Risk Management Tool of Last Resort: Bankruptcy Offers Protections to Qualifying Agricultural Operations and Fishermen to Restructure Business and Survive Tough Economic Times

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Agriculture like many businesses is full of risks: marketing, financial, production, labor, and legal. With each risk area, producers must develop strategies to manage those risks. To manage marketing risks, for example, a producer would develop a plan for how to handle crops grown over the course of the season to maximize profits. Managing financial risks may require a producer to purchase crop insurance to cover losses if a crop fails. But sometimes in an operation, the risks may outnumber the strategies developed to manage those risks, and the operation may experience significant financial losses.

Bankruptcy is often a risk management tool of last resort for a farming operation. For many family farmers and fishermen, the idea of bankruptcy is enough to lose the benefits from avoiding filing in a reasonable time. ***Chapter 12*** of the U.S. Bankruptcy Code has made business reorganization and debt repayment a much more streamlined process, allowing family farmers and fishermen to reorganize their operation to avoid total business collapse. Chapter 12 is useful for most farmers and fishermen seeking help under U.S. Bankruptcy Code. ***Chapter 7*** and ***Chapter 13*** is useful for debts of a single individual in business with unexpected business difficulties, and ***Chapter 11*** may be used as a last resort when a debtor's debt exceeds limits from other chapters, or are not qualified for a ***Chapter 12.***

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For an operation threatened by large amounts of debt impeding the success of the business, proceeding with a Chapter 12 bankruptcy to reorganize a business may be a good idea. Waiting too long may result in not being able to restructure, forcing liquidation of the business. Chapter 12 may give a business a second chance.

Chapter 12 Bankruptcy Is an Option for Qualifying Family Farms and Fishermen

USDA's Economic Research Service (ERS) projects national net farm income at $62.3 billion in 2017, down nearly 9% from last year and the lowest net farm income since 2002 (Congressional Research Service, 2017). From 2013-16, total bankruptcy filings were down 25 percent, but filings of Chapter 12 bankruptcy for farms and fishing operations were up 17 percent (U.S. Courts, 2017). With lower projected net farm incomes and an increase in Chapter 12 filings, it is wise for family farmers and fishermen to understand the Chapter 12 process as it may apply to their operation under certain conditions.

For an operation threatened by large amounts of debt impeding the success of the business, proceeding with a Chapter 12 bankruptcy to reorganize a business may be a good idea. Waiting too long may result in not being able to restructure, forcing liquidation of the business. Chapter 12 may give a business a second chance. The earlier an operation can address financial issues the better chance the chance of surviving.

Chapter 12 of the Bankruptcy Code was enacted in 1986 and made permanent in 2005, creating laws geared towards family farmers and fishermen to help restructure finances to avoid liquidation/foreclosure. Chapter 12 provides the framework for family farms and fishing operations to reorganize. Those eligible to file are individuals, an individual and their spouse, or a corporation or partnership. The family farmer or fisherman must also have "regular annual income" which is "sufficiently stable and regular enough income" to make payments for a restructured business through this chapter (11 U.S.C. § 101(19)).

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Chapter 12 also allows a debtor to alter debt owed by reducing total debt "to the fair market value of the property, reducing the interest rate to the current market rate, and … extending the payment period" (Schneider, 2015). To file, a debtor pays a filing fee of $200; after 15 days, the debtor must also provide a $500 deposit to their assigned trustee. A farmer's debt must not exceed $4,031,575, and a commercial fisherman's debt must not exceed $1,868,200. For many farms or fishing operations, these debt limits may be too low, forcing them to file bankruptcy under a different chapter.

In addition to debt limits, family farm or fishing operations must also:

- Have at least 50% of debt related to the farming operation for a family, and at least 80% of the debt related to the fishing operation for commercial fishermen.
- Show that at least 50% of the individual's or couple's gross income from the preceding tax year has come from the family farm or fishing operation.
- Be run by the individual or couple filing for Chapter 12 bankruptcy.

To initiate a Chapter 12 bankruptcy, a debtor files a voluntary petition for relief and a trustee is assigned who serves "as a disbursing agent, collecting payments from the debtor and making distributions to creditors" (U.S. Courts, 2017). Meanwhile, the fishing or farming operation often continues. As part of the filing, a debtor must propose a repayment plan within 90 days, detailing repayment of debts over 3 to 5 years. Along with the petition, the debtor should file information on assets, liabilities, income, expenditures, contracts, expired leases, and a statement of financial affairs. Official bankruptcy forms must include a list of creditors, amount and nature of the claim, the source, amount, and frequency of debtors' income, a list of debtors' properties, and a detailed list of monthly farming and living expenses.

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The appointed bankruptcy trustee will review documents, monitor operations, and advise the court. The filing of the petition immediately stops most collection actions. Between 21 and 35 days after filing the petition, the trustee will hold a meeting of a debtor's creditors. The debtor will be put under oath during this meeting, allowing the creditors and trustee to ask questions.

Bankruptcy claims against an operation take one of three forms. Priority claims are granted special status by bankruptcy law, including taxes. With secured claims, the creditor has the right to liquidate when the debtor fails to pay the underlying debt. Farmland purchased with an outstanding mortgage is an example of a secured claim. Unsecured claims are those that the creditor has no special rights to collect. Within 45 days after filing the plan, a bankruptcy judge decides at a confirmation hearing if the repayment plan will feasibly meet fair repayment of debts to creditors. Creditors with notice at least 21 days in advance may appear at the hearing to object to rulings on their claims. General objections might include complaints that payments under the plan are less than what creditors would receive if liquidating the assets, or that the plan doesn't commit all disposable income for the year's repayment plan.

Most Chapter 12 bankruptcy plans will provide for:

- The payment of debt to creditors over a period, including interest on the value of the secured creditor's collateral.
- The liquidation of nonessential assets.
- The collection of payments by the trustee for certain amounts at certain times.
- The full repayment of priority claims.
- The surrender of assets to secured creditors.


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Although discharging a bankruptcy typically happens after making all payments, it is possible a debtor may receive a "hardship discharge" even after failing to complete a payment plan. A court may grant a hardship discharge to those borrowers unable to meet their payment plan due to circumstances beyond their control. To complete a hardship discharge, creditors must receive at least as much as they would have in Chapter 7 bankruptcy and the debtor must go out of business. In some cases, a debtor may dismiss a Chapter 12 case, but it is not very common for a bankruptcy court to accept a motion of conversion from a creditor.

Chapter 7 Bankruptcy Provides a Liquidation of a Debtor's Assets

Should the debtor fail to correctly follow their payment plan, the court may dismiss the case, and convert it to a Chapter 7 case, but a creditor would need to demonstrate any fraud connected to the case. For example, Charlie voluntarily files for bankruptcy under Chapter 12. Charlie's plan required him to turn over certain farm equipment to his bank to satisfy the debt for a security interest in the equipment. Unknown to the bank, Charlie sold that equipment to a neighbor and turned over older and less valuable equipment to the bank. In previous cases, this has been considered fraud and courts have then granted requests to convert Chapter 12 bankruptcies into Chapter 7 bankruptcies.

If an agricultural business operator is personally liable for the business debts, the operator may need to file for personal bankruptcy under Chapter 7 or 13. Chapter 7 is an option available to businesses with little likelihood of a successful economic future and which end up liquidating. When a business has such overwhelming debt that reorganizing the business is not possible, Chapter 7 is appropriate. At the end of this process, a business owner will receive a discharge freeing them from the obligation of debt. Filing a bankruptcy petition automatically stays most debt collections by creditors. With the stay in place, creditors may not initiate or continue lawsuits, wage garnishment, or even phone calls.

PHOTO: EDWIN REMSBERG

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Twenty-one to 40 days after filing the case, the assigned trustee meets with the debtor or debtors (if spouses file jointly) to ask questions regarding financial affairs and property. The debtor provides any financial records or documents the trustee requests. The trustee makes the debtor aware of consequences of filing for bankruptcy, the effect of receiving a discharge, and potential effects on credit history. If determined best, a Chapter 7 bankruptcy may be converted to a case under Chapters 11, 12, or 13 if the debtor has not converted to a Chapter 7 bankruptcy in the past six years.

To begin a Chapter 7 bankruptcy, a debtor files a petition with the area bankruptcy court. With the petition will be paperwork including schedules of assets, liabilities, income, expenses, statement of financial affairs, and schedule of contracts. Each case is assigned a trustee, who will need copies of tax returns from the most recent years. Married couples may file a joint petition or individual petitions. Filing will cost $245, plus $75 administrative fee, and a $15 trustee surcharge. These fees may be waived if the debtor's income is less than 150% of the poverty level. The debtor must provide information including:

- Creditors and amount/nature of claim
- Source, amount, and frequency of debtor's claim
- List of debtor's properties
- Detailed list of debtor's monthly living expenses

At the end of Chapter 7, the court grants a discharge releasing debtors from personal liability for most debts excluding alimony and child support, about 60-90 days after meeting with creditors. A court will not grant a discharge if it discovers the debtor failed to keep or produce adequate records, committed a bankruptcy crime, or fraudulently transferred, concealed, or destroyed property. The court may revoke a discharge at the request of the trustee or creditor if the debtor obtained a discharge through fraud, failed to report the acquisition of property, or made a material misstatement during the process. Filing for Chapter 7 will remain on a debtor's credit report for up to 10 years, making it difficult to obtain a mortgage, and the debtor may not file for another Chapter 7 bankruptcy for six years after the last filing. Chapter 7 will not get rid of student loan debt. From the beginning of filing until the discharge of a Chapter 7 case lasts three to six months. In most circumstances, chapter 7 will protect against losing personal belongings and will allow a debtor to keep salary or wages after filing.

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A court will not grant a discharge under Chapter 7 if it discovers the debtor failed to keep or produce adequate records, committed a bankruptcy crime, or fraudulently transferred, concealed, or destroyed property.

Chapter 13 Bankruptcy Allows Individuals to Develop a Repayment Plan for Debts Owed

Chapter 13 bankruptcy is for the reorganization of consumer debt, including a sole proprietorship. Those filing have experienced short-term financial setbacks such as job loss, illness, or unexpected expenses. Chapter 13 does not require a means test to qualify and will not liquidate assets to cover debts.

To file under Chapter 13, a debtor must have a regular source of income, enough disposable income to make regular payments, and fall within preset limits for secured and unsecured debts. A debtor must have a regular monthly income to repay some or all debt. Secured debts cannot exceed $1,184,200, and unsecured debts cannot exceed than $394,725. A debtor must complete credit counseling before filing for Chapter 13, and complete a repayment plan after filing.

To file under Chapter 13, a debtor must have a regular source of income, enough disposable income to make regular payments, and fall within preset limits for secured and unsecured debts.

A debtor's Chapter 13 plan must include how secured debts such as a car loan or mortgage will be paid off, and specify that any disposable income after making required payments will go to paying unsecured debts. If a debtor's income for the last six months is higher than their state's median income, their plan must propose five years of payment. If the debtor's income for the last six months is below the state's median income, the debtor's plan must recommend three years of payment. In many cases, unsecured debts do not have to be paid in full or at all, but debtor's plans must show remaining income going towards unsecured debt.

It is possible that a business owned as a sole proprietorship may have personal assets liquidated, including a personal home, if those assets are also tied up in the business. Losing personal assets due to bankruptcy can be avoided in Chapter 7, unlike some other chapters. Like Chapter 7, Chapter 13 protects debtors from aggressive debt collection after filing the petition.

Under Chapter 13 a debtor must pay priority debts in full, such as child support and alimony, wages to employees, and certain tax obligations. After completing an approved plan, all remaining debts are eligible for discharge. Further, debtors must complete an approved financial management course before a court can grant discharge. A Chapter 13 bankruptcy may even permit a debtor to retain their business and simply reorganize business structure.

Crop Insurance Can Also Provide Risk Management Tools to Producers

As you can see bankruptcy is not a tool that will work for every producer. A producer considering bankruptcy should discuss options with a qualified bankruptcy attorney to determine what will work in each individual situation. Other tools exist to also help a producer manage risk in the operation. One such risk management tool is the crop insurance program through multi-peril crop insurance (MPCI).

The federal crop insurance program is the cornerstone of the current federal farm safety net for agricultural producers. Crop insurance policies are available on 20 agricultural enterprises in Maryland with a variety of coverage levels to choose from. Premiums paid by an agricultural producer will vary depending on coverage level. The portion of the premium subsidized by the federal government will also vary depending on coverage level. The basic level of coverage is Catastrophic Risk Protection (CAT) and is available to all farmers regardless of farm size with no premium costs and an administrative fee of $300 for each crop insured.

The current farm bill requires producers to be in compliance with conservation practices in order to be eligible for crop insurance premium subsidies. Producers need to be in conservation compliance with wetland provisions and highly erodible land provisions in order to receive premium subsidies. Nationwide farmers pay between 33 to 62 percent of the actual cost of crop insurance depending on the coverage level chosen. Maintaining eligibility for the premium subsidies is important for producers needing to minimize the cost of crop insurance.

To better understand how crop insurance can impact your operation and help manage risks in your operation, see Harper and Goeringer, Crop Insurance For Maryland Field Crops And Livestock (2016) and Leathers and Goeringer, A Primer on Crop Insurance (2016). These resources will help you better understand the crop insurance program and what options may work for your operation.

Conclusion

Having a general knowledge of the bankruptcy procedure and options may allow an operator to take steps to protect a business before things become too complicated. Chapter 12 bankruptcy can significantly benefit farmers and fishermen who need to restructure to prevent total loss under certain debt limits and requirements. Chapters 7 and 13, however, may be useful in more specific situations. Chapter 7 may be particularly useful when an individual is responsible for business liabilities, and Chapter 13 will be best to resolve issues from short-term business setbacks. Realizing what options exist before a company faces bankruptcy will help prevent total business collapse.

Glossary

Chapter 7: a straight bankruptcy where a debtor's property is collected and distributed to creditors.

Chapter 11: a form of bankruptcy which allows a business to reorganize business operations as opposed to liquidation.

Chapter 12: a reorganization bankruptcy for family farmers and fishermen.

Chapter 13: a bankruptcy which allows an individual to reorganize his/her financial affairs instead of liquidating assets.

Creditor: a person or entity with a claim against the debtor.

Debtor: a person who brings a case under the bankruptcy title of the U.S. Code.

Hardship discharge: a situation where, under Chapter 13, a debtor can file to wipe out dischargeable debt after an unexpected drop in income through no fault of the debtor's, such as loss of a job or disability.

Regular annual income: annual income of a family farmer which is sufficiently stable and regular to enable making payments under a Chapter 12 plan.

Trustee: a person appointed by a court to take charge of a debtor's property for the benefit of the debtor's creditors.

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