

## Farm Management

# Chapter 12 bankruptcies designed for agriculture



## Country Counsel

By ROBERT MOORE

**N**o one ever wants to think about the possibility of bankruptcy. However, some farms may inevitably face financial stress that will be too much to overcome. In these unfortunate situations, bankruptcy may allow the farm to get relief from some debt so that it can continue as a viable business into the future.

For obvious reasons, bankruptcy has a negative connotation; but, in reality, it provides hope for farmers who would otherwise lose their farm.

There are several different types of bankruptcies known by the different chapters in the U.S. bankruptcy code:

**Chapter 7** is a liquidation bankruptcy. A trustee is appointed to collect all assets owned by the debtor and liquidate the assets. Proceeds are then paid to the creditors.

**Chapter 11** is a reorganization bankruptcy primarily for businesses. The debtor remains in possession of the business with oversight from the bank-

### Key Points

- Bankruptcy may enable a farm to continue despite financial stress.
- The debt of the farm may be reduced to the value of the collateral securing it.
- Chapter 12 is complex and requires legal advice.

ruptcy court and reorganizes the business so that it may continue.

**Chapter 13** is a reorganization bankruptcy for individuals. Those individuals that have significant debt but enough disposable income to fund the bankruptcy are eligible for a Chapter 13. The debtor in a Chapter 13 establishes a plan that allows him or her to pay back the debt over a number of years.

### Chapter 12

Farmers have a bankruptcy chapter designed just for them (and for fishermen). Chapter 12 bankruptcy was developed for family farms with a debt load of less than \$3.2 million. This type of bankruptcy has several features that are very favorable to family farmers.

One of the primary benefits of Chapter 12 is a "cram down" of the debt. That is, the debt of the farm is reduced to the

value of the collateral securing the debt. For example, a farmer has a loan with the bank for \$1,000,000. The loan is secured by land worth \$700,000. The farmer's debt will be reduced by \$300,000, or "crammed down" to the value of the collateral. This method of reducing debt is unique to Chapter 12.

Additionally, Chapter 12 allows the interest rates to be reduced to the current market rate. Also, the debt repayment period may be extended to allow the debtor a longer period of time to pay back the debt. Both of these measures are meant to allow the debtor to have a better cash flow so as to have a better chance of paying the debt.

### Executory contracts

Another benefit to Chapter 12 involves executory contracts, or contracts that have yet to be fully performed by the parties. A typical executory contract for a farmer is a lease. Chapter 12 allows the farmer to decide if he or she wishes to keep the contract or void the contract. For example, a dairy farm leasing cows could decide to void the contract. Chapter 12 bankruptcy would allow the lease to be voided without penalty to the farmer.

A bankruptcy trustee and the bank-

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ruptcy court oversee the Chapter 12 bankruptcy. The bankruptcy court is involved extensively in the first few months of the bankruptcy while the farmer submits a bankruptcy plan to the court. After the court has confirmed the plan, the bankruptcy trustee will oversee the operation of the farm for the next three to five years. After that time, the trustee will be dismissed, the farmer will be discharged from bankruptcy, and the farmer will continue to make long-term debt payments.

While Chapter 12 is very good for financially stressed farmers, some creditors will not be paid some, or all, of their owed debt. Secured creditors may not be paid any debt that exceeds the value of their collateral. Using the example above, the bank would be out \$300,000. Creditors that have no security such as mortgages or liens often will bet paid nothing or pennies on the dollar. So, while bankruptcy helps family farms, it can also be detrimental to debtors, some who are farmers themselves.

Farmers who are in severe financial stress should consider bankruptcy. It allows the farm to be liquidated in a controlled manner or perhaps continued through debt restructuring. Bankruptcy, particularly a Chapter 12, can be a complex matter. Sound legal advice should be sought before entering bankruptcy.



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