

Agribusiness Alert: Trump Expands Debt Ceiling for Chapter 12 Bankruptcy

August 26, 2019

On August 23, 2019, President Trump signed into law an amendment to the Bankruptcy Code (11 U.S.C. 101 *et al*) that increased the debt ceiling for Chapter 12 farmers from \$4,411,400 to \$10,000,000 (the "Amendment"). The increase of the debt ceiling for purposes of Chapter 12 eligibility was the only amendment to the Bankruptcy Code. We believe the Amendment will result in:

- **An increase of Chapter 12 filings — however, it will be seen if the additional Chapter 12 filings will be cases that would have otherwise been filed under Chapter 11 and if there will actually be a net increase of filings.** The benefits of Chapter 12 (as opposed to Chapter 11) are significant. For instance:
 - Favorable treatment of capital gains. Capital gain taxes can be treated as a general unsecured claim under Chapter 12 (as opposed to being paid in full under a Chapter 11 plan). The favorable treatment allows a Chapter 12 debtor to liquidate low-basis assets without having to incur all of the associated taxes consequences of the sale.
 - No committees (and related legal fees). No unsecured creditor or other committees are authorized under Chapter 12 — which reduce the litigation and costs typically associated with Chapter 11 reorganizational bankruptcies. Chapter 11 committees represent the interests of certain classes of creditors or other interested parties.
 - Favorable treatment of administrative claims. Administrative claims can be paid through a Chapter 12 plan (as opposed to paying the administrative fees at plan confirmation under a Chapter 11 plan).
 - No absolute priority rule. There is no absolute priority rule under Chapter 12. The absolute priority rule requires a creditor's claim to have absolute priority over an owner equity claim. The absolute

priority rule allows Chapter 11 creditors to potentially derail a Chapter 11 plan of reorganization.

- Allows for "dirt for debt" plans. "Dirt for debt" plans are permitted under Chapter 12 — which allow a Chapter 12 debtor to surrender collateral in satisfaction of secured debt obligations.

Distressed farmers that were not eligible under Chapter 12 have historically still filed Chapter 11 bankruptcies in an effort to stave off foreclosure. Distressed farmers had no other options. The Amendment will provide distressed farmers more options - and an increased opportunity to confirm a plan of reorganization. However, it remains to be seen if the additional Chapter 12 filings will be cases that would have otherwise been filed under Chapter 11 and if there will actually be a net increase of bankruptcy filings. We expect a minimal increase of net farm bankruptcy filings.

An increase of Chapter 12 filings for non-traditional and commercial (closely held) agri-businesses.

There is no asset ceiling — only a debt ceiling — for purposes of Chapter 12 eligibility and the definition of "farming operation" is broad under the Bankruptcy Code^[1], so the Amendment may result in increased Chapter 12 filings by non-traditional and commercial agri-businesses. For instance, a closely held company that owns and operates a contract harvesting operation, a commercial seed company or a livestock breeder may arguably be eligible under Chapter 12. Furthermore, there was no corresponding adjustment of the 50% farm expense requirement under Chapter 12 — meaning that only \$5,000,001 of the debts needs to be related to the "farming operation" — which may result in filings by businesses that have economic interests outside of farming. The Bankruptcy Code requires that 50% of the shareholders to be involved in the farming operation so any non-traditional farming or commercial agricultural filing would likely be limited to closely held companies.

- **An increase of "first day" related negotiations.** With increased creditor claim amounts comes increased oversight. Under the earlier Chapter 12 eligibility requirements, secured creditors often would not dispute the use of cash collateral by the Chapter 12 debtor and not press for adequate protection payments and post-petition replacement liens. With an increase in the eligibility requirements to \$10,000,000 (and the associated increase of creditor claim amounts), we expect secured creditors will more actively assert their rights early in the Chapter 12 bankruptcy case.



The Amendment will increase options for distressed farmers, however, the economic reality is that to successfully confirm a Chapter 12 plan and obtain a discharge under Chapter 12, the reorganized farming operation must cash flow. The Chapter 12 discharge is entered upon the successful completion of the plan payments under a three- to five-year Chapter 12 plan. Most Chapter 12 debtors do not successfully confirm a Chapter 12 plan and complete the Chapter 12 plan payments (and obtain a bankruptcy discharge). Stated differently, a Chapter 12 may serve as a temporary bandage but a Chapter 12 debtor needs to make substantive changes to their farming operation to obtain a bankruptcy discharge (e.g., sell non-revenue generating assets, sell unnecessary or under-used farming equipment, sell and lease back cropland, supplement farm revenue with off-farm employment).

The willingness to make substantive changes to their farming operation (and not an increase in the debt ceiling) will continue to determine whether a Chapter 12 debtor is successful. The increase in the debt ceiling will open the door for more farmers to file Chapter 12 — but the question remains as to whether these same farmers will make the necessary substantive changes to their farming operation to successfully emerge from Chapter 12.

Contact the Reorganization and Bankruptcy team at Gray Plant Mooty with any questions you have about the new amendment or about Chapter 12 bankruptcy.

[1] See *Marone Acee v. Oneida Sav. Bank*, 529 B.R. 494 (N.D.N.Y. 2015) (game farm constitutes a farming operation for purposes of Chapter 12 eligibility); *In re McMahon Family L.P.*, 2013 Bankr. LEXIS 2771, 58 Bankr. Ct. Dec. 51 (Bankr. E.D. Wis. July 10, 2013) (tree farming is a farming operation); *In re Williams*, 2016 WL 1644189 (Bankr. W.D. Ky. 2016) (contracting with a third party for the planting and harvesting of a crop constitutes farming)