

CRS Report for Congress

Received through the CRS Web

Chapter 12 of the U.S. Bankruptcy Code: Family Farmer Reorganization

Robin Jeweler
Legislative Attorney
American Law Division

Summary

Chapter 12 of the U.S. Bankruptcy Code, dealing with “family farmer” reorganization, expired on January 1, 2004. In the absence of chapter 12, insolvent farmers’ bankruptcy options include reorganization under chapter 11 or 13, or liquidation under chapter 7.

The most recent temporary extension of chapter 12 was effected by P.L. 108-73, which was retroactive to the previous extension through July 1, 2003.

The 107th Congress enacted five temporary extensions of the chapter. P.L. 107-377, extended chapter 12 through July 1, 2003. P.L. 107-170 extended chapter 12 through June 1, 2002. It was signed by President Bush on May 7, 2002. P.L. 107-171, the Farm Security and Rural Investment Act of 2002, was signed by the President on May 13, 2002. With the exception of P.L. 107-377 and P.L. 107-171, which applied the extension prospectively, prior temporary extensions were applied retroactively. Retroactive reinstatement was intended to benefit debtors who may have filed under alternative chapters of the Code during a period when chapter 12 was not in effect who wanted to convert their cases to chapter 12. On May 5, 2001, President Bush signed P.L. 107-8 which extended chapter 12 through June 1, 2001. On June 26, 2001, President Bush signed another extension, P.L. 107-17, which extended chapter 12 through October 1, 2001.

Background. In 1986, Congress added chapter 12 entitled “Adjustments of Debts of a Family Farmer with Regular Annual Income” to the U.S. Bankruptcy Code.¹ It is modeled after chapter 13, which governs consumer reorganization. Chapter 12 was created to provide farmers with the opportunity to reorganize and thus to preserve their farms through a streamlined and expeditious bankruptcy process. Intended to respond to

¹ P.L. 99-554 (Oct. 27, 1986).

the downturn in the farm economy in the 1980's, it was considered “experimental.”² Originally enacted as a temporary measure with a sunset date of Oct. 1, 1993,³ it was subsequently extended ten times.⁴

In the absence of chapter 12, insolvent farmers’ bankruptcy options include reorganization under chapter 11 or 13, or liquidation under chapter 7.⁵ Chapter 11 governs business reorganization and is more expensive and procedurally cumbersome than chapter 12 or 13. Chapter 13 is designed for “individuals with a regular income” or wage earners. The nature of farming is such that many farmers do not realize income on a “regular” schedule comparable to that of wage earners. Also, many farms are not individually owned, but are operated as corporations or partnerships. And, when chapter 12 was enacted in 1986, chapter 13 had a jurisdictional debt limit of \$350,000 in secured debt and \$100,000 in unsecured debt. Farmers’ indebtedness often exceeded that limit, so chapter 12 provided a jurisdictional debt limit of \$1,500,000. In 1994, however, chapter 13 was liberalized; the limit is currently \$871,550 in secured debt and \$290,525 in unsecured debt.

Procedural overview. The goal of chapter 12, indeed of all the operative bankruptcy reorganization chapters, is to offer a debtor a means of financial rehabilitation outside of liquidation. Historically, the *quid pro quo* for reorganization is the debtor’s obligation to commit postbankruptcy income to prebankruptcy indebtedness.⁶

Definition of “family farmer.” For chapter 12 purposes, a family farmer includes an individual and spouse, or a family-owned partnership or corporation, with debts of less than \$1,500,000, eighty percent of which arises from the farming operation. The debtor must derive at least fifty percent of gross annual income from farming.⁷

Expedited time frame. A chapter 11 debtor has at least 120 days (four months) after filing to submit a proposed reorganization plan. A family farmer must submit a proposed plan within 90 days of filing,⁸ and the court must hold a confirmation hearing

² H.Rept. 103-32, 103d Cong., 1st Sess. 3 (1993).

³ P.L. 99-554, §302(f).

⁴ P.L. 103-65 (extension through Sept. 30 1998); P.L. 105-277 (extension through April 1, 1999); P.L. 106-5 (extension through October 1, 1999); P.L. 106-70 (extension through July 1, 2000); P.L. 107-8 (extension through June 1, 2001); P.L. 107-17 (extension through October 1, 2001); P.L. 107-170 (extension through June 1, 2002); P.L. 107-171 (extension through January 1, 2003); P.L. 107-377 (extension through July 1, 2003); and P.L. 108-73 (extension through Jan. 1, 2004).

⁵ Farmers may not be forced into bankruptcy involuntarily. 11 U.S.C. § 303.

⁶ Under chapter 7, prebankruptcy assets are liquidated to pay off prebankruptcy debts. A chapter 7 liquidation does not generally commit the debtor’s postbankruptcy assets and/or income, nor will it discharge postbankruptcy debts.

⁷ 11 U.S.C. § 101(18).

⁸ 11 U.S.C. § 1221.

within 45 days.⁹ Only the debtor may propose the reorganization plan, which must be completed within a specified three to five-year time frame. The debtor's plan must meet the statutory requirements for chapter 12, but, unlike chapter 11, creditor committees are not appointed, and the plan is not voted on by creditors. The debtor receives a discharge of indebtedness upon completion of all payments under the plan.

Appointment of a standing trustee. A trustee is rarely appointed under chapter 11. Although chapter 12 requires the participation of a standing trustee, the trustee's duties are administrative and the farmer retains possession and control of the farm throughout the reorganization.

Benefits of chapter 12. As noted above, chapter 12 borrows many debtor-friendly features from chapter 13, and adapts some provisions specifically to the needs of farm debtors. Among these provisions are:

- *Liberalized “cramdown.”* Cramdown is a term used in bankruptcy law to refer to the procedure which enables a debtor to modify a creditor's claim over the creditor's objection. Chapter 12 debtors are not bound to “the absolute priority rule” which applies in chapter 11. Hence, secured creditors of a chapter 12 farmer, despite objections they may harbor, have less ability to influence or reject the reorganization plan than chapter 11 creditors. As in chapter 13, dissenting creditors may object to the debtor's reorganization plan. The objection triggers the Code's requirement that all of the debtor's projected disposable income be applied to plan payments. Creditors must receive at least as much payout on their claims in chapter 12 as they would if the debtor were liquidated.¹⁰
- *Bifurcation of liens or “lien stripping.”*¹¹ A family farmer is permitted to reduce – or “strip” – the value of a lien on secured property.¹² Hence, in situations where there is deflation in the value of the farm property, the debtor may reduce the amount owed to the secured lender and discharge the unsecured portion. Lien stripping is not generally permitted in chapter 7.¹³ It is permitted in chapter 13, but the debtor may not modify a home mortgage. Although lien stripping is permitted under chapter 11, creditors whose security interests are bifurcated into secured and unsecured claims have greater power to shape and/or veto the debtor's

⁹ 11 U.S.C. § 1224.

¹⁰ 11 U.S.C. § 1225.

¹¹ When a secured creditor holds a claim in which the value of the collateral is less than the contractual amount owed the creditor, the Bankruptcy Code splits or “bifurcates” it. It is treated as a secured claim up to the value of the collateral, and an unsecured claim for the amount which constitutes the discrepancy between the collateral's value and the contractual amount of the claim. 11 U.S.C. § 506. In other words, the claim of a secured creditor is legally protected up to the value of the collateral which secures the claim.

¹² *Harmon v. United States Through Farmers Home Admin.*, 101 F.3d 574 (8th Cir. 1996).

¹³ *Dewsnup v. Timm*, 502 U.S. 410 (1992).

reorganization plan. Chapter 12 also permits repayment of reformed secured claims over a period of time exceeding the plan period. Because chapter 12 provides the family farmer in bankruptcy with expanded authority to renegotiate with lenders, its influence may extend to informal renegotiations outside of bankruptcy as well.

- *Adequate protection and tax requirements.* Any bankruptcy debtor who retains collateral must provide the creditor “adequate protection” for the value of the collateral subject to the debtor’s use.¹⁴ Chapter 12 has its own standards for awarding “adequate protection”¹⁵ and a provision governing “special tax provisions.”¹⁶

Although chapter 12 was enacted as a temporary measure, it has been continuously extended. There have been – and are currently – legislative proposals to make it a permanent part of the U.S. Bankruptcy Code. The chapter, however, is not without its critics. Questions asked include whether the benefits of chapter 12 outweigh its costs; whether it encourages economic inefficiency in the farm sector; and whether the ability of farmers to write off secured debt has a positive impact on agricultural lending.¹⁷

Legislative Activity and Outlook. The House and Senate-passed comprehensive bankruptcy reform bills in the 106th Congress included provisions to enact chapter 12 permanently.¹⁸ But the 106th Congress concluded with neither a temporary nor a permanent enactment of Family Farmer Reorganization.

Early in the 107th Congress, major bankruptcy reform legislation passed both chambers, H.R. 333 in the House and S. 420 (passed as H.R. 333) in the Senate. Although a conference was appointed and a report issued,¹⁹ the report was not passed prior to adjournment *sine die* of the 107th Congress. The Conference Report would have enacted chapter 12 permanently. It provided for adjustment of the jurisdictional debt limit in accordance with the cost of living index,²⁰ and had several additional provisions. Among those were amendments to the jurisdictional filing requirements that raised the debt limit from \$1,500,000 to \$3,237,000 and lowered the percentage requirement for income that must be derived from farming. It expanded the time frame for measuring

¹⁴ 11 U.S.C. § 361.

¹⁵ 11 U.S.C. § 1205.

¹⁶ 11 U.S.C. § 1231.

¹⁷ Jerome Stam, “Do Farmers Need a Separate Chapter in the Bankruptcy Code,” Information Bulletin No. 724-09, Economic Research Service, USDA (October 1997).

¹⁸ H.Rept. 106-970 to accompany H.R. 2415, 106th Cong., 2d Sess., §1001(2000). *See also*, H.R. 833 (S. 625), 106th Cong., 2d Sess. § 1001 (2000)(Senate-passed version); H.R. 833, 106th Cong., 1st Sess. § 201 (1999)(House-passed version).

¹⁹ H. Rep. 107-617, 107th Cong., 2d Sess. (2002).

²⁰ *Id.* at. §§ 1001, 1002.

farm income from one to three years.²¹ In addition, the report added a new category of “family fishermen” to chapter 12.²²

These provisions were reintroduced in the 108th Congress in H.R. 975, the “Bankruptcy Abuse Prevention and Consumer Protection Act of 2003,” which passed the House on March 19, 2003.²³ On November 25, 2003, the Senate passed S. 1920, 108th Cong., 1st Sess. (2003) by unanimous consent. The bill would have extended chapter 12 for another six months, through July 1, 2004. The House passed S. 1920 on January 28, 2004, after substituting the text of the bill with the language of H.R. 975. The House has requested a conference with the Senate and has appointed conferees. The Senate has not yet acted.

²¹ *Id.* at 1004, 1005.

²² *Id.* at § 1007.

²³ H.R. 975, 108th Cong., 1st Sess., Title X (2003). *See* H.Rept. 108-40, Part 1, 108th Cong., 1st Sess. (2003).