

community BANKER

SEPTEMBER / OCTOBER 2017

Welcome to the latest issue of the COMMUNITY BANKER.

The Community Banker is prepared by attorneys at Olson & Burns P.C. to provide information pertaining to legal developments affecting the field of banking. In order to accomplish this objective, we welcome any comments our readers have regarding the content and format of this publication. Please address your comments to:

Community Banker
c/o Olson & Burns P.C.
P.O. Box 1180
Minot, ND 58702-1180

olsonpc@minotlaw.com
Also, visit our web site at:
www.minotlaw.com

The attorneys at Olson & Burns represent a wide range of clients in the financial and commercial areas. Our attorneys represent more than 30 banks throughout North Dakota.

CHAPTER 12. FAMILY FARMER OR FAMILY FISHERMAN BANKRUPTCY – A PRIMER

Because we've had quite a few good years, lenders and boards of directors need to get up to speed again on bankruptcy law. Bankruptcy is simply a process for the discharge of debt, and three bankruptcy "chapters" may apply to farms.

- Chapter 7 — This is the basic theory of bankruptcy. A chapter 7 bankruptcy case does not involve the filing of a plan of repayment. Instead, the bankruptcy trustee gathers and sells the debtor's nonexempt assets and uses the proceeds of those assets to pay creditors; priority is given to those creditors with valid liens. The debtor may keep certain "exempt" property to help him toward his "fresh start", and a trustee will liquidate the debtor's remaining assets.



OLSON & BURNS P.C.

17 FIRST AVENUE S.E. • P.O. BOX 1180 • MINOT, NORTH DAKOTA 58702-1180
TELEPHONE (701) 839-1740 • FACSIMILE (701) 838-5315 • E-MAIL: olsonpc@minotlaw.com

- Chapter 11 — Chapter 11, or “reorganization”, usually involving a business such as a corporation or partnership. A chapter 11 debtor usually proposes a plan of reorganization to keep its business alive and pay creditors over time. Big operations may file for a Chapter 11.

Individuals in business can also seek relief in chapter 11. By filing for personal bankruptcy under Chapter 11, a person may be able to reorganize his debts while keeping his small business open or restructuring a significant amount of personal debt. Under Chapter 11 personal bankruptcy, debtors are able to keep their assets while undergoing a reorganization aimed at repaying creditors.

- Chapter 12 — This is a special chapter created by Congress in 1985 during that severe farm crisis; it is especially for smaller "family farms" and "family fisherman" to avoid liquidation and foreclosure. It was created as a temporary measure and made permanent in 2005.

A. BACKGROUND

Chapter 12 is designed for "family farmers "with "regular annual income." It enables financially distressed family farmers 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).

Chapter 12 is more streamlined, less complicated, and less expensive than chapter 11, which is better suited to large corporate reorganizations.

Only a family farmer with "regular annual income" may file a petition for relief under chapter 12. 11 U.S.C. §§ 101(18), 101(19A), 109(f). This 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; chapter 12 also makes allowance for situations in which family farmers have income that is seasonal in nature. Chapter 12 is voluntary - only the debtor may file a petition under the chapter.

Under the Code, "family farmers" fall into two categories: **(1)** an individual or individual and spouse and **(2)** a corporation or partnership. Farmers 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:

- 1.0 The individual or husband and wife must be engaged in a farming operation;
- 2.0 The total debts (secured and unsecured) of the operation must not exceed \$4,031,575 (if a farming operation);
- 3.0 If a family farmer, at least 50% of the total debts that are fixed in amount (exclusive of debt for the debtor's home) must be related to the farming operation; and
- 4.0 More than 50% of the gross income of the individual or the husband and wife for the taxable year preceding; or for each of the 2nd and 3rd prior tax years 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:

- 1.0 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;
- 2.0 The family or the family and its relatives must conduct the farming operation;
- 3.0 More than 80% of the value of the corporate or partnership assets must be related to the farming operation;
- 4.0 The total indebtedness of the corporation or partnership must not exceed \$4,031,575 if a farming operation;
- 5.0 At least 50% for a farming 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 operation;
- 6.0 If the corporation issues stock, the stock cannot be publicly traded.

A debtor cannot file under chapter 12 (or any other chapter) if during the preceding 180 days (1) 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 (2) 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) and (e). Like the debtors in other chapters, the family farmer debtor must also complete the required credit counseling.

B. HOW CHAPTER 12 WORKS

A chapter 12 case begins by filing a petition with the bankruptcy court. 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). 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:

- 1.0 A list of all creditors and the amounts and nature of their claims;
- 2.0 The source, amount, and frequency of the debtor's income;
- 3.0 A list of all of the debtor's property; and
- 4.0 A detailed list of the debtor's monthly farming and living expenses, *i.e.*, food, shelter, utilities, taxes, transportation, medicine, feed, fertilizer, etc.

Married individuals must gather this information for each spouse regardless of whether they are filing a joint petition, separate individual petitions, or even if only one spouse is filing so that the court, the trustee, and the creditors can evaluate the household's financial position.

When a chapter 12 petition is filed, a trustee is appointed to administer the case. 11 U.S.C. § 1202. Chapter 12 trustees in North Dakota are assigned by the U.S. Trustee on a case by case basis. The trustee both evaluates the case and serves as a paying agent, collecting payments from the debtor and making distributions to creditors. 11 U.S.C. § 1202. 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.

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 - for a personal, family, or household purpose - from any individual who is liable with the debtor. 11 U.S.C. § 1201(a).

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. 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). 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.

C. THE CHAPTER 12 PLAN AND CONFIRMATION HEARING

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. Unsecured claims, of course, are those for which the creditor has no lien or right to collect against particular property owned by the debtor.

A chapter 12 plan usually lasts three to five years. It must provide for full payment of all priority claims, unless a priority creditor agrees to different treatment of the claim. 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).

Within 45 days after filing the plan, the 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. (3) 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).

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).

D. 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 negatively affect 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 upon a showing that the debtor has committed fraud in connection with the case. 11 U.S.C. § 1208(d).

E. THE CHAPTER 12 DISCHARGE

The debtor will receive a discharge after completing all payments under the chapter 12 plan as long as the debtor certifies (if applicable) that all domestic support obligations that came due before making such certification have been paid. 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.

Like the other chapters, certain categories of debts are not discharged in chapter 12 proceedings, such as alimony and child support, debts for willful and malicious injury, etc. 11 U.S.C. § 1228(a).

TIP: If you are secured, don't panic. Generally, secured claims can ride out a bankruptcy case so that the claimholder either receives the collateral or the value of the collateral. If you are oversecured, you may even get your attorneys' fees paid by the estate.

F. 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.

DISCLAIMER

COMMUNITY BANKER is designed to share ideas and developments related to the field of banking. It is not intended as legal advice and nothing in the COMMUNITY BANKER should be relied upon as legal advice in any particular matter. If legal advice or other expert assistance is needed, the services of competent, professional counsel should be sought.