

Saving The Family Farm: The Benefits of Considering Chapter 12 in Montana

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Chapter 12 is the most powerful chapter under Title 11 of the United States Code Annotated. This chapter of the Code is designed to protect the livelihoods of the family farmer and rancher, among other qualifiers not discussed herein. These folks are your beloved family and friends, and often as important, your clients. Family farms and ranches are a cornerstone of the Montana economy, and they are deserving of protection and advocacy in financially difficult times. Therefore, the main purpose of this article is intended to demonstrate to practitioners that represent farmers and ranchers the value (and necessity) of advising your clients of the benefits of Chapter 12, and referring out where appropriate as failure to properly advise your clients of the availability and benefit of Chapter 12 could be a costly professional mistake.

An ancillary purpose of this article is to encourage bankruptcy practitioners to consider entering the Chapter 12 arena. More practitioners are leaving the Chapter 12 practice than are being replaced. This author's hope is to renew interest in a waning practice area that is critical to the continued success of an important aspect of Montana's economy.

The good news for the non-bankruptcy practitioner is that the Chapter 12 screening process is very simple. All one must do is look to Sections 101(18)(A)–(B) which contains the requirements for both individual and non-individual debtors. The requirements are summarized for the reader below:

Characteristic	Individual (or Individual and Spouse)	Non-Individual
Debt Limit	Aggregate debts of \$12,562,250.	Aggregate debts of \$12,562,250.
Debt Composition	≥50% aggregate noncontingent, liquidated debts arise out of a farming operation owned by individual or individual and spouse.	None.
Income Qualification	>50% of the gross income is from farming and ranching in the year before filing, or >50% of the gross income is from farming and ranching in both the second and third year before filing.	None.
Asset Composition	None.	>80% of the value of assets consists of assets related to the farming/ranching operation.
Ownership Restriction	Not Applicable.	>50% of the outstanding stock or equity is held by one family, or by one family and the relatives of such family, and the same conduct the farming operation.
Publicly Traded	Not Applicable.	Not Allowed.
Farming/Ranching Operation Required?	Not always.	Yes.

Let us assume that you have a client who has recently engaged in farming or ranching, the client is facing financial struggles, and that you have determined that they appear to be eligible for a Chapter 12 bankruptcy. The following are a few of the extraordinary benefits that farmers and ranchers may utilize under Chapter 12 of the Bankruptcy Code.

Cramdown of Secured Claims.

In order to be paid under a bankruptcy plan, creditors typically must file a proof of claim. Section 506(a) provides for the bifurcation of a creditor's claim into secured and unsecured portions, depending on the value of the collateral

which secures the claim. This section allows the claim to be treated as secured up to the value of the collateral with any excess being treated as unsecured. In a hypothetical scenario, say a farmer owns a tract of land valued at \$1,000,000. This tract may also contain the farmer's principal residence, as would be typical. However, let us assume that this same tract is encumbered by a secured creditor to the tune of \$1,500,000.

Section 506(a) provides that the secured portion of the creditor's claim is \$1,000,000, while the unsecured portion is \$500,000. In a Chapter 12 case, the farmer can cramdown the debt owed to the creditor to the value of the collateral.

In this simple example, that is up to a 33% savings to the farmer, and the ability to modify mortgages secured by the principal residence is often essential to a successful reorganization. However, this particular example is frustrated under other chapters of the Bankruptcy Code due to the existence of the homestead. Chapters 11 and 13 often disallow cramdowns of certain debts, particularly those secured by mortgages on a debtor's principal residence (see e.g., §§ 1123(b)(5), 1322(b)(2)). Section 1222(b)(2) of Chapter 12 contains no such restriction.

Reamortization of Secured Loans.

Is your farming or ranching client six months behind on their land note or equipment loan? Did your client have a balloon due last year, and they are now being sued by the bank for failure to pay? Chapter 12 offers a solution. Under Section 1222(b)(5), (9) and 1222(c), the plan may provide for the curing of any defaults on any unsecured or secured claim within a reasonable time, and such allows the farmer or rancher to pay their secured claims over a period exceeding the term of the plan. In other words, the debtor may get caught up on their non-dischargeable unsecured obligations (while dumping the dischargeable ones after their final plan payment) and stretch out payments on their secured obligations for a period beyond the term of the plan, up to the usable life of the asset. Depending on the character of the asset, this could be several years beyond the prior contractual maturity date—often 25–30 years for farmland and 5–7 years for farm equipment.

In addition to the term of the loan, interest rates can also easily be affected through negotiation and confirmation of the Chapter 12 plan. The Supreme Court in *Till v. SCS Credit Corp.*, 541 U.S. 465 (2004) adopted an approach for determining the cramdown interest rate. The interest rate is calculated by taking the prime rate as of the effective date of the plan and adding a risk adjustment of approximately 0.25% to 3.0% based on factors such as: (1) probability of plan completion/default risk; (2) duration of the plan or payments made to the creditor; (3) quality and liquidity of the collateral; and (4) the creditor's equity cushion. It is not uncommon for this author to see interest rates adjusted between 0.5% to 1.0%.

Flexible Payment Schedule.

First, the timing involved with filing the Chapter 12 plan is worth mentioning. Rule 3015(b), F.R.B.P., requires a Chapter 13 debtor to file a plan within 14 days of the petition date. Chapter 12 debtors need not file a plan until 90 days after the petition date, as provided under Rule 3015(a), F.R.B.P., and Section 1221 of the Code. The circumstances of either example may warrant an extension, but the default rules greatly favor the Chapter 12 debtor and their

professional(s) as the plan is being thoughtfully prepared.

Second, a Chapter 13 debtor must typically start making regular monthly plan payments within 30 days of filing as required by Sections 1326(a)(1), 1325(a)(5)(B)(iii)(I). Chapter 12 contains no such requirement whether the subject debts are secured or otherwise. Chapter 12 debtors are able make payments as infrequent as annually, and they often do due to the nature of the business.

Capital Gains Hack.

There are two certainties in this life—death and taxes. Congress even codified this certainty in the Bankruptcy Code, at least to some extent. Section 507(a)(8) treats certain tax debt as priority debt under the Bankruptcy Code. Section 1222(a)(2) instructs that the bankruptcy plan must provide for the full payment of all creditor claims entitled to priority under Section 507, unless the holder of a particular claim agrees to different treatment of that claim. Oftentimes, it proves difficult to get the holder of a priority claim to agree to different treatment, and such could involve the debtor giving up something of value, e.g., a security interest in property. Even more damning, there are certain debts that are non-dischargeable under the

Bankruptcy Code. One such type debt, under Section 523(a)(1), are those debts for a tax of the kind specified in 507(a)(8).

However, there is one very important exception to this rule. This exception falls under Sections 1232(a)(1)–(4) which provide,

“Any unsecured claim of a governmental unit against the debtor or the estate that arises before the filing of the petition, or that arises after the filing of the petition and before the debtor's discharge under section 1228, as a result of sale, transfer, exchange, or other disposition of any property used in the debtor's farming [or ranching] operation—(1) shall be treated as an unsecured claim...(2) shall not be entitled to priority...and (4) shall be discharged.”

Let us summarize. Pre-petition tax debt otherwise entitled to priority is now nonpriority. In other words, while the same must be provided for by the plan, such is no longer required to be paid in full or prioritized over other unsecured creditors. Additionally, even though a tax debt may have arisen post-petition, which typically would not be dischargeable, the farmer or rancher is entitled to treat said tax debt as if it arose pre-petition. If the farmer or rancher does not generate income sufficient to pay the tax debt under the plan, the now nonpriority tax debt is simply discharged after the farmer or rancher makes their final plan payment and obtains an order for discharge.

No Consent Necessary.

You might be asking yourself, “How does the

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bankruptcy attorney get away with all of the foregoing shenanigans?” The answer is simple: we just can. While the Chapter 12 debtor attorney strives to resolve all disputes amicably through stipulation, we are well equipped to go toe-to-toe with any number of creditors and their attorneys in the bankruptcy case. Chapter 12 plans often achieve great success, over and above what a Chapter 11 plan can provide for under similar circumstances due to the firm disclosure and voting requirements that one would expect under a Chapter 11 business reorganization (see e.g., §§ 1125, 1126, 1129(a)(7)–(10)).

Farming and ranching is undoubtedly a business. However, confirmation of a Chapter 12 plan is more akin to confirmation of a Chapter 13 plan (compare §§ 1225, 1325). The farmer and rancher proffering a plan under Chapter 12 need only prove to the Bankruptcy Court that the statutory requirements are met, and that the plan is confirmable. This may be done over the objections of one or more creditors and the Chapter 12 trustee. The farm and ranch business does not have the same hoops to jump through as an individual or non-individual business debtor under chapter 11. The farmer or rancher simply goes to a hearing with counsel, and if diligently prepared and proceeding in good faith, stands a very good chance at confirming a plan of reorganization.

Conclusion.

There are so few areas of state and federal law that permit an attorney to walk around with a trump card in their back pocket. Debtor attorneys that practice under Chapter 12 get the privilege of doing so every day they walk into their office and get to work on their clients’ cases. If this does not get the reader excited, I am uncertain what will. If you are a bankruptcy practitioner that has found earlier success under Chapter 13 or 11, you can easily find success under Chapter 12. All it takes is a little careful study of the Bankruptcy Code and related caselaw, and perhaps a few calls to trusted colleagues when the going gets tough. If you are not interested in bankruptcy, but you represent farmers and ranchers in any respect, I implore you to consider referring your financially distressed farm and ranch client to a Chapter 12 practitioner. Alternatively, you should at least not hesitate to pick up the phone and call one yourself to pick their brain. Why spend years of costly defense work and debt workouts when a few months under Chapter 12 can provide a workable solution? Bankruptcy is always an uncomfortable and precarious endeavor for the affected clients. However, those with familiarity in the subject matter enthusiastically propound the extraordinary relief that Chapter 12 has to offer.

In memory of Gary S. Deschenes, a friend of and counsel to Montana farmers and ranchers.



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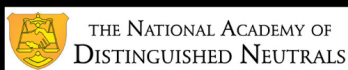
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