DUST OFF YOUR CHAPTER 12 KNOWLEDGE: INCREASE TO DEBT LIMITS MAY REVIVE FAMILY FARMER BANKRUPTCIES

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On August 1, 2019 the U.S. Senate passed the Family Farmer Relief Act of 2019, which more than doubled the debt limit for "family farmers" qualifying for relief under Chapter 12 of the U.S. Bankruptcy Code to $10,000,000. The House of Representatives previously passed the same legislation on July 29, 2019; the legislation will now proceed to the White House for the President's signature. While it is less than a page long and contains no other revisions to Chapter 12, other than to increase the debt limit, the act may have an important impact on the ability to restructure the debts of American farmers.

BACKGROUND

Chapter 12 of the U.S. Bankruptcy Code was first enacted in 1986, during the height of 1980s farm crisis. Designed to be a hybrid of the more complicated Chapter 11 business reorganization and the individual-only Chapter 13 adjustment of debts, Chapter 12 allows "family farmers" (both businesses and individuals meeting certain farm-related asset and income tests) to adjust their debts in a simpler, more debtor-friendly, bankruptcy proceeding. Because the legislation was enacted on an emergency basis and was intended for smaller "family" operations, the debt limit for Chapter 12 family farmers was originally $1,500,000 million, and the legislation provided that the Chapter would expire in seven years. In 1993, the sunset date was first extended, then later eliminated, and the debt limit was intermittently increased (most recently to $4,153,150). However, use of Chapter 12 continued to decrease over time, in large part due to the low debt limit for eligibility. Historically, the largest number of Chapter 12 filings was in 1987, when almost 6,000 cases were filed. By 2018, less than 500 Chapter 12 cases were filed.

NEW LEGISLATION

The new debt limit, if enacted, may increase the number of family farmers utilizing Chapter 12, and creditors should familiarize themselves with the important differences between Chapter 12 and Chapter 11.

Some of those differences include:

- Co-Debtor Stay - Like Chapter 13, Chapter 12 includes a stay against co-debtors, with respect to "consumer debts."
- Shortened Timelines - The Debtor's plan of reorganization must be filed within 90 days after the petition date. Confirmation of the plan is to be concluded in most cases within 45 days after the plan is filed. As with Chapter 13, the plan period may be three to five years.

- Chapter 12 Trustee, but no Committee - Chapter 12 provides for the appointment of a Trustee with powers similar, but not identical to, a Chapter 13 Trustee. No Unsecured Creditors' Committee is appointed. In some jurisdictions, the standing Chapter 13 Trustee is also the Chapter 12 Trustee, and in many instances, the Chapter 12 Trustee takes an active role in the formulation of the Debtor's plan of reorganization.
- Asset Sales without a Section 363(f) block - Section 1206 of the Code provides that, in addition to Section 363(f), the "trustee" may sell farmland and farm equipment, free and clear of interests in those assets. This "super sale" right is subject to uncertainty in some jurisdictions, with cases and secondary authorities disagreeing over whether the right is reserved only to the Chapter 12 Trustee, or whether it may also be exercised by the Debtor as debtor-in-possession. Objecting secured creditors may still credit bid up to the amount of their debt.
- Different Standard for Adequate Protection - Section 361 of the Code does not apply to Chapter 12; instead there is a separate standard in Section 1205 that includes, as adequate protection, payment of current market rent for use of farmland and eliminates the "indubitable equivalent" option.
- Expanded Cramdown Rights - The Debtor's plan may "modify the rights of holders of secured claims", without any further statutory qualification. Unlike Chapter 11 or Chapter 13 plans, this modification may include loans secured by the Debtor's primary residence. Courts have allowed lengthy "cramdown" terms on real estate loans and on fully matured prepetition short-term equipment loans in order to save the family farm.
- No One Votes - Creditors do not vote on Chapter 12 plans; they may only rely on their plan objection rights. There is no disclosure statement accompanying Chapter 12 plans. As with Chapter 13, this tends to focus plan confirmation disputes on cramdown terms, and whether the plan is feasible.
- No Absolute Priority Rule - Chapter 12 presumes that the Debtor will maintain its ownership of the farm assets. Accordingly, there is no rule in Chapter 12 requiring classes of claims to be paid in full before the Debtor may maintain its ownership.

The foregoing list is not exhaustive; creditors and other parties who contract with family farmers in a variety of capacities should carefully review Chapter 12 and its related rules, as well as (the sometimes limited) Chapter 12 caselaw in their jurisdiction and other relevant jurisdictions. Creditors should also be prepared for renewed statutory interpretation disputes as an increase in Chapter 12 filings and amounts in dispute may focus attention on uncertain issues that may not have been cost-effective to litigate under lower debt limits.

AGRIBUSINESS IMPACTS

An increase in debt limits for "family farmers" could have a market impact across the spectrum of agribusiness activities. Landlords may want to consider the potential impact of increased filings on their statutory lien rights under applicable state and bankruptcy law - both as a lease drafting point, and for purposes of determining their security. Debtors in Chapter 12 may assume or reject leases of real property, and Section 545 of the Bankruptcy Code authorizes the Trustee to avoid certain statutory liens for rent or distress for rent. Lenders in the agribusiness sector may want to carefully review their loan documentation to confirm that their security interests are properly protected, perfected, and documented. The increased potential for involuntary loan restructuring under Chapter 12 may impact loan origination, underwriting, and renewal. Finally, buyers and sellers in the supply chain may want to take this opportunity to verify that their underwriting and contracting practices account for the counterparty credit risk associated with the potential for a higher number of Chapter 12 filings.

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