAN WORK

The provisions of a confirmed plan bind the debtor and each creditor. 11 U.S.C. § 1227. Once the court confirms the plan, the debtor must make the plan succeed. The debtor must make regular payments to the trustee, which will require adjustment to living on a fixed budget for a prolonged period. Furthermore, while confirmation of the plan entitles the debtor to retain property as long as payments are made, the debtor may not incur any significant new debt without consulting the trustee, because additional debt may compromise the debtor's ability to complete the plan. 11 U.S.C. §§ 1222(a)(1), 1227. In any event, failure to make the plan payments may result in dismissal of the case. 11 U.S.C. § 1208(c). In addition, the court may dismiss the case or convert the case to a liquidation case under chapter 7 of the Bankruptcy Code upon a showing that the debtor has committed fraud in connection with the case. 11 U.S.C. § 1208(d).

THE CHAPTER 12 DISCHARGE

The debtor will receive a discharge after completing all payments under the chapter 12 plan. The discharge has the effect of releasing the debtor from all debts provided for by the plan allowed under section 503 or disallowed under section 502, with

limited exceptions. Those creditors who were provided for in full or in part under the plan may no longer initiate or continue any legal or other action against the debtor to collect the discharged obligations.

Certain categories of debts are not discharged in chapter 12 proceedings. 11 U.S.C. § 1228(a). Those categories include debts for alimony and child support; money obtained through filing false financial statements; debts for willful and malicious injury to person or property; debts for death or personal injury caused by the debtor's operation of a motor vehicle while the debtor was intoxicated; and debts from fraud or defalcation while acting in a fiduciary capacity, embezzlement or larceny. Those debts that will not be discharged should be paid in full under a plan. With respect to secured obligations, those debts may be paid beyond the end of the plan payment period and, accordingly, are not discharged.

CHAPTER 12 HARDSHIP DISCHARGE

The court may grant a "hardship discharge" to a chapter 12 debtor even though the debtor has failed to complete plan payments. 11 U.S.C. § 1228(b). Generally, 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. 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. For example, injury or illness that precludes employment sufficient to fund even a modified plan may serve as the basis for a hardship discharge. The hardship discharge does not apply to any debts that are nondischargeable in a chapter 7 case. 11 U.S.C. § 523.