

Family Farmer Bankruptcy - Chapter 12

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Background

Chapter 12 is designed for “family farmers” with “regular annual income” who desire to pay their debts but are currently unable to do so. The purpose of chapter 12 is to enable financially distressed “family farmers,” under court supervision and protection, to propose and carry out a repayment plan under which creditors are paid over an extended period of time. Under this chapter, debtors are permitted to repay creditors, in full or in part, in installments over a three-year period, during which time creditors are prohibited from starting or continuing collection efforts. A plan providing for payments over more than three years must be “for cause” and be approved by the court. In no case may a plan provide for payments over a period longer than five years, with the exception that some secured claims may be paid beyond the five year period. 11 U.S.C. § 1222(b)-(c).

In tailoring chapter 12 to meet the economic realities of family farming, this law has eliminated many of the barriers that family farmers had faced when seeking to reorganize successfully under either chapter 11 or 13 of the Bankruptcy Code. For example, chapter 12 is more streamlined, less complicated, and less expensive than chapter 11, which is better suited to the large corporate reorganization. In

addition, few family farmers find chapter 13 to be advantageous because it was designed for wage earners who have smaller debts than those facing family farmers. In chapter 12,

While the information presented herein is accurate as of the date of publication, it should not be cited or relied upon as legal authority. This information should not be used as a substitute for reference to the United States Bankruptcy Code (title 11, United States Code) and the Bankruptcy Rules, both of which may be reviewed at local law libraries, or to any local rules of practice adopted and disseminated by each bankruptcy court. Finally, this fact sheet should not substitute for the advice of competent legal counsel.

Congress sought to combine the features of the Bankruptcy Code which can provide a framework for successful family farm reorganizations. At the time of the enactment of chapter 12, Congress could not be sure whether chapter 12 relief for the family farmer would be required indefinitely. Accordingly, the law (which first provided that no chapter 12 cases could be filed after September 30, 1993) currently provides that no cases may be filed under chapter 12 after October 1, 2001. As of

June 30, 2002, legislation is pending in Congress to extend that deadline.

The Bankruptcy Code provides that only a family farmer with “regular annual income” may file a petition for relief under chapter 12. 11 U.S.C. §§ 101(18), 109(f). 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. Allowance is made under chapter 12, however, for situations in which family farmers may have income that is seasonal in nature. Relief under this chapter is voluntary; thus, only the debtor may file a petition under chapter 12.

Under the Bankruptcy Code, those eligible to file as “family farmers” fall into two categories: (1) an individual or individual and spouse and (2) a corporation or partnership. Those 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.
2. The total debts (secured and unsecured) of that farming operation must not exceed \$1.5 million.
3. Not less than 80% of the total

debts which are fixed in amount must be related to the farming operation.

4. More than 50% of the gross income of the individual or the husband and wife for the preceding tax year must have come from the farming operation.

In order for a corporation or partnership to fall within the second category of debtors eligible to file as "family farmers," 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 of 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 operation.

3. More than 80% of the value of the corporate or partnership assets must be related to the farming operation.

4. The total indebtedness of the corporation or partnership must not exceed \$1.5 million.

5. Not less than 80% of the corporation's or partnership's total debts which are fixed in amount must come from the farming operation owned or operated by the corporation or partnership.

6. If the corporation issues stock, the stock cannot be publicly traded.

An individual or family farmer cannot file under chapter 12 or any other chapter if, during the preceding 180 days, a prior bankruptcy petition was dismissed due to the debtor's willful failure to appear before the court or comply with orders of the court or was voluntarily dismissed after creditors sought relief from the bankruptcy court to recover property upon which they hold liens. 11 U.S.C. §§ 109(g), 362(d)-(e).

How Chapter 12 Works

A chapter 12 case begins with the filing of 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. Bankruptcy Rule 1007(b). A husband and wife may file a joint petition or individual petitions. 11 U.S.C. § 302(a). (The Official Forms may be purchased at legal stationery stores or downloaded from the Internet at www.uscourts.gov/bankform/. They are not available from the court.)

Currently, the courts are required to charge a \$200 case filing fee and a \$30 miscellaneous administrative fee (a total of \$230). The fees

should be paid to the clerk of the court upon filing or may, with the court's permission, be paid by individual debtors in installments. 28 U.S.C. § 1930(a); Bankruptcy Rule 1006(b); Bankruptcy Court Miscellaneous Fee Schedule, Item 8. Bankruptcy Rule 1006(b) limits to four the number of installments for the filing fee. The final installment shall be payable not later than 120 days after filing the petition. For cause shown, the court may extend the time of any installment, provided that the last installment is paid not later than 180 days after the filing of the petition. Bankruptcy Rule 1006(b). The \$30 administrative fee may be paid in installments in the same manner as the filing fee. If a joint petition is filed, only one filing fee and one administrative fee are charged. Debtors should be aware that failure to pay these fees may result in dismissal of the case. 11 U.S.C. § 1208(c)(2).

In order to complete the Official Bankruptcy Forms which make up the petition, statement of financial affairs, and schedules, the debtor will need to compile the following information:

1. A list of all creditors and the amounts and nature of their claims;
2. The source, amount, and frequency of the debtor's income;
3. A list of all of the debtor's property; and
4. A detailed list of the debtor's

monthly farming and living expenses, *i.e.*, food, shelter, utilities, taxes, transportation, medicine, feed, fertilizer, etc.

When a husband and wife file a joint petition or each spouse files an individual petition, the above detailed data must be gathered for both spouses. So that financial responsibilities can be accurately assessed when only one spouse files, the income and expenses of the non-filing spouse should be included in the debtor's schedules and statement of financial affairs.

Upon the filing of the petition, an impartial trustee is appointed to administer the case. 11 U.S.C. § 1202. If the number of cases so warrants, the United States trustee may appoint a standing trustee to serve in all chapter 12 cases in a district. 28 U.S.C. § 586(b). As in chapter 13, the trustee's primary responsibility is to act as a disbursing agent, receiving payments from debtors and making distributions to creditors. 11 U.S.C. § 1202.

The filing of the petition under chapter 12 "automatically stays" most collection actions against the debtor or the debtor's property. 11 U.S.C. § 362. As long as the "stay" is in effect, creditors generally cannot initiate or continue any lawsuits, wage garnishments, or even telephone calls demanding payments. Creditors receive notice of the filing of the petition from the clerk or the trustee. Further, chapter 12 contains a special automatic stay provision applicable to creditors. Specifically, after the

commencement of a chapter 12 case, 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).

The debtor must file a plan of repayment with the petition or within 90 days afterward, unless the court determines that the need for an extension is attributable to circumstances for which the debtor should not be held accountable. 11 U.S.C. § 1221. The chapter 12 plan must provide for the full payment of all claims entitled to priority under section 507¹ (unless the holder of a particular claim agrees to different treatment of the claim); if the plan classifies claims and interests, provide the same treatment for each claim or interest within each class (unless the holder of a particular claim or interest agrees to less favorable treatment); and provide for the submission of such portion of the debtor's future income to the supervision of the trustee as is necessary for the execution of the plan. 11 U.S.C. § 1222. Other plan provisions are permissive. *Id.* Plans, which must be approved by the court, provide for payments of fixed amounts to the trustee on a regular basis, typically biweekly or monthly. The trustee then distributes the funds to creditors according to the terms of the plan, which may offer creditors less than full

payment on their claims. If the trustee or a creditor with an unsecured claim² objects to confirmation of the plan, the debtor is obligated to pay the amount of the claim or commit to the proposed plan all projected "disposable income" during the period in which the plan is in effect. 11 U.S.C. § 1225(b). Disposable income is defined as income not reasonably necessary for the maintenance or support of the debtor or dependents. If the debtor operates a business, disposable income is defined as excluding those amounts which are necessary for the payment of ordinary operating expenses. 11 U.S.C. § 1225(b)(2)(A)-(B). One of the special features of Chapter 12 is that, in certain circumstances, payments to secured creditors can continue longer than the three-to-five-year period the plan provides for payment to unsecured and priority creditors.

A meeting of creditors is held in every case, during which the debtor is examined under oath. It is usually held 20 to 35 days after the petition is filed. If the United States trustee or bankruptcy administrator³ designates a place for the meeting which is not regularly staffed by the United States trustee or bankruptcy administrator, the meeting may be held no more than 60 days after the order for relief. Bankruptcy Rule 2003(a). The debtor must attend the meeting, at which creditors may appear and ask questions regarding the debtor's financial affairs and the proposed terms of the plan. 11

U.S.C. § 343. If a husband and wife have filed a joint petition, they both must attend the creditors' meeting. The trustee will also attend the meeting and question the debtor on the same matters. In order to preserve their independent judgment, bankruptcy judges are prohibited from attending. 11 U.S.C. § 341(c). If there are problems with the plan, they are typically resolved during or shortly after the creditors' meeting. Generally, problems may be avoided if the petition and plan are complete and accurate and the trustee has been consulted prior to the meeting.

In a chapter 12 case, unsecured creditors who have claims against the debtor must file their claims with the court within 90 days after the first date set for the meeting of creditors. Bankruptcy Rule 3002(c). A governmental unit, however, may file a proof of claim until the expiration of 180 days from the date the case is filed. 11 U.S.C. § 502(b)(9).

Within 45 days after the filing of the plan, the presiding bankruptcy judge must determine 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 will receive 20 days' notice of the hearing, may appear at the hearing and object to confirmation. Bankruptcy Rule 2002(a)(8). While a variety of objections may be made, the typical arguments are that

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 plan is confirmed by the bankruptcy judge, the chapter 12 trustee commences distribution of the funds received in accordance with the plan. 11 U.S.C. § 1226(a). If the plan is not confirmed, the debtor has a right to file a modified plan. 11 U.S.C. § 1223. The debtor also has a right to convert the case to a liquidation case under chapter 7.⁴ 11 U.S.C. § 1208(a). If the plan or modified plan is not confirmed and the case is dismissed, the court may authorize the trustee to retain a specified amount for costs, but all other funds paid to the trustee are returned to the debtor. 11 U.S.C. § 1226(a).

On occasion, changed circumstances will affect a debtor's ability to make plan payments, a creditor may object or threaten to object to a plan, or a 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 be 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 are binding on the debtor

and each creditor. 11 U.S.C. § 1227. Once the court confirms the plan, it is the responsibility of the debtor to 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 credit obligations without consulting the trustee, as such credit obligations may have an impact upon the execution of 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

As is the case under chapter 13, upon successful completion of all payments under a chapter 12 plan, the debtor will receive a discharge. 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. In fact, the discharge is more limited in chapter 12 than it is in a chapter 13 case. The bankruptcy law regarding the scope of a chapter 12 discharge is complex, however, and debtors should consult competent legal counsel in this regard prior to filing. Those debts which 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

After confirmation of a plan, there are limited circumstances under which the debtor may request the court to grant a "hardship discharge" even though the debtor has failed to complete plan payments. 11 U.S.C. § 1228(b). Generally, such a 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, after creditors have received at least as much as they would have received in a chapter 7 liquidation case and when modification of the plan is not possible. 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.

NOTES

1. Section 507 sets forth nine categories of unsecured claims which Congress has, for public policy reasons, given priority of distribution over other unsecured claims.
2. Unsecured debts generally may be defined as those for which the extension of credit was based purely upon an evaluation by the creditor of the debtor's ability to pay. In contrast, secured debts are those for which the extension of credit was based upon not only the creditor's evaluation of the debtor's ability to pay, but upon the creditor's right to seize pledged property on default.
3. Bankruptcy Administrators, rather than U.S. trustees, serve in the judicial districts in the states of Alabama and North Carolina.
4. A fee of \$15 is charged for converting a case under chapter 12 to a case under chapter 7.