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AN OVERVIEW OF

CHAPTER 12

OF THE

BANKRUPTCY CODE

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AN OVERVIEW OF CHAPTER 12 OF THE BANKRUPTCY CODE

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I. INTRODUCTION

Chapter 12 of the Bankruptcy Code, the so-called "family farmer" reorganization chapter, is designed to be a streamlined, efficient reorganization chapter for those farmers who are eligible to file under Chapter 12 as "family farmers." The purpose of Chapter 12 is to provide family farmers with a faster, simpler and cheaper alternative to Chapter 11 and Chapter 13 procedures, while at the same time preserving the fair treatment of creditors under those Chapters. It was designed to give family farmers facing bankruptcy a fighting chance to reorganize their debts and keep their land while preventing abuse to the system and ensuring that farm lenders received a fair repayment. *Knudsen v. IRS*, 581 F.3d 696 (8th Cir. 2009) (abrogated on other grounds by *Hall v. U.S.*, 566 U.S. 506, 132 S. Ct. 1882, 182 L. Ed. 2d 840 (2012)), *Wiese v. Community Bank of Cent. Wis.*, 552 F.3d 584 (7th Cir. 2009), *In re Victorious, LLC*, 545 B.R. 815 (Bankr. Vt. 2016); Chapter 12 of the Bankruptcy Code allows eligible family farmer debtors to adjust their debts while they remain in control and possession of their property, and they maintain the ability to operate their farms. *In re Dawes*, 415 B.R. 815 (Bankr. D. Kan. 2009).

There are many advantages of Chapter 12 as opposed to Chapter 11. There is no "absolute priority" rule in Chapter 12, creditors are not entitled to "vote" for or against the plan of reorganization and the debtor is not required to file a disclosure statement.

In addition, family farmers are eligible to modify mortgages upon their primary residences even where the first lienholder has no other collateral.

The eligibility requirements for Chapter 12 are relatively straightforward and limits who may file Chapter 12.

In many other respects, case administration, the plan of reorganization and the confirmation process closely resemble those of Chapter 11, with some features of Chapter 13 mixed in for good measure.

II. ELIGIBILITY FOR RELIEF IN CHAPTER 12

The term "family farmer" is defined in 11 U.S.C. §101(18)

> (18) The term "family farmer" means –
>
> (A) individual or individual and spouse engaged in a farming operation whose aggregate debts do not exceed $4,153,150 and not less than 50 percent of whose aggregate noncontingent, liquidated debts (excluding a debt for the principal residence of such individual or such individual and spouse unless such debt arises out of a farming operation), on the date the case is filed, arise out of a farming operation owned or operated by such individual or such individual and spouse, and such individual or such individual and spouse receive from such farming operation more than 50 percent of such individual's or such individual and spouse's gross income for –
>
> (i) the taxable year preceding; or
>
> (ii) each of the 2d and 3d taxable years preceding; the taxable year in which the case concerning such individual or such individual and spouse was filed; or
>
> (B) corporation or partnership in which more than 50 percent of the outstanding stock or equity is held by one family, or by one family and the relatives of the members of such family, and such family or such relatives conduct the farming operation, and
>
> (i) more than 80 percent of the value of its assets consists of assets related to the farming operation;
>
> (ii) its aggregate debts do not exceed $4,153,150 and not less than 50 percent of its aggregate noncontingent, liquidated debts (excluding a debt for one dwelling which is owned by such corporation or partnership and which a shareholder or partner maintains as a principal residence, unless such debt arises out of a farming operation), on the date the case is filed, arise out

> of the farming operation owned or operated by such corporation or such partnership; and
>
> (iii) if such corporation issues stock, such stock is not publicly traded

Eligibility for relief under Chapter 12 is not limited to individuals, as the statute provides for filing of Chapter 12 by a corporation or a partnership.

In 2005, Congress amended Chapter 12 (and related provisions) to provide for eligibility for "family fishermen" to file for relief under Chapter 12. The definitional provisions of 11 U.S.C. §101(19)(a) define family fishermen:

> (19A) The term "family fisherman" means –
>
> (A) an individual or individual and spouse engaged in a commercial fishing operation –
>
> (i) whose aggregate debts do not exceed $1,500,000 and not less than 80 percent of whose aggregate noncontingent, liquidated debts (excluding a debt for the principal residence of such individual or such individual and spouse, unless such debt arises out of a commercial fishing operation), on the date the case is filed, arise out of a commercial fishing operation owned or operated by such individual or such individual and spouse; and
>
> (ii) who receive from such commercial fishing operation more than 50 percent of such individual's or such individual's and spouse's gross income for the taxable year preceding the taxable year in which the case concerning such individual or such individual and spouse was filed; or
>
> (B) a corporation or partnership –
>
> (i) in which more than 50 percent of the outstanding stock or equity is held by –
>
> (I) 1 family that conducts the commercial fishing operation; or

(II) 1 family and the relatives of the members of such family, and such family or such relatives conduct the commercial fishing operation; and

(ii) (I) more than 80 percent of the value of its assets consists of assets related to the commercial fishing operation;

(II) its aggregate debts do not exceed $1,500,000 and not less than 80 percent of its aggregate noncontingent, liquidated debts (excluding a debt for 1 dwelling which is owned by such corporation or partnership and which a shareholder or partner maintains as a principal residence, unless such debt arises out of a commercial fishing operation), on the date the case is filed, arise out of a commercial fishing operation owned or operated by such corporation or such partnership; and

(III) if such corporation issues stock, such stock is not publicly traded.

Certain other definitional sections bear mention here.

The term "farmer" is defined in 11 U.S.C. §101(20):

(20) The term "farmer" means (except when such term appears in the term "family farmer") person that received more than 80 percent of such person's gross income during the taxable year of such person immediately preceding the taxable year of such person during which the case under this title concerning such person was commenced from a farming operation owned or operated by such person.

The definition of a "farming operation" is found in 11 U.S.C. §101(21):

(21) The term "farming operation" includes farming, tillage of the soil, dairy farming, ranching, production or raising of crops, poultry, or livestock, and production of poultry or livestock products in an unmanufactured state.

Thus, Chapter 12 includes two groups of "farmers" who may qualify for eligibility. The first group includes persons who are "family farmers with regular annual income" as that term is defined in 11 U.S.C. §101(19):

> (19) The term "family farmer with regular annual income" means family farmer whose annual income is sufficiently stable and regular to enable such family farmer to make payments under a plan under chapter 12 of this title.

The second group who may qualify for eligibility for relief under Chapter 12 includes persons who are "family fishermen with regular annual income" as that term is defined in 11 U.S.C. §101(19B):

> (19B) The term "family fisherman with regular annual income" means a family fisherman whose annual income is sufficiently stable and regular to enable such family fisherman to make payments under a plan under chapter 12 of this title.

Eligibility for Chapter 12 relief is not relegated to the "traditional" row crop, cattle, dairy or poultry operation or aquaculture operations: *In re Carter*, 570 B.R. 500 (Bankr. M.D.N.C. 2017); growing flowering plants, trees and shrubs; *In re Teolis*, 419 B.R. 151 (Bankr. D.R.I. 2009); leasing farmland to grow alfalfa; *In re Osborne*, 323 B.R. 489 (Bankr. Or. 2005); raising timber as a farming operation, *In re Glenn*, 181 B.R. 105 (Bankr. E.D. Okla. 1995); leasing farmland on a crop share basis, *In re Burke*, 81 B.R. 971 (Bankr. S.D. Iowa 1987); raising livestock and breeding farm animals, *In re Showtime Farms, Inc.*, 267 B.R. 541 (Bankr. E.D. Tex. 2000).

The statutory requirements for eligibility are relatively straightforward, but for additional discussion of them, please see *When is a Family Farmer a "Family Farmer?": An Analysis of Chapter 12 Income Qualifications*, Robert J. Haupt – 29 OK City Univ. L. Rev. 725 (2004).

III. CASE ADMINISTRATION

A. Codebtor Stay

Chapter 12 contains a "limited" codebtor stay in 11 U.S.C. §1201:

> **11 U.S.C. § 1201 – Stay of action against codebtor**
>
> (a) Except as provided in subsections (b) and (c) of this section, after the order for relief under this chapter, a creditor may not act, or commence or continue any civil action, to collect all or any part of a consumer debt of the debtor from any individual that is liable on such debt with the debtor, or that secured such debt, unless
>
> (1) such individual became liable on or secured such debt in the ordinary course of such individual's business; or
>
> (2) the case is closed, dismissed, or converted to a case under chapter 7 of this title.
>
> (b) A creditor may present a negotiable instrument, and may give notice of dishonor of such an instrument.
>
> (c) On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided by subsection (a) of this section with respect to a creditor, to the extent that
>
> (1) as between the debtor and the individual protected under subsection (a) of this section, such individual received the consideration for the claim held by such creditor;
>
> (2) the plan filed by the debtor proposes not to pay such claim; or
>
> (3) such creditors interest would be irreparably harmed by continuation of such stay.
>
> (d) Twenty days after the filing of a request under subsection (c)(2) of this section for relief from the stay provided by subsection (a) of this section, such stay is terminated with respect to the party in interest making such request, unless the debtor or any individual that is liable on such debt with the debtor files and serves upon such party in interest a written objection to the taking of the proposed action.

This particular codebtor stay closely resembles the codebtor stay in 11 U.S.C. §1301. The codebtor stay is applicable only in individual cases in Chapter 12, not to corporate or partnership cases. In addition, the codebtor stay is limited to debts that are "consumer debts" of the debtor. Debts for farming operations, debts incurred by a family farmer if they are incurred to finance the farming business or debts incurred to enhance the profitability of the debtor's business are not protected by the codebtor stay. *In re Terry Props., LLC,* 569 B.R. 76 (Bankr. W.D. Va. 2017); *In re SWF, Inc.*, 83 B.R. 27 (Bankr. S.D. Cal. 1988); *In re Smith*, 189 B.R. 11 (Bankr. C.D. Ill. 1995).

B. Appointment and Compensation of a Trustee

A trustee is always appointed in a Chapter 12 case. The statutory basis for the appointment of a trustee, and the descriptions of the trustee's duties are found in 11 U.S.C. §1202:

> **11 U.S.C. §1202 - Trustee**
>
> a) If the United States trustee has appointed an individual under section 586(b) of title 28 to serve as standing trustee in cases under this chapter and if such individual qualifies as a trustee under section 322 of this title, then such individual shall serve as trustee in any case filed under this chapter. Otherwise, the United States trustee shall appoint one disinterested person to serve as trustee in the case or the United States trustee may serve as trustee in the case if necessary.
>
> (b) The trustee shall
>
> (1) perform the duties specified in sections 704(2), 704(3), 704(5), 704(6), 704(7), and 704(9) of this title;
>
> (2) perform the duties specified in section 1106(a)(3) and 1106(a)(4) of this title if the court, for cause and on request of a party in interest, the trustee, or the United States trustee, so orders;
>
> (3) appear and be heard at any hearing that concerns
>
> (A) the value of property subject to a lien;
>
> (B) confirmation of a plan;
>
> (C) modification of the plan after confirmation; or

(D) the sale of property of the estate;

(4) ensure that the debtor commences making timely payments required by a confirmed plan;

(5) if the debtor ceases to be a debtor in possession, perform the duties specified in sections 704(8), 1106(a)(1), 1106(a)(2), 1106(a)(6), 1106(a)(7), and 1203; and

(6) if with respect to the debtor there is a claim for a domestic support obligation, provide the applicable notice specified in subsection (c).

(c) (1) In a case described in subsection (b)(6) to which subsection (b)(6) applies, the trustee shall

(A) (i) provide written notice to the holder of the claim described in subsection (b)(6) of such claim and of the right of such holder to use the services of the State child support enforcement agency established under sections 464 and 466 of the Social Security Act for the State in which such holder resides, for assistance in collecting child support during and after the case under this title; and

(ii) include in the notice provided under clause (i) the address and telephone number of such State child support enforcement agency;

(B) (i) provide written notice to such State child support enforcement agency of such claim; and

(ii) include in the notice provided under clause (i) the name, address, and telephone number of such holder; and

(C) at such time as the debtor is granted a discharge under section 1228, provide written notice to such holder and to such State child support enforcement agency of

(i) the granting of the discharge;

(ii) the last recent known address of the debtor;

(iii) the last recent known name and address of the debtor's employer; and

> (iv) the name of each creditor that holds a claim that
>
> (I) is not discharged under paragraph (2), (4), or (14A) of section 523 (a); or
>
> (II) was reaffirmed by the debtor under section 524 (c).
>
> (2) (A) The holder of a claim described in subsection (b)(6) or the State child support enforcement agency of the State in which such holder resides may request from a creditor described in paragraph (1)(C)(iv) the last known address of the debtor.
>
> (B) Notwithstanding any other provision of law, a creditor that makes a disclosure of a last known address of a debtor in connection with a request made under subparagraph (A) shall not be liable by reason of making that disclosure.

In certain circumstances, courts have considered expanding the duties of the Chapter 12 trustee. *In re Graven*, 84 B.R. 630 (Bankr. W.D. Mo. 1988), and its progeny *In re Graven*, 101 B.R. 109 (Bankr. W.D. Mo. 1989), *In re Graven*, 936 F.2d 378 (8th Cir. 1991), and *In re Graven*, 196 B.R. 506 (Bankr. W.D. Mo. 1996).

The compensation of a trustee is established in 28 U.S.C. § 586(e). Under § 586(e)(1)(B), the standing trustee receives a percentage fee not to exceed ten percent (10%) of payments made "under the plan" up to $450,000.00 and three percent (3%) of payments made "under the plan" in excess of $450,000.00. In many Chapter 12 plans, the debtor provides that certain payments will be made "outside" the plan (that is, directly to a creditor) and other payments will be made "inside" the plan (that is, directly to the Chapter 12 trustee). Typically, all payments to unsecured creditors are

made directly to the Chapter 12 trustee who then disburses them to the unsecured creditors on a pro-rata basis.

The Code is somewhat ambiguous and not very helpful with respect to the circumstances under which debtors may elect to make payments "outside" the plan, thereby "escaping" the ten percent (10%) fee of the Chapter 12 trustee.

A Chapter 12 plan providing for direct payments to creditors, with the corresponding avoidance of Chapter 12 trustee fees, can be confirmed when all statutory requirements for confirmation are met, including feasibility. *Haden v. Pelofsky*, 212 F.3d 466 (8th Cir. 2000).

There is no provision in Chapter 12 of the Bankruptcy Code that prohibits direct payments from debtors to creditors. *In re Hernandez*, 549 B.R. 551 (Bankr. P.R. 2016); Direct payments are appropriate to Chapter 12 secured creditors even if those secured creditors' rights are modified in a Chapter 12 plan. *In re Land*, 82 B.R. 572 (Bankr. D. Colo. 1988)*, opinion affirmed* 96 B.R. 310.

A Chapter 12 Plan may provide for payments directly to secured creditors, thereby bypassing the Chapter 12 trustee and his fees. *In re Wagner*, 36 F.3d 723 (8th Cir. 1994). *See also In re Smith* (Bankr. S.D. Tex. 2019); and *In re Overholt*, 125 B.R. 202 (Bankr. S.D. Ohio 1990).

An excellent discussion of this issue is found in *8 Collier on Bankruptcy* ¶1226.03 (Allen N. Resnick and Henry J. Sommer Eds., 16th Ed.), and the cases collected in that article. The issue is thoroughly discussed in *In re Speir*, 2018 Bankr. LEXIS 2359 (Bankr. N.D. Miss. 2018), and a copy of Judge Jason Woodard's opinion in that case is appended to this article. The opinion is important not only with respect to whether (and when) "direct" payments are authorized and allowed, it reviews

the cases that deal with whether the Chapter 12 trustee's compensation can be based upon "direct" payments. While this issue of trustee compensation is not as important now with the statutory "cap" of a little over $4 million, in the event pending legislation in Congress that will increase the "cap" to slightly over $10 million is enacted into law, trustee compensation will be much more important in those cases where the distributions to creditors (whether inside or outside the plan) are much more substantial than in current cases. Judge Woodard's opinion discusses the issue on a case-by-case basis, utilizing factors found in other cases and balancing that with equitable factors that exist in a particular case.

C. Rights and Powers of the Debtor

The Chapter 12 debtor is the debtor-in-possession, and has similar rights to a debtor-in-possession in Chapter 11 as noted by 11 U.S.C. §1203:

> **11 U.S.C. § 1203 – Rights and powers of debtor**
>
> Subject to such limitations as the court may prescribe, a debtor in possession shall have all the rights, other than the right to compensation under section 330, and powers, and shall perform all the functions and duties, except the duties specified in paragraphs (3) and (4) of section 1106(a), of a trustee serving in a case under chapter 11, including operating the debtors farm or commercial fishing operation.

The debtor may operate the Chapter 12 business under 11 U.S.C. §363 in the ordinary course. The prohibitions against use of cash collateral of 11 U.S.C. §363(c)(2)(4) apply in cases under Chapter 12 as do the requirements of 11 U.S.C. §363 for the sale of property of the estate outside the ordinary course of business. 11 U.S.C. §1206.

The debtor-in-possession is authorized to obtain credit or borrow money under 11 U.S.C. §364 on an unsecured basis, or on a secured basis upon court approval after notice and hearing.

The debtor has the ability to assume or reject executory contracts under 11 U.S.C. §365.

The debtor also has the authority to employ professionals on behalf of the estate under 11 U.S.C. §1203, which does not provide, interestingly (contrasted with 11 U.S.C. §1107(b) in Chapter 11 cases), that a professional who is retained by the debtor prior to the filing of the petition is not disqualified from representing the debtor-in-possession simply because the professional represented the debtor prior to the filing of the petition. Still, the professional must be a "disinterested person."

D. Adequate Protection

Adequate protection is discussed in 11 U.S.C. §1205:

> **11 U.S.C. § 1205 - Adequate Protection**
>
> (a) Section 361 does not apply in a case under this chapter.
>
> (b) In a case under this chapter, when adequate protection is required under section 362, 363, or 364 of this title of an interest of an entity in property, such adequate protection may be provided by
>
> (1) requiring the trustee to make a cash payment or periodic cash payments to such entity, to the extent that the stay under section 362 of this title, use, sale, or lease under section 363 of this title, or any grant of a lien under section 364 of this title results in a decrease in the value of property securing a claim or of an entity's ownership interest in property;
>
> (2) providing to such entity an additional or replacement lien to the extent that such stay, use, sale, lease, or grant results in a decrease in the value of property securing a claim or of an entity's ownership interest in property;
>
> (3) paying to such entity for the use of farmland the reasonable rent customary in the community where the property is located, based upon the rental value, net income, and earning capacity of the property; or

> (4) granting such other relief, other than entitling such entity to compensation allowable under section 503 (b)(1) of this title as an administrative expense, as will adequately protect the value of property securing a claim or of such entity's ownership interest in property.

However, most motions for relief from the automatic stay are litigated with the adequate protection requirements of 11 U.S.C. §361 and Chapter 11 cases in mind. Some of the cases considering a motion to lift the stay rely upon typical adequate protection/lift stay concepts: motions for the stay are dealt with in Chapter 12 in essentially the same fashion as motions brought in cases under other chapters of the Code. *In re Simpson* (Bankr. Vt. 2018); the finding of an equity cushion (*In re Glenn*, 181 B.R. 105 (Bankr. E.D. Okla. 1995); lack of possibility that the debtor could confirm a Chapter 12 plan, *In re Ziebarth*, 113 B.R. 591 (Bankr. D.N.D. 1990), *In re Wald,* 211 B.R. 359 (Bankr. N.D. 1997). The methods of providing adequate protection in §1205(b) are through cash payments, additional replacement liens, paying reasonable rent on farm land and the catch-all provision of §1205(b)(4).

E. Conversion or Dismissal

The operative code section for conversion or dismissal of a Chapter 12 case is 11 U.S.C. §1208:

> **11 U.S.C. §1208 - Conversion or dismissal**
>
> (a) The debtor may convert a case under this chapter to a case under chapter 7 of this title at any time. Any waiver of the right to convert under this subsection is unenforceable.
>
> (b) On request of the debtor at any time, if the case has not been converted under section 706 or 1112 of this title, the court shall dismiss a case under this chapter. Any waiver of the right to dismiss under this subsection is unenforceable.

> (c) On request of a party in interest, and after notice and a hearing, the court may dismiss a case under this chapter for cause, including
>
> (1) unreasonable delay, or gross mismanagement, by the debtor that is prejudicial to creditors;
>
> (2) nonpayment of any fees and charges required under chapter 123 of title 28;
>
> (3) failure to file a plan timely under section 1221 of this title;
>
> (4) failure to commence making timely payments required by a confirmed plan;
>
> (5) denial of confirmation of a plan under section 1225 of this title and denial of a request made for additional time for filing another plan or a modification of a plan;
>
> (6) material default by the debtor with respect to a term of a confirmed plan;
>
> (7) revocation of the order of confirmation under section 1230 of this title, and denial of confirmation of a modified plan under section 1229 of this title;
>
> (8) termination of a confirmed plan by reason of the occurrence of a condition specified in the plan;
>
> (9) continuing loss to or diminution of the estate and absence of a reasonable likelihood of rehabilitation; and
>
> (10) failure of the debtor to pay any domestic support obligation that first becomes payable after the date of the filing of the petition.
>
> (d) On request of a party in interest, and after notice and a hearing, the court may dismiss a case under this chapter or convert a case under this chapter to a case under chapter 7 of this title upon a showing that the debtor has committed fraud in connection with the case.
>
> (e) Notwithstanding any other provision of this section, a case may not be converted to a case under another chapter of this title unless the debtor may be a debtor under such chapter.

The debtor has the statutory right to convert a Chapter 12 case to a case under Chapter 7. Prior court approval need not be obtained. In addition, 11 U.S.C. §1208(b) grants the debtor an absolute right to dismiss a Chapter 12 case at any time unless the case has already been converted to a Chapter 12 from a Chapter 7 or a Chapter 11. However, if the debtor has committed fraud in

connection with the case, the debtor may not be entitled to dismissal. Some examples are: false statements and schedules, false statements all related to admitted to omissions of assets, liabilities, income and transfers, *In re Packer*, 586 B.R. 274 (Bankr. N.D. Ill. 2018); application of the definition of actual fraud in finding "damage to the bankruptcy process" justifies conversion, *In re Nichols,* 447 B.R. 97(Bankr. N.D.N.Y. 2010); absence of proof of fraudulent intent or any intent to hinder, delay or defraud, *In the Matter of Stephen M. Hibbard,* 448 B.R. 296 (Bankr. S.D. Ga. 2009); trustee's investigation revealed multiple transactions by the debtor that were questionable; *In re Graven,* 936 F.2d 378 (8th Cir. 1991), *In re Williamson*, 414 B.R. 892 (Bankr. S.D. Ga. 2008); *In re Goza*, 142 B.R. 766 (Bankr. S.D. Miss. 1992). The statute (§1208) does not provide for conversion to Chapter 7 upon the motion of a non-debtor [Compare prohibition barring the filing of an involuntary petition against a farmer or a family farmer. 11 U.S.C. §303(a).].

There are ten specific grounds, pursuant to 11 U.S.C. §1208(c), that may constitute cause for dismissal of a Chapter 12 case, although these are not exhaustive. *In re Dickenson,* 517 B.R. 622 (Bankr. W.D. Va. 2014), In *re Eurle Farms, Inc.*, 861 F.2d 1089 (8th Cir. 1998). Some cases find dismissal appropriate where there is no possibility of plan confirmation, *In re Blake,* 585 B.R. 539 (Bankr. S.D. Ill. 2018), *In re Victorious, LLC,* 545 B.R. 815 (Bankr. Vt. 2016), *In re Perkins,* 2013 Bankr. LEXIS 4539 (Bankr. E.D. Tenn. 2013), *In re Renegade Holdings, Inc.* (Bankr. N.D.N.C. 2013), *In re Strickland* (Bankr. S.C. 2013), *In re Mosbrucker*, 227 B.R. 434 (BAP 8th Cir. 1998); failure to propose a confirmable plan despite three chances, *Ellis v. NBT Bank, N.A.* (N.D.N.Y. 2013), *In re Rice*, 357 B.R. 514 (BAP 8th Cir. 2006), *affirmed* 271 Fed. Appx. 538; or a bad faith

filing, *In re Carter,* 570 B.R. 500 (Bankr. M.D.N.C. 2017), *In re Pertuset,* 485 B.R. 478 (B.A.P. 6th Cir. 2012), *In re Walton*, 116 B.R. 536 (Bankr. N.D. Ohio 1990) and related grounds.

IV. THE PLAN

Most of the action in a Chapter 12 case centers around plan confirmation. (*But see In re Sandifer*, 448 B.R. 382 (Bankr. D.S.C. 2011), which held that while the regularity of the Chapter 12 debtor's income is a feasibility matter that is best left to plan confirmation hearings, when an objection is raised that the debtor is not a family farmer with regular annual income and thus not eligible for Chapter 12 relief, efficiency dictates that the court will have to address that issue earlier in the process.) Part of the reason for this is that 11 U.S.C. §1221 requires the debtor to file the plan not later than ninety (90) days after the petition is filed, unless the court extends such period based upon circumstances as to which the debtor should not be held accountable. The hearing must be concluded not later than 45 days after the filing of the plan. 11 U.S.C. §1224. Accordingly, because of the fast pace (*see In re Henderson*, 352 B.R. 439 (Bankr. N.D. Tex. 2006)), the Bankruptcy Code requires for the filing and confirmation of a plan, it is actually much easier to litigate substantially all of the major issues in the case – such as adequate protection and lifting of the automatic stay – as part of the confirmation hearing. There is no provision in Chapter 12 that allows any entity other than the debtor to file a plan.

A. Contents of Plan

The mandatory, and permissive, requirements of the contents of the plan are found in 11 U.S.C. §1222:

11 U.S.C. § 1222 – Contents of plan

a) The plan shall

(1) provide for the submission of all or such portion of future earnings or other future income of the debtor to the supervision and control of the trustee as is necessary for the execution of the plan;

(2) provide for the full payment, in deferred cash payments, of all claims entitled to priority under section 507, unless the holder of a particular claim agrees to a different treatment of that claim;

(3) if the plan classifies claims and interests, provide the same treatment for each claim or interest within a particular class unless the holder of a particular claim or interest agrees to less favorable treatment; and

(4) notwithstanding any other provision of this section, a plan may provide for less than full payment of all amounts owed for a claim entitled to priority under section 507(a)(1)(B) only if the plan provides that all of the debtors projected disposable income for a 5-year period beginning on the date that the first payment is due under the plan will be applied to make payments under the plan; and

(5) subject to section 1232, provide for the treatment of any claim by a governmental unit of a kind described in section 1232(a).

(b) Subject to subsections (a) and (c) of this section, the plan may

(1) designate a class or classes of unsecured claims, as provided in section 1122 of this title, but may not discriminate unfairly against any class so designated; however, such plan may treat claims for a consumer debt of the debtor if an individual is liable on such consumer debt with the debtor differently than other unsecured claims;

(2) modify the rights of holders of secured claims, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims;

(3) provide for the curing or waiving of any default;

(4) provide for payments on any unsecured claim to be made concurrently with payments on any secured claim or any other unsecured claim;

(5) provide for the curing of any default within a reasonable time and maintenance of payments while the case is pending on any unsecured claim or secured claim on which the last payment is due after the date on which the final payment under the plan is due;

(6) subject to section 365 of this title, provide for the assumption, rejection, or assignment of any executory contract or unexpired lease of the debtor not previously rejected under such section;

(7) provide for the payment of all or part of a claim against the debtor from property of the estate or property of the debtor;

(8) provide for the sale of all or any part of the property of the estate or the distribution of all or any part of the property of the estate among those having an interest in such property;

(9) provide for payment of allowed secured claims consistent with section 1225(a)(5) of this title, over a period exceeding the period permitted under section 1222(c);

(10) provide for the vesting of property of the estate, on confirmation of the plan or at a later time, in the debtor or in any other entity;

(11) provide for the payment of interest accruing after the date of the filing of the petition on unsecured claims that are nondischargeable under section 1228(a), except that such interest may be paid only to the extent that the debtor has disposable income available to pay such interest after making provision for full payment of all allowed claims; and

(12) include any other appropriate provision not inconsistent with this title.

(c) Except as provided in subsections (b)(5) and (b)(9), the plan may not provide for payments over a period that is longer than three

> years unless the court for cause approves a longer period, but the court may not approve a period that is longer than five years.
>
> (d) Notwithstanding subsection (b)(2) of this section and sections 506(b) and 1225(a)(5) of this title, if it is proposed in a plan to cure a default, the amount necessary to cure the default, shall be determined in accordance with the underlying agreement and applicable nonbankruptcy law.

Section 1222(a) sets forth the requirement that the debtor submit income or earnings to the supervision and control of the trustee as are necessary for the execution of the plan. This does not mean all future earnings or income – only such earnings and income as are necessary to pay the debtor's obligations "under" the plan.

Section 1222(a)(2) requires that priority claims (under 11 U.S.C. §507) must be provided for and paid in full in deferred cash payments.

If the plan classifies claims and interests, 11 U.S.C. §1222(a) provides that the same treatment must be afforded each claim or interest within a particular class, unless the holder of the claim or interest agrees otherwise. The plan may not discriminate unfairly between classes. 11 U.S.C. §1222(b)(1).

There are a number of discretionary or permissive provisions under §1222(b) that a plan may include. The plan may designate a class or classes of unsecured claims to the extent allowed by §1122 in Chapter 11 cases. Accordingly, the claim may be placed in a class only if the claim is substantially similar to other claims that are within the class.

A plan may modify the rights of the holders of secured claims by splitting the claims into unsecured and secured portions and "lien stripping" the unsecured portion of the lien. *In re Holloway,* 261 B.R. 490 (M.D. Ala. 2001), *In re Zabel*, 249 B.R. 764 (Bankr. E.D. Wis. 2000).

The plan may provide that a default may be cured or it may be waived, the plan may provide for payments to be made concurrently on any secured or unsecured claim and the plan may assume or reject executory contracts or unexpired leases.

The plan may also provide for sales of assets or of the entire estate.

The plan may alter or modify a debt that is owed to a secured creditor similar to modification provisions of secured debt in Chapter 11. In considering a plan's repayment period, the court may consider the length of the underlying note and the creditor's customary repayment periods for similar loans, *In re Elkhorn Crossing, LLC* (Bankr. Neb. 2016); the plan must satisfy the present value requirement, *In re Howe Farms, LLC* (Bankr. N.D.N.Y. 2014); *In re Elk Creek Salers, Ltd.*, 286 B.R. 387 (Bankr. W.D. Mo. 2002). A Chapter 12 plan may restructure a loan obligation to provide for payment of secured claims beyond the length of the plan, so long as the payment is consistent with § 1225(a)(5). *In re Perkins,* (Bankr. E.D. Tenn. 2013); *In re Hand*, Case No. 3:09-bk-5691-PMG (Bankr. M.D. Fla. 2010). There must be a likelihood that the debtor has sufficient disposable income to pay the secured claim as provided by the Code. *In re Chambers*, Case No. 08-31399 (Bankr. E.D. Tenn. 2008). The Court in *In re Graves Farms*, 465 B.R. 196 (Bankr. Kan. 2019) applied the "Till" discount rate in a Chapter 12 case, noting the similarity of Chapter 12 to Chapter 13, in that regard; *In re Woods*, 465 B.R. 196 (B.A.P. 10th Cir. 2012), *vacated on other grounds* 743 F.3d 689 (10th

Cir. 2014). The Chapter 12 plan may restructure debts that have matured prior to the commencement of the case which extend beyond the length of the plan, *In re Perkins* (Bankr. E.D. Tenn. 2013). *In re Torelli;* 338 B.R. 390 (Bankr. E.D. Ark. 2006); *In re Tognini* (Bankr. E.D. Va. 2011); *Travelers Ins. Co. v. Bullington*, 878 F.2d 354 (11th Cir. 1989), *rehearing denied* 889 F.2d 276 (11th Cir. 1989); *In re Elk Creek Salers, Ltd.*, 286 B.R. 387 (Bankr. W.D. Mo. 2002).

The debtor must commit all "projected disposable income" to payment of unsecured creditors. Disposable income is income that is not necessary for family living or for the "continuation, preservation, and operation of the debtor's business." 11 U.S.C. §1225(b)(2). Disposable income, determined at confirmation, can only be modified under very limited circumstances. 11 U.S.C. §1229. *In re Linden,* 174 B.R. 769 (C.D. Ill 1994); *In re Bowlby,* 113 B.R. 983 (Bankr. S.D. Ill 1990); *In re Meyer*, 173 B.R. 419 (Bankr. Kan. 1994).

The duration of the plan is controlled by §1222(c). The maximum time frame for payment of unsecured claims is three (3) years unless the court, for cause, approves a longer time frame. However, the extended time frame cannot exceed five (5) years.

B. Confirmation Standards and Hearing

As previously noted, 11 U.S.C. §1224 requires a confirmation hearing to be conducted on expedited notice and concluded within 45 days after the plan has been filed. The trustee, the United States Trustee or any party in interest may object to plan confirmation.

The standards of confirmation are found in 11 U.S.C. §1225:

11 U.S.C. § 1225 – Confirmation of plan

(a) Except as provided in subsection (b), the court shall confirm a plan if

(1) the plan complies with the provisions of this chapter and with the other applicable provisions of this title;

(2) any fee, charge, or amount required under chapter 123 of title 28, or by the plan, to be paid before confirmation, has been paid;

(3) the plan has been proposed in good faith and not by any means forbidden by law;

(4) the value, as of the effective date of the plan, of property to be distributed under the plan on account of each allowed unsecured claim is not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under chapter 7 of this title on such date;

(5) with respect to each allowed secured claim provided for by the plan

(A) the holder of such claim has accepted the plan;

(B) (i) the plan provides that the holder of such claim retain the lien securing such claim; and

(ii) the value, as of the effective date of the plan, of property to be distributed by the trustee or the debtor under the plan on account of such claim is not less than the allowed amount of such claim; or

(C) the debtor surrenders the property securing such claim to such holder;

(6) the debtor will be able to make all payments under the plan and to comply with the plan; and

(7) the debtor has paid all amounts that are required to be paid under a domestic support obligation and that first become payable after the date of the filing of the petition if the debtor is required by a judicial or administrative order, or by statute, to pay such domestic support obligation.

(b) (1) If the trustee or the holder of an allowed unsecured claim objects to the confirmation of the plan, then the court may not approve the plan unless, as of the effective date of the plan

(A) the value of the property to be distributed under the plan on account of such claim is not less than the amount of such claim;

(B) the plan provides that all of the debtors projected disposable income to be received in the three-year period, or such longer period as the court may approve under section 1222 (c), beginning on the date that the first payment is due under the plan will be applied to make payments under the plan; or

(C) the value of the property to be distributed under the plan in the 3-year period, or such longer period as the court may approve under section 1222(c), beginning on the date that the first distribution is due under the plan is not less than the debtors projected disposable income for such period.

(2) For purposes of this subsection, disposable income means income which is received by the debtor and which is not reasonably necessary to be expended

(A) for the maintenance or support of the debtor or a dependent of the debtor or for a domestic support obligation that first becomes payable after the date of the filing of the petition; or

(B) for the payment of expenditures necessary for the continuation, preservation, and operation of the debtors business.

(c) After confirmation of a plan, the court may order any entity from whom the debtor receives income to pay all or any part of such income to the trustee.

C. Specific Plan Confirmation Requirements

- The plan must have been proposed in good faith. 11 U.S.C. §1225(a)(3); *In re Barger,* 233 B.R. 80 (8th Cir. 1999); *In re Mann Farms, Inc.*, 917 F.2d 1210 (9th Cir. 1990). *See also* 8 *Collier on Bankruptcy* ¶1225.02 [3] (Allen S. Resnick and Henry J. Sommer Eds., 16th Ed.).
- Priority claims must be paid in full.
- Unsecured creditors must receive as much under the plan as if the debtor were liquidated in a Chapter 7 case. 11 U.S.C. § 1225(a)(4); *In re CF Beef & Grain, LLC,* 590 B.R. 849 (Bankr. E.D. Wis. 2018); *In re Blake,* 585 B.R. 539 (Bankr. S.D. Ill. 2018); *Matter of Fortney*, 36 F3d 701 (7th Cir. 1994).
- The Chapter 12 trustee, one in every case, disburses payments made under the plan, including the trustee's compensation.
- Debtor must establish all six elements of 11 U.S.C. § 1225 to have the plan approved. *In re Meinders* (Bankr. N.D. Iowa 2016); *In re Rice*, *id.*, *affirmed* 271 Fed. Appx. 538; *In re Gough*, 190 B.R. 455 (Bankr. M.D. Fla. 1995); *In re Weber*, 297 B.R. 567 (Bankr. N.D. Iowa 2003). The debtor bears the burden of proving the proposed plan satisfies all the requirements for confirmation. *In re Torelli*, 338 B.R. 390 (Bankr. E.D. Ark. 2006).
- The plan must be feasible. *FB Acquisition Prop. I, LLC v. Gentry (In re Gentry),* 807 F.3d 1222 (10th Cir. 2015); *First Nat'l Bank of Durango v.*

Wood (In re Wood), 465 B.R. 196 (B.A.P. 10th Cir. 2012); *Wells Fargo Fin. Leasing Inc. v. Grigsby* (N.D. Ala. 2014); *In re McSwine Creek Farms, Inc.,* 276 B.R. 461 (Bankr. N.D. Miss. 2001); *Matter of Rice,* 171 B.R. 399 (Bankr. N.D. Ala. 1994) *In re Ames,* 973 F.2d 849, *cert. denied* 507 US 912 (10th Cir. 1992).

As noted, debtors are required to devote all of their "disposable" income to payments under the plan. In *In re Meyer*, 186 B.R. 267 (Bankr. D.Kan. 1995), the court held that expenses associated with the Debtors' maintenance of a second home were "necessary" and "reasonable" and were properly excluded in calculating the debtors' "disposable income". Further, the court found that expenses associated with the maintenance of the debtors' hog farming facility were likewise necessary and reasonable and had to be excluded. However, the court found that wages which the debtors paid to their own unemancipated children for working a minimum number of hours around the farm were not "necessary" or "reasonable" for disposable income purposes. *See also In re Meyer*, 173 B.R. 419 (Bankr. Kan. 1994), for earlier litigation involving some of the same disposable income issues in the same case.

The requirement of good faith was discussed at length in *In re Barger*, 233 B.R. 80 (B.A.P. 8th Cir. 1999). In that case, the debtors filed a Chapter 11 case in 1986 that was dismissed in April of 1990 because the plan of reorganization was not feasible. Debtors filed a Chapter 12 case one month later but it also failed and debtors voluntarily dismissed that case in late 1995. One month later, debtors commenced the case at issue under Chapter 12. In 1994, the debtors apparently

transported their 1994 crop out of Nebraska and sold it in Colorado, and failed to remit the proceeds to Hayes County Non-stock Co-op (the "Co-op"), the creditor holding the security interest on the crops. Debtors proposed several different Chapter 12 plans of reorganization in which they either treated the Co-op as completely unsecured, as minimally secured or they ignored the Co-op's claim altogether. The Co-op objected to confirmation of the current plan on the basis of, among other things, the lack of good faith.

The bankruptcy court entered an order on July 13, 1998, denying confirmation of the current debtors' plan because, among other things, the debtors had not filed their plan in good faith and they failed to treat the Co-op as a secured creditor, in violation of prior directions from the court.

The Eighth Circuit Appellate panel first noted that Chapter 12 requires that a plan be proposed in good faith and that:

> . . . An identical "good faith" requirement is applicable to confirmation of plans in Chapter 11 and Chapter 13 cases. *See* 11 U.S.C. §1129(a)(3); *id.* §1325(a)(3). Thus, cases considering the scope of the good faith requirement under these two chapters apply equally in a Chapter 12 case. *Traders State Bank v. Mann Farms, Inc.*, *(In re Mann Farms, Inc.)*, 917 F.2d 1210, 1214 (9th Cir. 1990).
>
> Whether a plan is proposed in good faith turns on an examination of the totality of the circumstances surrounding the plan and the bankruptcy filing. (Citations omitted.) The court must focus on factors such as whether the debtor has stated debts and expenses accurately; whether the debtor has made any fraudulent misrepresentation to mislead the bankruptcy court; or whether the debtor has unfairly manipulated the Bankruptcy Code. (Citations omitted.) ("In the context of a chapter 11 reorganization ... a plan is considered proposed in good faith 'if there is a reasonable likelihood that the plan will achieve a result consistent with the standards prescribed under the Code.'") (Citation omitted.) (court should consider whether the plan has been proposed with the legitimate and honest objective of preserving the Debtor's business while maximizing the return available to creditors). Pre-filing conduct is not determinative of the good faith issue,

> but it is nonetheless relevant. [Citation omitted.) In essence, the good faith inquiry looks at the debtor's fairness in dealing with creditors.

In affirming the bankruptcy court, the appellate panel noted:

> The bankruptcy court's decision that Debtors did not propose their plan in good faith will be affirmed. Debtors admittedly sold crops subject to a security interest without notifying a fully secured creditor or paying any of the proceeds to that creditor. Having unilaterally acted to convert the creditor's collateral, they then attempted to use the Bankruptcy Code to diminish their obligation to the Co-op. In the plan that is the subject of this appeal, Debtors ignored the Co-op altogether and attempted to force the Co-op to protect its rights outside of bankruptcy. Given the Debtors' bankruptcy history, the many warnings provided by the bankruptcy court, and the Debtors' abysmal record of delay, this is a clear manipulation and abuse of the Code.

Debtors are given the ability to restructure secured claims of creditors over an extended period of time. In *Travelers Insurance Company v. Bullington,* 878 F.2d 354 (11th Cir. 1989), the Court of Appeals held that a plan's restructuring of a secured debt over 30-year mortgage, did not violate the Bankruptcy Code and the plan gave full value of the allowed secured claim of the creditor. Interestingly, the Court also ruled that a computer projection of the farm yields was admissible as opinion testimony to prove feasibility of the plan. The confirmation issues in *In re Elk Creek Salers, Ltd., id.*, also dealt with, in part, the "stretching" of secured creditor claims over a long period of time. The court noted that §1222(b)(9) of the Bankruptcy Code allows the payment of secured claims over a period exceeding the otherwise applicable five-year limitation of §1222(c) if those payments are consistent with §1225(a)(5). The court ruled that in order to satisfy the Code, a secured creditor must be allowed to retain its lien and the debtor must pay the creditor the present value of the collateral. The secured creditors in *Elk Creek* objected to the interest rates proposed by

the debtor. The plan proposed to pay one secured claim over 20 years with an interest rate of 7.4% (secured by real estate valued at more than the amount of the claim) and another claim (secured by cattle and equipment) over 7 years with an interest rate of 6.22%. The debtor based the interest rate on the Treasury bond rate for similar time periods (either 20 years or 7 years, as appropriate), plus a two percent (2%) risk factor. The court declined to award the contract rate of interest to the objecting creditors, and approved the debtor's requested interest rates.

The court also considered the feasibility objection of the secured creditors and noted:

> . . . The feasibility test requires the court to analyze the debtor's proposed plan payments in light of the debtor's projected income and expenses and to determine that the debtor is likely to be able to make all payments required by the plan. . . . The test is whether the things which are to be done after confirmation can be done as a practical matter under the facts. . . . .

At the confirmation hearing, the debtor provided a past history of its annual gross income, its operating expenses and net profit. The court noted that the plan was feasible and found that the projected income would exceed the projected plan payments by almost 15% per year.

However, *In the Matter of Rice, id.*, the Court would not approve a plan which provided for a 15-year term for the payment of the bank's claim secured by the debtors' poultry houses, where the houses were approximately two (2) years old, had an average life expectancy of ten (10) years and the houses would not maintain their value at a rate equal to the rate that the debt was being serviced.

The debtors could not prove feasibility in *In re Weber*, 297 B.R. 567 (Bankr. N.D. Iowa 2003). The court in that case discussed the feasibility issue:

> This feasibility standard requires the Court to determine whether the plan offers a reasonable prospect of success and is workable....
>
> ... Because past behavior and productivity are excellent indicators of future production, courts have frequently rejected plans which are premised on highly optimistic projections of increased production.... Courts generally grant debtors every reasonable benefit of the doubt in matters concerning plan feasibility in furtherance of the rehabilitative policies underlying the Code.... They will not, however, blindly confirm a plan which will not cash flow, and which is, therefore, unfeasible.

Chapter 12 contains no provisions for the establishment of an unsecured creditors committee (or any other committee, for that matter). Chapter 12 trustees often take the position that they represent the interests of the unsecured creditors. The protection afforded unsecured creditors by Chapter 12 was a subject in *In the Matter of Fortney,* 36 F.3d 701 (7th Cir. 1994). In that case, the Chapter 12 trustee argued that the debtor was obligated to restructure secured debts in a manner which would maximize the amount of disposable income that would be paid to unsecured creditors. The court disagreed with the trustee's argument and ruled:

> We cannot agree with the Trustee that the disposable income text implicitly grants unsecured creditors the right to insist upon any particular amortization of secured debts. Congress has given unsecured creditors two specific protections: the best interests test and the disposable income test. The federal courts have no power to add novel protections to this precise list, especially at the expense of creditors with secured interests. The disposable income test guarantees that unsecured creditors will receive any farm income remaining after necessary expenses are paid.... The Fortneys' payments to Vernon County [a secured creditor], upon which the Trustee fixates, do not even implicate the disposable income test, because the income used to make these payments *is not disposable*. The statutory definition of disposable income excludes all 'expenditures necessary for the continuation, preservation, and operation of the debtor's business.' ....

> Because payments to the county scheduled under the Fortneys' plan are "necessary" to prevent foreclosure, the unsecured creditors have no claim to this income.
>
> Finally, we reject the Trustee's suggestion that all secured debts must be extended if the bankruptcy court permits the debtor to extend the repayment of any particular secured obligation.

V. DISCHARGE

A debtor will not receive a discharge until all payments are made under the confirmed Chapter 12 plan. 11 U.S.C. §1228(a).

A plan which proposes to grant a Chapter 12 debtor a discharge upon confirmation is not confirmable and, additionally, a plan provision granting a partial discharge of all debts by rendering a creditor's claim *in rem* upon confirmation could not be confirmed unless the creditor consented to that treatment. *In re Butler*, 97 B.R. 508 (Bankr. E.D. Ark. 1988).

Failure to make the payments of disposable income as required by a confirmed plan may result in case dismissal and will not entitle debtors to a discharge. *In re Wood*, 122 B.R. 107 (Bankr. D. Idaho 1990).

VI. TAX AND PRIORITY CLAIM TREATMENT AND ISSUES

Family farmers had been given a "break" on taxes resulting from the sale of farm assets under 11 U.S.C. §1222(a)(2)(A) with the result that governmental claims arising from asset sales are stripped of their priority status and treated as general, unsecured claims subject to discharge after less than full payment. Initially, taxes that are incurred and are dischargeable were to have been incurred by the estate, to be entitled to priority and subject to the statutory exception. This statute was at issue

in *Hall v. U.S.,* 566 U.S. 506, 132 S. Ct. 1882, 182 L. Ed. 2d 840 (2012). There, the debtors sold their farm after filing a Chapter 12 petition. The debtors' plan relied upon payment of debt by use of the sale proceeds. The IRS objected to the plan, and claimed it was owed income taxes of $29,000.00 on the capital gains that resulted from the assets sale**.** The debtors sought to treat the income tax as a general, unsecured claim that would be paid under the plan to the extent that there were funds to pay unsecured creditors, but discharged if the funds were not sufficient to pay unsecured creditors in full. The IRS objected to the plan and argued that the capital gains taxes were the debtors' individual responsibility and not collectible or dischargeable in bankruptcy. The issue made its way to the United States Supreme Court and, in a five to four decision, the Court, writing through Justice Sotomayor*,* ruled that Chapter 12 bankruptcy estates are not taxable entities, and the capital gains tax could only be incurred by the individual debtors. Since the post-petition tax was not "incurred by the estate", the Supreme Court ruled for the IRS. The Supreme Court declined to adopt the policy argument that the purpose of the statute in question was to provide Chapter 12 family farm debtors with as much tax relief as possible and declined to re-write the statute, stating:

> If Congress wished to alter these background norms, it needed to enact a provision to enable post-petition income taxes to be collected in the Chapter 12 plan in the first place.

However, subsequent to the *Hall* decision, Congress, led by Senator Grassley of Iowa, enacted 11 U.S.C. § 1232 which provides, in part, as follows:

> (a) Any unsecured claim of a governmental unit against the debtor or the estate that arises before the filing of the petition, or that arises after the filing of the petition and before the debtor's discharge under section 1228, as a result f the sale, transfer, exchange, or

> other disposition of any property used in the debtor's farming operating -
>
> (1) shall be treated as an unsecured claim arising before the date on which the petition was filed;
>
> (2) shall not be entitled to priority under section 507;
>
> (3) shall be provided for under a plan; and
>
> (4) shall be discharged in accordance with section 1228.
>
> (b) For purposes of applying sections 1225(a)(4), 1228(b)(2), and 1229(b)(1) to a claim described in subsection (a) of this section, the amount that would be paid on such claim if the estate of the debtor were liquidated in a case under chapter 7 of this title shall be the amount that would be paid by the estate in a chapter 7 case if the claim were an unsecured claim arising before the date on which the petition was filed and were not entitled to priority under section 507.

This "cures" the problem the Supreme Court had in the *Hall* case. This statute is commonly known as the "priority stripping" provision. *In re Pedersen,* 593 B.R. 785 (Bankr. N.D. Iowa 2018)

VII. EFFECT OF CONFIRMATION ORDER

A final order confirming a plan of reorganization bars litigation of a matter that could and should have been asserted earlier in the proceeding. *In re Texas Wyoming Drilling, Inc.*, 422 B.R. 612 (Bankr. N.D.Tex. 2010).

In re: GEORGE A. SPEIR, Debtor.

Case No.: 16-11947-JDW

UNITED STATES BANKRUPTCY COURT NORTHERN DISTRICT OF MISSISSIPPI

August 8, 2018

The Order of the Court is set forth below. The case docket reflects the date entered.

Chapter: 12

ORDER GRANTING IN PART, AND DENYING IN PART, OBJECTION TO CONFIRMATION (DKT. # 57)

This matter is before the Court on the *Objection to Confirmation* (Dkt. # 57) (the "Objection") filed by the chapter 12 standing trustee, Harold J. Barkley, Jr. (the "Trustee"), in the bankruptcy case of George A. Speir (the "Debtor"). The issues raised in the Objection have all been resolved (Dkt. # 96), except for the question of whether the Debtor must make all payments through the Trustee, or may instead pay his secured creditors directly. The Trustee does not receive a commission from direct payments, while he receives a ten percent commission on payments he distributes.

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An evidentiary hearing was held on the Objection on June 21, 2018. Justin Jones appeared as the attorney for the Trustee, and Craig Geno appeared on behalf of the Debtor. Both the Debtor and the Trustee testified. At the conclusion of the hearing, the Court took the matter under advisement. The Court has considered the evidence, pleadings and relevant case law, and finds and concludes that under the unique facts and circumstances of this case, the Debtor may make all payments to secured creditors directly, except for payments due to State Bank & Trust Company ("State Bank").

I. JURISDICTION

This Court has jurisdiction pursuant to 28 U.S.C. §§ 151, 157(a) and 1334(b) and the United States District Court for the Northern District of Mississippi's *Order of Reference of Bankruptcy Cases and Proceedings Nunc Pro Tunc*, dated August 6, 1984. This is a core proceeding arising under Title 11 of the United States Code as defined in 28 U.S.C. § 157(b)(2)(A), (L) and (O).

II. FACTS[1]

The Debtor filed his chapter 12 bankruptcy petition on June 8, 2016. (Dkt. # 1) and plan of reorganization on October 17, 2016. (Dkt. # 56). Regions Bank and State Bank objected to confirmation, but both objections were resolved by agreed orders. (Dkt. # 75 and 104).

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The plan provided that the Debtor would make payments on unsecured claims to the Trustee's office for distribution, but the Debtor would pay secured claims directly to those creditors. The Trustee was to receive his ten percent statutory compensation on the unsecured claim payments, but would receive no commission on the direct payments. The Trustee objected to the Debtor's plan, arguing, *inter alia*, that the Debtor must pay to the Trustee "a sum equal to 10% of payments made to unsecured creditors and payments to secured creditors on altered pre-petition debts, and expenses of his attorneys." (Dkt. # 57). At the confirmation hearing, the parties agreed that the plan should be confirmed with this issue reserved, and a confirmation order was entered by this Court. (Dkt. # 109).

A. The Secured Creditors

The secured creditors who were to receive direct payments are: (1) Regions Bank ("Regions"), (2) Tallahatchie County Bank ("TCB"), (3) the Gregory Family Revocable Trust (the "Gregory Trust"), (4) Herbert Schultz ("Schultz"), and (5) State Bank. (Dkt. # 56). None of the secured creditors objected to direct payments.

The bankruptcy plan had little impact on four of the five secured creditors. Regions and TCB are sophisticated creditors. While their claims are impaired by the plan, the modification is *de minimus*. Schultz is the Debtor's

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brother-in-law. His claim has not been substantially modified, and he did not object to confirmation. The Gregory Trust claim is unimpaired.

State Bank is the exception. State Bank is also a sophisticated creditor. Its claim includes a home loan and an equipment loan. Not only were its claims modified by the bankruptcy, those claims were modified twice. The Debtor conceded that State Bank's prepetition repayment terms were substantially modified in the chapter 12 plan. At the hearing, the Debtor testified that he was unable to make his plan payments to State Bank, and the parties entered into post-confirmation negotiations that further modified State Bank's treatment. (Dkt. # 182).

B. The Debtor

The Debtor's testimony made clear that he is a sophisticated debtor. He was aware of the details of each of his secured creditors' claims, understood how bankruptcy modified those claims, and knew the amount and due date of each payment. He also appeared to understand the bankruptcy process, using the phrase "in the plan," detailing post-petition negotiations that had taken place, and confirming that the plan had been modified.

The Debtor's testimony also made clear that he is acting in good faith. There was no indication that he was abusing the bankruptcy process or using the bankruptcy process for any ulterior purpose. In fact, as discussed above, the majority of the secured claims have not been significantly modified.

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This is not to say that his case has been without issue. There has been a post-confirmation modification of State Bank's claim, although he is now current on payments to State Bank. Additionally, the Debtor was unaware that he should have been separately listing the direct payments on his monthly operating reports, rather than including the payments in a generic category with other business expenses. Once he became aware of the requirement that he separately list the payments, he began doing so.

C. The Trustee

The Trustee also testified about the statutory compensation structure and the practicality of this Trustee's situation. The Trustee's office receives a statutory fee not to exceed ten percent of the payments made under the plan, with respect to payments in an aggregate amount not to exceed $450,000, and three percent of payments made under the plan, above that amount. 28 U.S.C. § 586(e)(1). The Trustee contends that he cannot negotiate the percentage he receives—it is either ten percent or zero. Typically, half of the commission in each case pays his expenses and the other half is his compensation. If expenses exceed five percent, his compensation is decreased to make up the difference. If expenses are less than half of the commission, his compensation cannot exceed five percent, and

the excess must be turned over to the U.S. Trustee System Fund. 28 U.S.C. § 586(e)(2).

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The Trustee depends completely on the statutory commission. There have been times where the Trustee did not receive enough money from the commission and did not pay himself in order to pay his expenses. In September of 2017, the office only had $578 in its operating account. The U.S. Trustee's office does not intervene in these situations to bail out the chapter 12 Trustee's office.

This chapter 12 case is relatively simple and there are few creditors. Despite this, the Trustee testified that he has appeared in Oxford five times to attend court. The Trustee also attended the meeting of creditors and a Rule 2004 examination.

The fiscal year for the Trustee runs from July 1 to June 30. For the 2018 fiscal year, the Trustee has incurred $34,688 in expenses and anticipates similar budgets going forward. He is currently administering 15 cases. Based on the 2018 budget, the Trustee needs to average about $2,300 from each case, each year, just to pay expenses. He needs to average $4,600 from each case to be fully compensated.

Here, there is no dispute that the payments to unsecured creditors will go through the Trustee's office. The parties agree that payments to unsecured creditors will be $6,222 each year, yielding only $622 in annual commission.

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Based on the information available to the Court,[2] it appears that if all payments to secured creditors go through the Trustee, the resulting annual commission would be in excess of $10,800.

The Debtor testified that, like most farmers, his ability to pay the ten percent on all claims is directly related to the outcome of his crop. If he has an above-average year, he can pay the commission. If he has a bad year, he will be unable to pay the commission. If he has a normal year, it would be hard for him to pay. There is no indication that the next few years will be anything but average crop years.

III. CONCLUSIONS OF LAW

A. Direct Payments Do Not Create Trustee Commission

Under 28 U.S.C. § 586(e)(2), a standing trustee collects a commission on "all payments received by such individual under plans in the cases under chapter 12 or 13 of title 11 for which such individual serves as standing trustee." 28 U.S.C. § 586(e)(2). The statute is clear that a standing trustee is only entitled to a percentage fee on "payments received by" him under the plan. 28 U.S.C. § 586(e)(2). Payments may be made in one of two ways: (1) from the debtor to the trustee, who then disburses the funds to creditors, in which case the trustee supervises and disburses the payments in accordance with the plan

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provisions; or (2) by the debtor directly, in which case the debtor pays the creditor directly, and the trustee does not receive payments to disburse. This Court previously found in this case that, according to the plain language of the statute, the trustee is compensated for the former but not the latter. (Dkt. # 112), *rev'd on other grounds*, *Barkley v. Speir*, No. 3:17-CV-00104-NBB (N.D. Miss. Feb. 5, 2018).[3] This is clearly the majority position. *See*, *e.g.*, *Michel v. Beard (In re Beard)*, 45 F.3d 113 (6th Cir. 1995); *Foulston v. BDT Farms, Inc. (In re BDT Farms, Inc.)*, 21 F.3d 1019, 1021 (10th Cir. 1994); *Wagner v. Armstrong (In re Wagner)*, 36 F.3d 723, 727 (8th Cir. 1994); *Overholt v. Farm Credit*

Services (In re Overholt), 125 B.R. 202, 210 (S.D. Ohio 1990); *Matter of Pianowski*, 92 B.R. 225, 231 (Bankr. W.D. Mich. 1988); *In re Crum*, 85 B.R. 878 (Bankr. N.D. Fla.1988); *In re Cannon*, 93 B.R. 746, n. 2 (Bankr. N.D. Fla. 1988); *In re Land*, 82 B.R. 572 (Bankr. D. Colo. 1988); *In re Erickson Partnership*, 77 B.R. 738,751-53 (Bankr. D. S.D. 1987).

B. Factors to Determine Whether Payments May Be Made Directly

There is no statutory rule outlining when payments can be made directly to secured creditors, nor are there any Fifth Circuit cases addressing this issue

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in a chapter 12 case.[4] While direct payments in chapter 12 cases are contemplated by the Bankruptcy Code[5] (*see* 11 U.S.C. §§ 1226; 1225(a)(5)(B)(ii)) and are allowed as a general rule, the trustee is still the primary party responsible for administration of the estate. 11 U.S.C. §§ 1202(b); 1226(a). Whether to allow a debtor to make payments directly to secured creditors is within the discretion of the bankruptcy court. *Erickson*, 83 B.R. at 728; *In re Hagensick*, 73 B.R. 710, 713 (Bankr. N.D. Iowa. 1987).

Courts have taken three approaches to proposed direct payments. The first approach is a blanket rule prohibiting debtors from paying impaired secured creditors directly under any circumstances. *See Fulkrod v. Savage (In re Fulkrod)*, 973 F.2d 801 (9th Cir. 1992); *In re Marriot*, 161 B.R. 816 (Bankr. S.D. Ill. 1994). The second approach is a blanket rule allowing debtors to pay secured creditors directly, regardless of their impaired status. *See In re*

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Wagner, 36 F.3d 723, 726 (8th Cir. 1994); *In re Crum*, 85 B.R. 878 (Bankr. D. 1988).

This Court adopts the third approach, used by the majority of courts that have addressed the issue, which employs a number of factors to determine whether to allow direct payments on a case-by-case basis. *See In re Beard*, 134 B.R. 239 (Bankr. S.D. Ohio 1991), *aff'd* 454 F.3d 113, 116 (6th Cir. 1995); *In re Pianowski*, 92 B.R. 225 (Bankr. W.D. Mich. 1988). Under this approach, the majority of courts have used the *Pianowski* factors. *Pianowski*, 92 B.R. at 233-34; *Westpfahl v. Clark (In re Westpfahl)*, 168 B.R. 337 (Bankr. C.D. Ill. 1994); *In re Martens*, 98 B.R. 530 (Bankr. D. Colo. 1989); *In re Seamons*, 131 B.R. 459 (Bankr. D. Idaho 1991); *In re Golden*, 131 B.R. 201 (Bankr. N.D. Fla. 1991).[6]

A determination of whether payments will be made direct or through the trustee should be made on a case-by-case basis and, "within a given case, on an instance-by-instance basis." *Pianowski*, 92 B.R. at 233. This Court has determined that, while not bound by the *Pianowski* factors, those factors are

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instructive and summarize the considerations of courts that allow direct payments. In general, those factors are:

1. the past history of the debtor;

2. the business acumen of the debtor;

3. the debtor's post-filing compliance with statutory and court-imposed duties;

4. the good faith of the debtor;

5. the ability of the debtor to achieve meaningful reorganization absent direct payments;

6. the plan treatment of each creditor to which a direct payment is proposed to be made;

7. the consent, or lack thereof, by the affected creditor to the proposed plan treatment;

8. the legal sophistication, incentive and ability of the affected creditor to monitor compliance;

9. the ability of the trustee and the court to monitor future direct payments;

10. the potential burden on the Chapter 12 trustee;

11. the possible effect upon the trustee's salary or funding of the U.S. Trustee system;

12. the potential for abuse of the bankruptcy system;

13. the existence of other unique or special circumstances.

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92 B.R. at 243-44. Each factor may be considered, although different weight is afforded to each factor in a given case, or even to different claims in the same case.

1. Debtor's Past History

The past history of the debtor considers a debtor's motivation for filing bankruptcy. *Pianowski*, 92 B.R. at 233. This Debtor has demonstrated a sincere desire to reorganize and adjust his debtor-creditor relationships as permitted by law. He has not filed bankruptcy previously. This factor weighs in favor of direct payments.

2. Debtor's Business Acumen

This factor focuses on a debtor's management abilities. *Id.* The inquiry is whether a debtor is capable of maintaining accurate and reliable records of the farming operation and the future payments that would be made directly to creditors. *Martens*, 98 B.R. at 534.

This Debtor has demonstrated sufficient business acumen. He was aware of the details of each transaction he engaged in and knew his payment due dates. He understood the state of his affairs pre-bankruptcy and how they were affected by the bankruptcy case. He used bankruptcy terms of art in his testimony and understood the post-confirmation negotiations that have taken place. This factor also weighs in favor of direct payments.

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3. Debtor's Post-Filing Compliance

A debtor's post-filing compliance with statutory and court-imposed duties looks to a debtor's compliance with court orders and whether the debtor has accurately and timely filed any required reports. *Pianowski*, 92 B.R. at 233. This factor examines the Debtor's pre-petition and post-petition performance and whether there is a need for trustee oversight. *Martens*, 98 B.R. at 535.

This Debtor has been forced to further modify some of his payment terms because of his financial inability to comply with the confirmation order, but only with regard to State Bank. He has not always complied with the Court's orders, but has worked with creditors to resolve all issues and is currently in compliance. The Debtor has filed all monthly operating reports. This factor weighs against the Debtor, but only in regard to the State Bank payments.

4. Debtor's Good Faith

The good faith of a debtor looks for an ulterior motive for direct payments. *Pianowski*, 92 B.R. at 233. This Debtor has proposed paying direct in good faith. There is no indication of the Debtor playing any games. He has been involved in his case and running his business and understands how the two intersect. The Debtor is making his best effort to complete his case. This factor weighs in favor of direct payments.

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5. Debtor's Ability to Reorganize Absent Direct Payments

This factor examines whether the plan is feasible if payments are made through the trustee. *Id.* Basically, the question is whether this Debtor is able to make payments to all creditors plus a ten percent fee. The answer here is unclear. The Debtor testified that in an above-average year, he would be able to pay the full trustee commission, but in a bad year, he could not. In a normal year, it would be tough. Absent any known factors indicating that the future crop years will be better or worse than normal, the Court must assume that the Debtor will have a normal year every year.[7] The Debtor did not indicate that *any* amount of additional trustee's commission would cause his plan to fail, but he did testify that it would be difficult for him to pay an additional ten percent if *all* of his payments to secured creditors went through the Trustee. This factor requires some balancing of interests.

6. Creditor's Plan Treatment

The plan treatment of each direct payee examines the extent of modification of each creditor's claim under the plan. *Pianowski*, 92 B.R. at 233. Pre-petition defaults and whether the debtor is current are also considered. *Id.* This requires the Court to make a determination for each claim. *Id.*

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This factor is of particular importance in this case. The majority of the creditors here are substantially unaffected by the bankruptcy case. The pre-petition terms are essentially reflected in the confirmed plan, with the exception of State Bank. Little negotiation took place regarding the treatment of the claims, again with exception of State Bank.

State Bank's claim has been substantially modified in a way that would not be possible but for the bankruptcy system. That claim was not only modified in the plan, but was again modified post-confirmation. The Debtor's use of the bankruptcy process to substantially modify State Bank's claim weighs in favor of the Trustee in regard to the State Bank claim, but not the other secured creditors.

7. Creditor's Consent

The consent of the affected creditors must also be considered on a claim-by-claim basis. *Pianowski*, 92 B.R. at 233; *Westpfahl*, 168 B.R. at 365. None of the creditors have objected to direct payments. State Bank and Regions filed objections to confirmation, but both were resolved by agreed orders. Thus, the Debtor's plan was consensual. This factor weighs in favor of the Debtor.

8. Creditors' Sophistication and Ability to Monitor

This factor considers the motivation of the creditors to monitor compliance and the burden on them to do so. *Pianowski*, 92 B.R. at 234. This case is not complex. Basically, the creditors just need to monitor whether

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payments are received according to the terms of the confirmed plan.[8] The majority of affected creditors in this case are banks with the means and motivation to monitor direct payments. The debts are large enough to

warrant their efforts and, because of their resources, it will not be a burden to monitor the case.

The only non-bank secured creditors are the Gregory Trust and Schultz. The Gregory Trust's claim is unmodified, so there will be no additional post-bankruptcy burden. The Schultz claim is paid to an individual, but is a simple annual payment that does not require close monitoring. Thus, this factor weighs in favor of direct payments.

9. Ability of the Trustee and Court to Monitor

The ability of a trustee and the court to monitor direct payments considers whether the debtor has demonstrated that he will provide reports which evidence that the payments have been timely made. *Id*. The Debtor has been filing his monthly operating reports, but was unaware that the direct payments were to be separately listed. He now understands this and began doing so before the hearing. It will take less than five minutes for the Trustee to monitor compliance by examining the monthly operating reports. This factor weighs in favor of the Debtor.

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10. Burden on the Chapter 12 Trustee

In determining the potential burden on a trustee, the court must evaluate whether direct supervision by the trustee will be required to ensure a direct payment will be made. *Pianowski*, 92 B.R. at 233. There are few creditors here and there will be no inordinate burden on the Trustee to monitor these direct payments, which can easily be done by checking the monthly operating reports. This factor weighs in favor of the Debtor.

11. Effect on Chapter 12 Trustee Salary and U.S. Trustee System

The possible effect upon a trustee's salary or funding of the U.S. Trustee system is a significant consideration in this case. This factor is focused on determining if direct payments will result in a trustee receiving less than adequate compensation for his efforts, duties, and responsibilities as it relates to the case. *Id*. This factor also considers if direct payments would undermine the funding of the U.S. Trustee office. *Id*.

To be fully compensated, the Trustee needs to receive an average of $4,600 from each case each year, based on current circumstances. If none of the payments to secured creditors go through the Trustee's office in this case, the Trustee will receive only $622 annually for a case that has required five hearings thus far. On the other hand, if all of the payments to secured creditors go through the Trustee's office, the Trustee would receive in excess of $10,800

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annually for a case that has been, apart from this issue, average. This factor requires some balancing. The Trustee should be compensated for his work in this case, but he should not receive a windfall that will result in a plan that is not feasible for the Debtor.

12. Potential for Abuse

The potential for abuse of the bankruptcy system factor is focused on the possibility of preferential treatment between or among the creditors receiving direct payments and those that will not. *Pianowski*, 92 B.R. at 233. Schultz is the Debtor's brother-in-law, but payment is made once a year. It would be relatively easy to monitor any preferential treatment by reviewing the monthly operating reports filed by the Debtor. There is no indication that the Debtor is trying to abuse the bankruptcy system through direct payments. The Debtor has demonstrated that he is acting in good faith. This factor weighs in favor of the Debtor.

13. Special Circumstances

The unique or special circumstances that exist in this case relate to the inordinate spread between the amount of compensation the Trustee's office would receive if all of the secured creditors are paid through their office or if none are. The Trustee must be compensated for his work, but the Debtor needs a feasible plan.

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These factors are to be applied and considered in regard to each secured creditor within a case. The factors in this case point to all of the payments being paid directly, except for those to State Bank. Because the Debtor has used the bankruptcy process to substantially modify the claim of State Bank, the Debtor will be required to pay this claim through the Trustee's office. The Debtor has entered into an arrangement with State Bank that would have been unavailable but for the bankruptcy process. The remaining creditors have remained mostly unaffected by the Debtor's bankruptcy.

Payment of the State Bank claim through the Trustee results in additional compensation to the Trustee of about $6,800, for a total of about $7,400 annually. This fairly compensates the Trustee but results in a feasible plan. Thus, the totality of the circumstances and consideration of the factors indicate that the Debtor should make all payments directly to secured creditors, except those to State Bank.

C. CONCLUSION

Again, the Court can use its discretion in deciding if a debtor can make payments direct and in determining how to apply these factors based on the facts of the case before it. *Foster*, 670 F.2d at 486 (same conclusion in a chapter 13 case); *Erickson*, 83 B.R. at 728; *Hagensick*, 73 B.R. at 713. Because of the unique facts and circumstances of this case, the factors weigh in favor of the Debtor paying all secured creditors directly except State Bank.

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ORDERED, **ADJUDGED** and **DECREED** that the Objection (Dkt. # 57) is **SUSTAINED IN PART** and **OVERRULED IN PART.** The confirmation order is amended to provide that the Debtor will pay the State Bank claim through the Trustee's office, with the Trustee receiving his statutory fee. The Debtor is further reminded that all monthly operating reports must include a line item listing each payment to each secured creditor.

SO ORDERED,

/s/
Judge Jason D. Woodard
United States Bankruptcy Judge

##END OF ORDER##

Footnotes:

1. To the extent any findings of fact are conclusions of law, they are adopted as such, and vice versa.

2. The amount of the claims as reflected in the plan, agreed orders, and testimony is not as precise as one might think.

3. In a prior opinion in this case, this Court mistakenly found that the parties had agreed that payments could be made directly in this case. That finding was reversed and is the subject of this opinion. The prior opinion examined more fully the question of whether the Trustee is entitled to a commission when payments do not flow through his office. The Court's holding that no compensation is owed on direct payments was left undisturbed on appeal.

[4.] The Fifth Circuit has addressed this issue in a chapter 13 case and held:

> If the bankruptcy court concludes that the debtor's acting as disbursing agent with respect to the current mortgage payments will not impair the debtor's ability to make all payments under, and to comply with, the plan, then the court is obligated to confirm the plan, assuming in all other respects with § 1325(a).

Matter of Foster, 670 F.2d 478, 486-88 (5th Cir. 1982). Additionally, the Fifth Circuit stated that the degree of responsibility of the debtor and his reasons for filing a chapter 13 may be significant. *Id*. at 487. The Fifth Circuit also noted that whether the debtor can make payments directly is within the bankruptcy court's discretion. *Id*. at 486.

[5.] The Bankruptcy Code is defined as Title 11 of the United States Code.

[6.] Some courts have used the *Erickson* test, which was subsumed, for the most part, within *Pianowski*. *In re Erickson Partnership*, 77 B.R. 738, 747-48 (Bankr. S.D. Ill. 1988), *aff'd* 83 B.R. 725 (D. S.D. 1988); *In re Cannon*, 93 B.R. 746 (Bankr. N.D. Fla. 1988). A few courts have considered different elements or a mixture of tests when making a determination. *In re McCann*, 202 B.R. 824 (Bankr. N.D. N.Y. 1996) (did not use any specific factors, just a case by case determination); *In re Kline*, 94 B.R. 557 (Bankr. D. Colo. 1988) (only allows impaired secured creditors to be paid direct if the debt will be fully satisfied by the plan); *In re Teigen*, 142 B.R. 397 (Bankr. D. Mont. 1992) (used eleven of the thirteen *Pianowski* factors and held that generally payments should go through the trustee, but courts should consider the impact of the commission on the debtor's ability to reorganize and the adequacy of the trustee's compensation).

[7.] Of course, the Debtor's farming income is dependent on factors other than just the crop itself. Large crop yields nationwide could drive down prices. Labor costs fluctuate. Tariffs may have an impact.

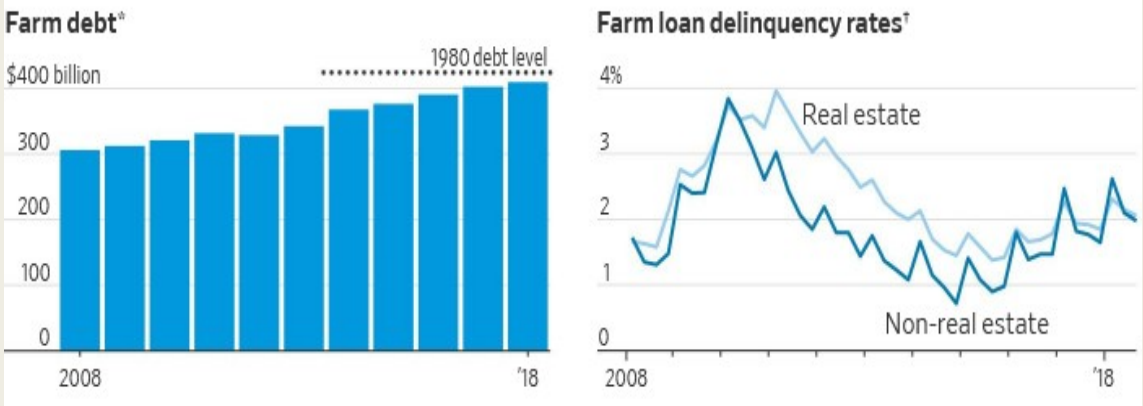
[8.] When a case is complex and has unsophisticated creditors, the trustee's close monitoring is helpful to ensure payments are made and the debtor does not discriminate among his creditors. That is not the case here.

OVERVIEW

- Since 2014, commodity prices have continued to decline resulting in significant deterioration in farm income
- Sharpest drop is in first half of 2019, particularly for export crops like soybeans, corn and wheat. Causes include:
  - trade tariffs
  - increased foreign production oversupply
  - rising interest rates natural disasters
- Result: substantial increase in agricultural workouts and bankruptcies

Farmers in Distress

U.S. farm debt is approaching record highs set around the 1980s farm crisis, and delinquency rates have climbed.



*Data are in inflation-adjusted terms and 2018 figure is estimate †At commercial banks through 3Q 2018

Sources: U.S. Department of Agriculture (debt); Agricultural Finance Databook (delinquency)

TESTIMONIES

Adverse effect from tariffs?

N.C. Commissioner of Agriculture Steve Troxler -

"I think there's plenty of evidence the tariffs have depressed commodity prices even further than they were . . . . We in the department spent a lot of lot of time in China developing relationships, and getting China tobacco [interests] over here to buy this tobacco. . . . We know that China is our No. 1 export customer in North Carolina.

Source: Dan Way, *Q&A: N.C. agriculturecommissioneraddressestariffs, state of farming,* Carolina Business Journal (Sep. 7, 2018).

CASH RECEIPTS HAVE BEEN TRENDING DOWN

Cash receipts* from NC farms (in thousand dollars):

Commodity	2013	2014	2015	2016
All commodities	12,672,234	12,947,511 (+)	11,647,921 (-)	10,609,202 (-)
Animals and products	8,305,629	8,802,012 (+)	7,944,019 (-)	7,213,512 (-)
Crops	4,366,605	4,145,500 (-)	3,703,902 (-)	3,395,690 (-)

*"Cash receipts": the gross income from sales of crops, livestock, and livestock products during a calendar year.

Source: NC Ag. Statistics 2017

CROP PRICES HAVE BEEN TRENDING DOWN

Selected NC crop prices (in dollars):

Year	Flue-cured tobacco (lb.)	Cotton (lb.)	Soybeans (bu.)	Sweet Potatoes (cwt.)	Corn (bu.)
2012	1.98	0.73	14.00	13.00	7.48
2013	2.11	0.82	13.10	24.90	4.96
2014	2.01	0.67	10.20	22.00	4.19
2015	1.85	0.62	8.68	19.40	4.32
2016	1.94	0.63	9.85	18.10	4.05

Source: NC Ag. Statistics 2017

Pamlico County farm property after Hurricane Florence.

Pamlico County farm property after Hurricane Florence.

HURRICANE MICHAEL: A MULTIBILLION-DOLLAR PAIN FOR GEORGIA AGRICULTURE

Breaking Down Hurricane Michael's Peach State Pummeling

- Timber: Approximately 1 million acres were destroyed, resulting in $1 billion in losses.
- Cotton: Estimated losses from Hurricane Michael range from $300 million to $800 million. The final loss estimate will be dependent on the ability to harvest what remains in the field.
- Pecans: Trees were either blown over or broken, resulting in an estimated $560 million-dollar loss. The damages will have a generational impact since it takes about seven years for a tree to begin producing marketable pecans.
- Specialty Crops: A wide variety of produce, including sweet corn, cucumbers, squash, peppers, tomatoes, and peas, suffered an estimated $480 million loss.
- Poultry: Estimated a $25 million hit, 97 chicken houses and well more than 2 million chickens were lost.
- Peanuts: Estimates for peanut losses range from $10 t $20 million, with the final loss estimate still to be determined.

Author: Paul Rusnak (November 9, 2018)

OTHER FACTORS CAUSING INSTABILITY

Natural disasters:

- Hurricane Matthew (2016) - estimated $4.8 billion in damage statewide, focused in agriculture-heavy Eastern North Carolina
- Hurricane Florence (2018) - impact TBD
  - Affected counties (among others):
    - Sampson (#1 in 2016 NC farm cash receipts)
    - Duplin (#2)
    - Robeson (#5)

Source: Ford Porter, *One Year Later: North Carolina Continues Recovering from Hurricane Matthew*, N.C. Governor's Office (Oct. 3, 2017).
Photo credits: Rodrigo Gutierrez, Reuters (top); Dave Martin, AP (bottom)

OTHER FACTORS CAUSING INSTABILITY(CONT.)

Pricing and Oversupply (especially in the dairy industry)

- Current oversupply of milk is causing milk prices to decline.
- Milk prices are averaging $18 per 100 pounds of milk and Class III milk, which goes into making cheese, is around $16 per 100 pounds of milk.
- Feed costs are increasing.
- The key ratio of income-to feed costs reveals that dairy farmers have very little margin left these days.
- Global market forces are also to blame.
- Many dairy farms are shutting down or consolidating.

Source: Bloomberg, Deena Shankerand Lydia Mulvany, "America is drowning in milk nobody wants" (October 17, 2018).

WATERMELONS IN FLORIDA

EFFECT OF CLIMATE CHANGE (TESTIMONIES)

- Warmer weather and an increasingly earlier growing season have, in many ways, been good for farmers like Sarah Frey. She used to start harvesting her South Florida watermelons in mid-April. This year, crews were picking in March. She'll be picking earlier in South Georgia, and expects to pull watermelons from fields in Missouri by the Fourth of July, which she said was rare when she was growing up in the 1990s.
- But earlier and longer growing seasons have consequences. For Ms. Frey, harvesting watermelons earlier than usual puts her into competition with the late-winter crop from Mexico. And new, more restrictive immigration policies could mean she won't have enough workers from Mexico to work the fields when she needs them — especially because many American produce growers are starting or expanding operations in Mexico. "Having it earlier is good for customers and good for business, but if it's overlapping with the import business and I can't get enough workers to harvest, that's a problem," she said.

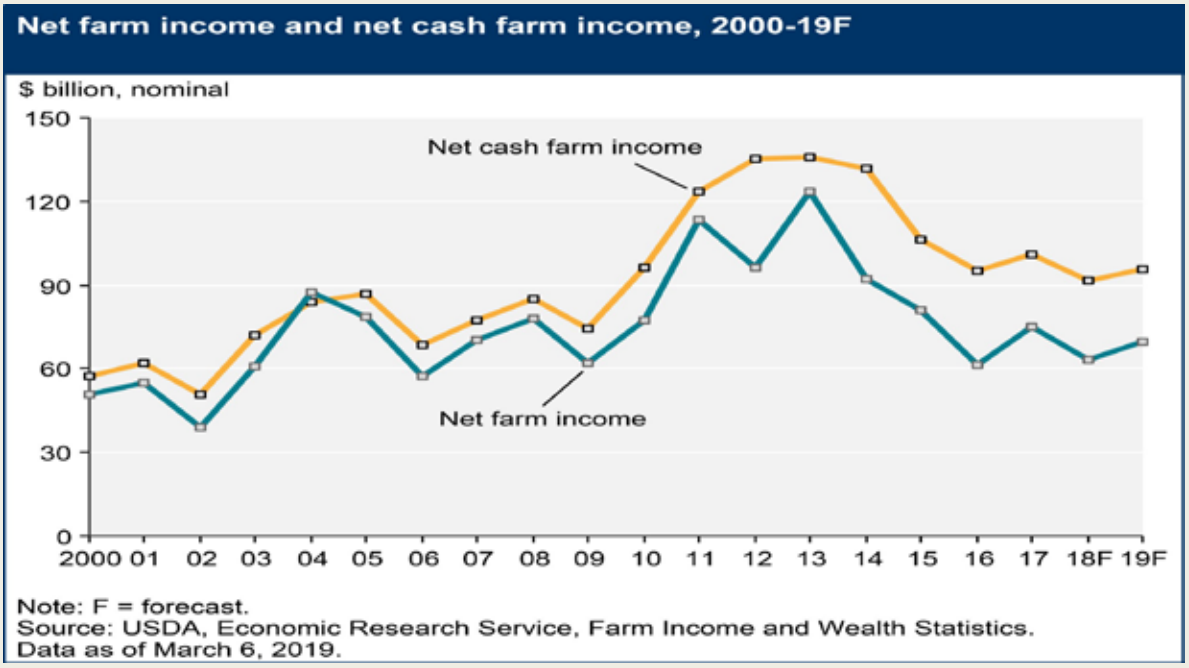
Source: https://www.nytimes.com/2019/04/30/dining/farming-climate-change.html?rref=collection%2Ftimestopic%2FAgriculture%20and%20Farming

PEACHES IN GEORGIA AND SOUTH CAROLINA

EFFECT OF CLIMATE CHANGE (TESTIMONIES)

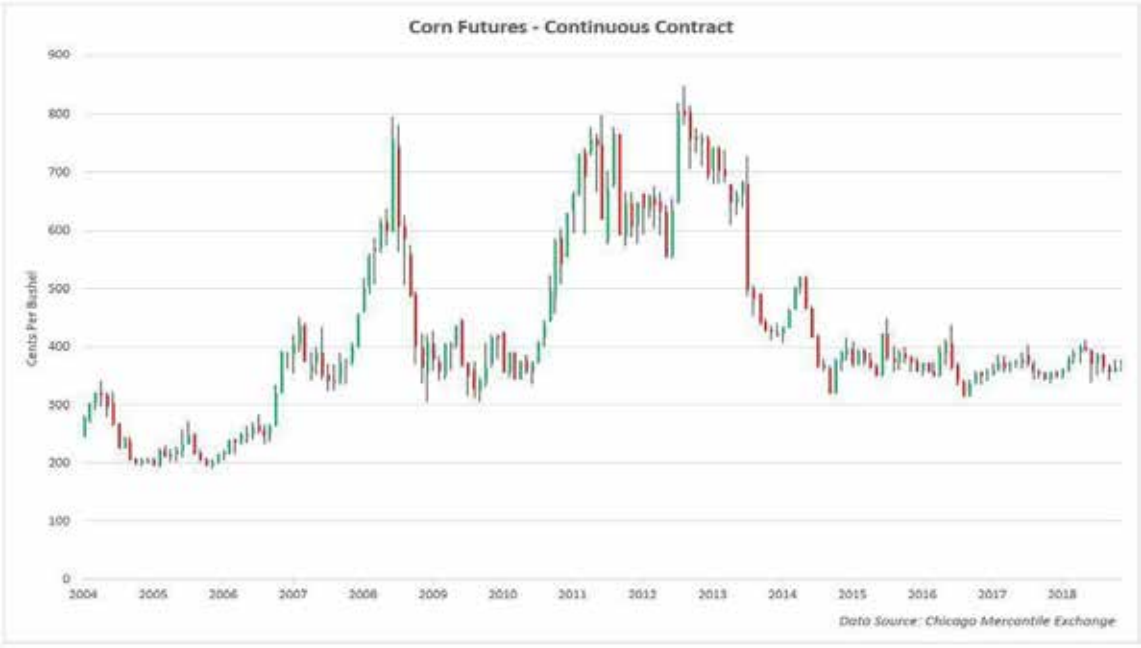
- The symbol of Georgia and the mainstay of a Southern kitchen, peaches could be devastated by climate change. They need a certain amount of consistent cold weather — what growers call chill hours — followed by dependably warm weather. Without enough chill hours, peach buds are weak, and weak buds make poor fruit.
- In addition, trees are blooming too early and then being hit by unusual frosts, which result in less sellable fruit. In 2017, a warm winter destroyed almost 85 percent of the state's $30 million peach crop. It's part of a pattern noted last year in the federally mandated National Climate Assessment, which predicted that it would continue. In response, researchers at places like Clemson University are trying to find new peach strains that can handle the shift, but new cultivars are still years away.

Source: https://www.nytimes.com/2019/04/30/dining/farming-climate-change.html?rref=collection%2Ftimestopic%2FAgriculture%20and%20Farming



CURRENT U.S. DOLLAR PER BUSHEL OF CORN OVER THE PAST TEN YEARS

Source: https://www.macrotrends.net/2532/corn-prices-historical-chart-data



U.S WHEAT PRICES PER BUSHEL OVER THE PAST TEN YEARS

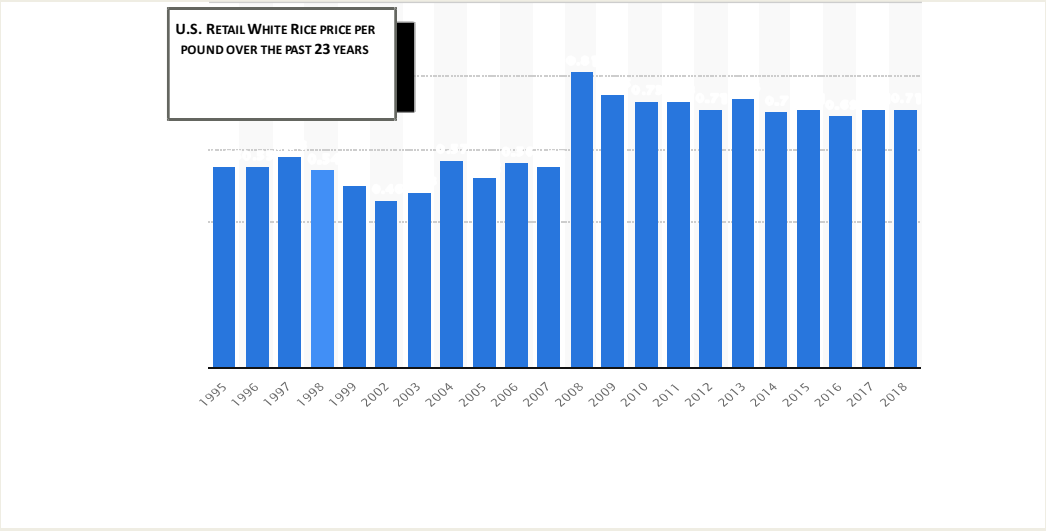
Source: https://www.macrotrends.net/2534/wheat-prices-historical-chart-data

U.S. SOYBEAN PRICES PER BUSHEL OVER THE PAST TEN YEARS

Source: https://www.macrotrends.net/2531/soybean-prices-historical-chart-data

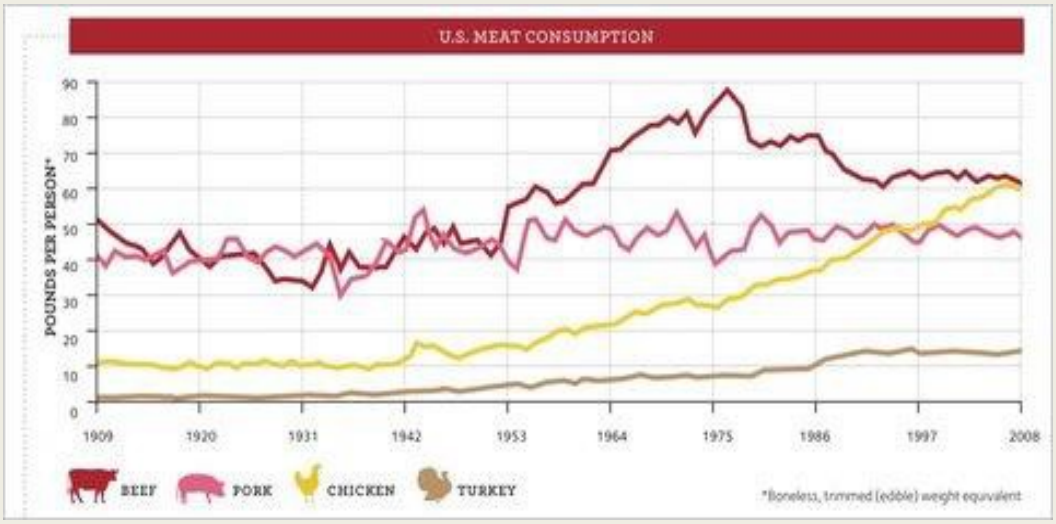
U.S. COTTON PER POUND OVER THE PAST TEN YEARS

Source: https://www.macrotrends.net/2533/cotton-prices-historical-chart-data



Source: https://www.statista.com/statistics/236628/retail-price-of-white-rice-in-the-united-states/

DESPITE RELATIVELY CONSTANT U.S. MEAT CONSUMPTION FROM THE EARLY 1900S THE PRICE THE FARMERS ARE BEING PAID FOR THE MEAT PRODUCTION CONTINUES TO DROP.



New Census of Ag Data Show Just How Much Farm Life is Changing

- There are 2.04 million farms and ranches (down 3.2% from 2012) with an average size of 441 acres (up 1.6%) on 900 million acres (down 1.6 %).
- The 273,000 smallest (1 to 9 acres) farms make up 0.1% of all farmland while the 85,127 largest (2,000 or more acres) farms make up 58% of farmland.
- Just 105,453 farms produced 75% of all sales in 2017, down from 119,908 in 2012.
- Of the 2.04 million farms and ranches, the 76,865 making $1 million or more in 2017 represent just more than 2/3 of the $389 billion in total value of production while the 1.56 million operations making under $50,000 represent just 2.9%.
- Farm expenses are $326 billion. The top farm expenses include feed, livestock purchased, hired labor, fertilizer, and cash rents.
- Average farm income is $43,053. A total of 43.6% of farms had positive net cash farm income in 2017.
- 96% of farms and ranches are family owned.
- Farms with Internet access rose from 69.6% in 2012 to 75.4% in 2017.
- A total of 133,176 farms and ranches use renewable energy producing systems, more than double the 57,299 in 2012.
- In 2017, 130,056 farms sold directly to consumers, with sales of $2.8 billion.

Source: https://www.growingproduce.com/fruits/new-census-of-ag-data-show-just-how-much-farm-life-is-changing/

Increased Farmer Bankruptcy Filings in the Southeastern United States

- The increase in Chapter 12 filings reflects low prices for corn, soybeans, milk and even beef. The situation for most farmers has worsened since June 2018 under retaliatory tariffs that have closed or reduced the Chinese market for soybeans, corn, wheat, milk, and pork, among other things.
- Since 2014, commodity prices have continued to decline resulting in significant deterioration in farm income. Sharpest drop was in the first half of 2019 due to trade tariffs, increased foreign production, oversupply, rising interest rates, and natural disasters.
- Climate changes has also led to additional difficulties in Farmer productivity. Natural disasters, droughts, and increasing temperatures have led to decreased profits and in turn increased farmer bankruptcies.
- All of the above results in substantial increases in agricultural workouts and bankruptcies.

CHAPTER 12

- Comparisons with Chapter 11
  - NoAbsolute Priority Rule
  - §1232 – Priority Claim Discharge
  - No Quarterly Fees
  - No Voting Requirements
  - No Disclosure Statement
  - Less Admin Expense
  - Plan terms in line with harvest timing
  - Conversion to 7 only for fraud
  - Living Allowanceflexibility
  - Ability to modify claims by personal residence

CHAPTER 12

- 1229(c) – modification
  - *In re Hart, 90 BR 150 (1988) EDNC*
  - *Secured claims may be spread out past 5 year limit*
- Disposableincome/ liquidation analysis
  - *CH 12 subject to DI issues*
  - *Key is careful projection of future years operations*
- DEBT LIMITS – $4.2 million as of April 2018 – readjustment to $10 million if statute passes

  11 USC §101(18)(B)(ii)

116TH CONGRESS

1ST SESSION **S. 897**

To amend title 11, United States Code, with respect to the definition of "family farmer".

IN THE SENATE OF THE UNITED STATES

Mr. GRASSLEY (for himself, Ms. KLOBUCHAR, Mr. JOHNSON, Mr. LEAHY, Mr.
TILLIS, Ms. SMITH, Ms. ERNST, and Mr. JONES) introduced the following bill; which was read twice and referred to the Committee

A BILL

To amend title 11, United States Code, with respect to the definition of "family farmer".

1 Be it enacted by the Senate and House of Representa-

2 tives of the United States of America in Congress assembled,

3 SECTION 1. SHORT TITLE.

4 This Act may be cited as the "Family Farmer Relief

5 Act of 2019".

6 SEC. 2. DEFINITION OF FAMILY FARMER.

7 Section 101(18) of title 11, United States Code, is

8 amended by striking "$3,237,000" each place that term

9 appears and inserting "$10,000,000".

ISSUES RAISED IN BANKRUPTCY

- How do I continue to operate the farm?
- What liens does secured creditor have?
- How does debtor provide adequate protection to secured lender?
- What post-petition financing options are available?
- Are there any PACA or other statutory liens which may impact operations or lender?
- What is the value of lender's collateral?
- Can a feasible plan be proposed?
- How do I get around absolute priority rule?

DEBTOR'S PERSPECTIVE – *PRACTICE POINTERS*

- Use of cash collateral
- Seasonal income and Projections
- Unexpected weather conditions
- Unsecured Creditors' Committees and grower claims
- Alternative sources of funding

CREDITOR'S PERSPECTIVE – *PRACTICE POINTERS*

- Preserve the collateral
- Look at loan documents and recorded documents to determine validity and priority of liens
- Review any modifications or forbearance agreements for releases or value determination
- Review schedules to determine other possible liens and debtor's value of collateral
- Obtain appraisal or other evidence of collateral value
- File proof of claim as soon as possible
- File Motion for Relief from Stay or in the alternative for Adequate Protection- Section 362
- If grounds exist, file Motion to Dismiss – Section 105 and applicable chapter sections
- Object to any surcharge of collateral under 506(c) other than to maintain and preserve collateral

CREDITOR'S PERSPECTIVE

Consider filing Section 503(b)(9) Claim

- Administrative claim for the value of goods sold in the ordinary course of business and received by the debtor within 20 days prior to its bankruptcy filing.
- Need to file motion for allowance and approval of administrative claim.

CREDITOR'S PERSPECTIVE

Consider filing - Section 546(c)(1) Claim

- Right to reclaim goods sold in the ordinary course of business and received by the debtor within 45 days prior to its bankruptcy filing.
- Claim subject to prior security interests.
- Written notice sent no later than 45 days after debtor received goods or not later than 20 days after the bankruptcy case was filed if the 45 day notice has expired.
- If notice not timely provided then creditor still has right to seek administrative claim under Section 503(b)(9).

CREDITOR'S PERSPECTIVE

File Motion to Prohibit Use of Cash Collateral under Section 363 if debtor has not previously sought use of cash collateral

- Replacement lien on post-petition collateral may not be sufficient to provide adequate protection.
  - Dairy Herd –lender with prepetition security interest in dairy herd and proceeds, products, offspring, or profits thereof entitled to post-petition security in all milk production and all monies derived therefrom. *Smith v. Dairymen, Inc.*,790 F. 2d 1107 (4th Cir. 1986)
  - Crops – old crops? New crops? (see 552 – first lien on post petition crops)

CREDITOR'S PERSPECTIVE

Creditor providing post-petition financing should obtain:

- First priority priming post-petition lien on assets (may be specific assets depending on financing)
- Administrative priority claim under Sections 503(b) or 507(a)
- Waivers of right to surcharge the collateral under 506(c) for any costs or expenses during the bankruptcy

PACA TRUST CLAIMS

- 7 U.S.C. § 499a et seq. – Perishable Agricultural Commodities Act
  - 7 U.S.C. § 499e – Liability to persons injured
- 7 C.F.R Part 46 (7 C.F.R. §§ 46.1-46.49)
  - 7 C.F.R. 46.46 – Statutory Trust

PACA TRUST CLAIMS

7 C.F.R. § 46.46(c)(1): "When a seller, supplier or agent who has met the eligibility requirements of paragraph (e)(1) and (e)(2) of this section, transfers ownership, possession, or control of goods to a commission merchant, dealer, or broker, it automatically becomes eligible to participate in the trust. Participants who preserve their rights to benefits in accordance with paragraph (f) of this section remain beneficiaries until they are paid in full."

PACA TRUST CLAIMS

1. Is the seller, supplier or agent eligible to participate in the trust (i.e., are the eligibility requirements of 7 C.F.R. § 46.46(e)(1) & (2) satisfied)?

2. If eligible, has the seller, supplier or agent preserved their trust rights in accordance with 7 C.F.R. § 46.46(f)?

PACA TRUST CLAIMS

A seller is eligible to participate in the PACA trust if the parties use:

- PACA default payment terms (e.g. "10 days after the day on which the produce is accepted")

OR

- A pre-transaction written agreement establishing different payment terms not to exceed 30 days after receipt and acceptance of the commodities as long as the agreed-upon time for payment is disclosed on "invoices, accountings, and other documents relating to the transaction"

PACA TRUST CLAIMS

- A seller is not eligible to participate in the PACA trust if:
  - The parties enter into a pre-transaction written agreement creating payment terms that exceed 30 days after the buyer's receipt and acceptance of the commodities (see In re Davis Distributors, Inc., 861 F.2d 416 (4th Cir. 1988)
  - The parties enter into a pre-transaction written agreement that uses payment terms different from the PACA default terms, and the seller fails to disclose the agreed-upon time for payment on its "invoices, accountings, and other documents relation to the transaction"
- Parties may enter into post-default payment plans without forfeiting a seller's eligibility to participate in the PACA trust (but the seller must still comply with the PACA preservation requirements)

PACA TRUST CLAIMS

What if the parties have a pre-transaction oral agreement that creates payment terms that exceed 30 days from the date of receipt and acceptance of the commodities?

PACA TRUST CLAIMS

- The majority of courts hold that an oral agreement creating payment terms in excess of 30 days does not render the seller ineligible to participate in the PACA trust
- Instead, the oral agreement modifying the payment terms is invalid and the PACA default payment terms apply
- A minority of courts have held that such an oral agreement will render the seller ineligible to participate in the PACA trust
- Even if the oral agreement may not render the seller ineligible for PACA protection, reliance on the payment terms purportedly established by the oral agreement may impact whether the seller has properly and timely preserved its PACA trust rights

PACA TRUST CLAIMS

Preserving a seller's PACA trust rights (§ 46.46(f)):

- Contents of the notice
- Timeliness of the notice

PACA TRUST CLAIMS

Contents of the notice

- Non-licensees:
  - In writing
  - Include statement that "it is a notice of intent to preserve trust benefits"
  - Include information for each shipment (see § 46.46(f)(1)(i)-(iv)), and if different payment terms are used such terms must be disclosed
- Licensees:
  - May use their "ordinary and usual billing invoice or statement"
  - Must disclose payment terms if terms differ from PACA default terms
  - Must contain statement set forth in § 46.46(f)(3)(i)

PACA TRUST CLAIMS

"The perishable agricultural commodities listed on this invoice are sold subject to the statutory trust authorized by section 5(c) of the Perishable Agricultural Commodities Act, 1930 7 U.S.C. 499(e)(c)). The seller of these commodities retains a trust claim over these commodities, all inventories of food or other products derived from these commodities, and any receivables or proceeds from the sale of these commodities until full payment is received."

PACA TRUST CLAIMS

Timeliness of the notice

- Written notice of intent to preserve PACA trust benefits must be given to the debtor within 30 calendar days:
  - After expiration of the time prescribed by PACA
  - After expiration of the time prescribed by the parties' agreement if in writing and made before the transaction (and no longer than 30 days)
  - After the seller received notice that a payment instrument promptly presented has been dishonored
- If PACA default 10-day payment term applies, then notice must be submitted within 40 days of receipt and acceptance
- If payment term is 30 days pursuant to pre-transaction written agreement, notice must be submitted within 60 days of receipt and acceptance

PACA TRUST CLAIMS

Notable EDNC cases involving PACA trust rights:

- Wayne Bailey, Inc. v. Southern Roots Farming Company, LLC (In re Wayne Bailey, Inc.), 598 B.R. 389 (Bankr. E.D.N.C. Feb. 14, 2019)
- Wayne Bailey, Inc. v. Kornegay Family Produce, LLC (In re Wayne Bailey, Inc.), 597 B.R. 300 (Bankr. E.D.N.C. Feb. 1, 2019)
- Wayne Bailey, Inc. v. Tull Hill Farms, Inc. (In re Wayne Bailey, Inc.), Case No. 18-00284-5-SWH (Bankr. E.D.N.C. Jan. 23, 2019)
- Wayne Bailey, Inc. v. Millstream Farming, Inc. (In re Wayne Bailey, Inc.), Case No. 18-00284-5-SWH, 2019 Bankr. LEXIS 60 (Bankr. E.D.N.C. Jan. 8, 2019)
- Wayne Bailey, Inc. v. Scott Farms, Inc., (In re Wayne Bailey, Inc.), 592 B.R. 79 (Bankr. E.D.N.C. Sept. 28, 2018)
- In re Southern Produce Distributors, Inc., Case No. 18-02010-5-SWH, 2019 Bankr. LEXIS 374 (Bankr. E.D.N.C. Feb. 8, 2019)
- Derek & Matthew Bissett Farms v. Bissett Produce, Inc. (In re Bissett Produce, Inc.), 512 B.R. 528 (Bankr. E.D.N.C. 2014)

PACA TRUST CLAIMS

"An individual who is in the position to control trust assets and who does not preserve them for the beneficiaries has breached a fiduciary duty, and is personally liable for that tortious act." Top Banana, L.L.C. v. Dom's Wholesale & Retail Ctr., Inc., 2005 U.S. Dist. LEXIS 12848, 2005 WL 1529736 (S.D.N.Y. June 27, 2005)

PACA LICENSES

- PACA licenses automatically terminate upon plan confirmation
- Debtor must apply for a new license
- Debtor may be required to post a surety bond
- Amount of bond may depend on volume and type of business and what is sufficient to provide assurance that the business will be conducted without violations and will cover any reparation awards

The Perishable Agricultural Commodities Act ("PACA"): PACA Trust Eligibility and Preservation

By

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I. PACA's Floating Trust

PACA "was enacted in 1930 to regulate the sale of perishable [agricultural] commodities and promote fair dealing in the sale of fruits and vegetables." Reaves Brokerage Co., Inc. v. Sunbelt Fruit & Vegetable Co., 336 F.3d 410, 413 (5th Cir. 2003). PACA defines "perishable agricultural commodities" to mean "fresh fruits and fresh vegetables of every kind and character." 7 U.S.C. § 499a(b)(4). In 1984, Congress amended PACA to create a statutory trust in favor of sellers "on certain assets of a defaulting buyer." In re Davis Distributors, Inc., 861 F.2d 416, 417 (4th Cir. 1988); Reaves Brokerage Co., Inc., 336 F.3d at 410; 7 U.S.C. § 499e(c)(3); 7 C.F.R. 46.46(g). The purpose for this trust was explained by Congress as follows:

> It is hereby found that a burden on commerce in perishable agricultural commodities is caused by financing arrangements under which commission merchants, dealers, or brokers, who have not made payment for perishable agricultural commodities purchased, contracted to be purchased, or otherwise handled by them on behalf of another person, encumber or give lenders a security interest in, such commodities, or on inventories of food or other products derived from such commodities, and any receivables or proceeds from the sale of such commodities or products, and that such arrangements are contrary to the public interest. This subsection is intended to remedy such burden on commerce in perishable agricultural commodities and to protect the public interest.

7 U.S.C. § 499e(c)(1).

Pursuant to the 1984 amendment, PACA creates "immediately upon delivery, a nonsegregated 'floating' trust in favor of sellers on the perishable commodities sold and the products and proceeds derived from the commodities." Reaves Brokerage Co., Inc. v. Sunbelt Fruit & Vegetable Co., 336 F.3d 410, 410 (5th Cir. 2003); 7 U.S.C. § 499e(c). The trust provides qualified sellers with "a superpriority right that trumps the rights of a buyer's other secured and unsecured creditors." In re Superior Tomato-Avocado, Ltd., 481 B.R. 866, 869 (Bankr. W.D. Tex. 2012); see also Nickey Gregory Co., LLC v. AgriCap, LLC, 597 F.3d 591, 595 (4th Cir. 2010); In re Yarnell's Ice Cream Co., Inc., 469 B.R. 823, 827 (Bankr. E.D. Ark. 2012).

The trust arises immediately in the perishable agricultural commodity once the commodity is "received" by the buyer.[1] 7 U.S.C. § 499e(c)(2); 7 C.F.R. § 46.46(b). PACA's regulations define "received" as "the time when the buyer, receiver, or agent gains ownership, control, or possession of the perishable agricultural commodities." 7 C.F.R. § 46.46(a)(1). The trust exists in the perishable commodities delivered to the buyer as well as (i) all inventories of food or other products derived from the commodities and (ii) any receivables or proceeds from the sale of such commodities. 7 U.S.C. § 499e(2); 7 C.F.R. § 46.46(b). The trust continues "until full payment of the sums owing in connection with such transactions has been received" by the seller. Id.

PACA's trust protection is designed to protect sellers of produce which sell "produce on a 'cash' or 'short term credit' basis." In re Davis Distributors, Inc., 861 F.2d 416, 417 (4th Cir. 1988); Am. Banana Co., Inc. v. Republic Nat'l Bank of N.Y., 362 F.3d 33, 42 (2d. Cir. 2004). PACA and its regulations establish "eligibility" and "preservation" requirements designed to ensure that a seller seeking trust protection is in fact selling produce on a cash or short-term credit basis. See 7 C.F.R. § 46.46(e)-(f); Davis Distributors, 861 F.2d at 417 (explaining that PACA and

[1] The PACA trust arises in produce received by a "commission merchant, dealer or broker," all of which are defined in 7 U.S.C. § 499a(b)(5)-(7).

its regulations contain "a number of procedural and substantive prerequisites to securing the protection of the PACA trust," all of which are "designed to insure that a produce supplier seeking the protection of the statutory trust is indeed a 'short-term' creditor"). PACA's "eligibility" requirements are set out the regulations at 7 C.F.R. 46.46(e). PACA's "preservation" requirements are found in PACA's statutory provisions at 7 U.S.C. § 499e(c)(3) and more specifically in the regulations at 7 C.F.R. 46.46(f).

II. PACA Trust Eligibility

Consistent with PACA's intent to protect "short-term credit" sellers, PACA's regulations establish default payment terms that require "[p]ayment for produce purchased by a buyer, within 10 days after the day on which the produce is accepted."[2] 7 C.F.R. 46.2(aa). The term "accepted" or "acceptance" means:

> (1) Any act by the consignee signifying acceptance of the shipment, including diversion or unloading;
>
> (2) Any act by the consignee which is inconsistent with the consignor's ownership, but if such act is wrongful against the consignor it is acceptance only if ratified by him; or
>
> (3) Failure of the consignee to give notice of rejection to the consignor within reasonable time as defined in paragraph (cc) of this section: Provided, that acceptance shall not affect any claim for damages because of failure of the produce to meet the terms of the contract.

7 C.F.R. § 46.2(dd).[3] If the 10-day default payment term applies to the parties' commodity transactions, PACA's trust eligibility requirement set out in 7 C.F.R. § 46.46(e)(1) will be met.

[2] PACA's regulations establish a variety of payment terms depending on the type of transaction involved. See 7 U.S.C. § 46.2(aa)(1)-(10).

[3] For an interesting opinion on what constituted "acceptance" under PACA, see Wayne Bailey, Inc. v. Southern Roots Farming Company, LLC (In re Wayne Bailey, Inc.), 598 B.R. 389 (Bankr. E.D.N.C. Feb. 14, 2019) (concluding that pursuant to a pre-transactional grower agreement, "acceptance" occurred when the buyer harvested the sweet potatoes).

PACA allows, however, parties to agree to different payment terms that change the 10-day default term, but for the agreement to be valid under PACA (and change the default term) the agreement must be a pre-transactional agreement and the parties must reduce the agreement to writing. 7 C.F.R. § 46.46(e)(1). If the parties fail to reduce their agreement to writing, PACA's default payment terms will apply. See, e.g., Epic Fresh Produce, LLC v. Olympic Wholesale Produce, Inc., 2017 U.S. Dist. LEXIS 201904, 2017 WL 6059971 at *10 (N.D. Ill. Dec. 7, 2017).

Although parties may agree to payment terms other than those established by PACA, "[t]he maximum time for payment for a shipment to which a seller, supplier, or agent can agree, prior to the transaction, and still be eligible for benefits under the trust is 30 days after receipt and acceptance[4] of the commodities as defined in § 46.2(dd) and paragraph (a)(1) of this section." 7 C.F.R. § 46.46(e)(2); In re Davis Distributors, Inc., 861 F.2d at 417-18. If a seller violates this prerequisite, and enters into a pre-transaction agreement allowing the buyer more than 30 days after "receipt and acceptance" to pay for produce, the seller will be ineligible for PACA trust protection. See, e.g., In re Davis Distributors, Inc., 861 F.2d at 417-18.

Although PACA's regulations require a pre-transactional agreement to be in writing in order to change PACA's default payment terms, courts are not in universal agreement on whether a seller violates 7 C.F.R. § 46.46(e)(2), and thus loses eligibility for PACA trust benefits, if the seller extends payment terms beyond 30 days in a pre-transactional oral agreement or through a prior course of dealing. See, e.g., Heeren, LLC v. Cherry Growers, Inc., No. 1:15-cv-47, 2015 U.S. Dist. LEXIS 171068, 2015 WL 9450851, at *13-16 (W.D. Mich. Dec. 23, 2015) (discussing split of authority on this issue). Most circuit courts that have addressed the issue (although in a post-default setting) have held that a seller will not violate 7 C.F.R. § 46.46(e)(2) even though it

[4] As previously discussed in this manuscript, the terms "received" and "acceptance" are defined in PACA's regulations at 7 C.F.R. § 46.46(a)(1) and 7 C.F.R. § 46.2(dd), respectively.

may have had an oral agreement extending payment terms beyond 30 days after the buyer's "receipt and acceptance" or the parties' course of dealing shows that the seller was allowing the buyer more than 30 days to pay for the produce. See id. (identifying the four circuits holding that oral agreements or course of dealing to terms in excess of 30 days will not invalidate PACA trust eligibility). Instead, these courts hold that a seller will only violate 7 C.F.R. § 46.46(e)(2) if the pre-transactional agreement extending payment terms beyond 30 days is reflected in a writing, reasoning that PACA does not recognize the validity of oral agreements or course of conduct for purposes of establishing payment terms. See, e.g., Hull Co. v. Hauser's Foods, Inc., 924 F.2d 777, 781-82 (8th Cir. 1991).

In contrast, the Second Circuit Court of Appeals, and several lower courts, have held that a seller will violate 7 C.F.R. § 46.46(e)(2), and thus lose eligibility for PACA trust benefits, if the seller prior to the transaction orally agrees to allow the buyer more than 30 days to pay for the produce or if the parties' prior course of dealing shows that the seller was allowing more than 30 days for payment. See American Banana Co. v. Republic Nat'l Bank of N.Y., N.A., 362 F.3d 33 (2d Cir. 2004); see also Spada Props. v. Unified Grocers, Inc., 121 F. Supp. 3d 1070 (D. Or. 2015); Heeren, LLC, 2015 U.S. Dist. LEXIS 171068, 2015 WL 9450851, at *13-16 (W.D. Mich. Dec. 23, 2015). The rationale for this opinion was explained by the Second Circuit as follows:

> In view of Congress's clearly expressed intention to extend trust protection solely to cash and short-term credit transactions … we cannot interpret this regulation to mean that parties are free to enter into agreements that violate PACA's prompt payment rules as long as they do not reduce their agreements to writing. Rather, we conclude that failure to reduce to writing an agreement that violates PACA, should not result in the preservation of the trust, where the same agreement, if memorialized, would have resulted in forfeiture of such protection.

Id.; see also Spada Props. v. Unified Grocers, Inc., 121 F. Supp. 3d 1070 (D. Or. 2015).

Courts which hold that a written agreement is necessary for a seller to violate 7 C.F.R. § 46.46(e)(2) also explain that the "writing" need not be a formal contract. See Belair Produce Co. v. Mixt Greens, Inc., 2012 U.S. Dist. LEXIS 151084, 2012 WL 5199421, at *17 (D. Md. Oct. 18, 2012). Rather, a seller will be disqualified from PACA trust protection if the seller's agreement to the extended payment term is reflected in "letters, invoices, or anything else reduced to writing[.]" Id. (citing Patterson Frozen Foods, Inc. v. Crown Foods Int'l, Inc., 307 F.3d 666, 671 (7th Cir. 2002)). These courts tend to focus on whether the writings taken together are sufficient to satisfy the applicable state's statute of frauds. See, e.g., Belair Produce Co. v. Mixt Greens, Inc., 2012 U.S. Dist. LEXIS 151084, 2012 WL 5199421, at *17 (D. Md. Oct. 18, 2012); Patterson Frozen Foods v. Crown Foods Int'l., 307 F.3d 666 (7th Cir. 2002).

The Bankruptcy Court for the Eastern District of North Carolina has recently addressed the "writing" requirement in two separate opinions. See Wayne Bailey, Inc. v. Southern Roots Farming Company, LLC (In re Wayne Bailey, Inc.), 598 B.R. 389 (Bankr. E.D.N.C. Feb. 14, 2019); Wayne Bailey, Inc. v. Millstream Farming, Inc. (In re Wayne Bailey, Inc.), Case No. 18-00284-5-SWH, 2019 Bankr. LEXIS 60 (Bankr. E.D.N.C. Jan. 8, 2019). In Southern Roots Farming Company, LLC, the parties had entered into a pre-transactional "grower's agreement" pursuant to which the buyer would harvest the grower's 2017 sweet potato crop. Southern Roots Farming Company, LLC, 598 B.R. at 394-96. The agreement established an outside due date of December 1, 2017, by which the buyer had to pay for the sweet potatoes harvested earlier that year. Id. at 394-95. After concluding that "acceptance" occurred when the buyer harvested the potatoes, the bankruptcy court concluded that the "grower's agreement" allowed the buyer more than 30 days from acceptance to pay the grower. Id. Thus, the grower was not eligible for PACA trust protection. Id. In Millstream Farming, Inc., the same court considered a series of pre-transactional

e-mail exchanges between the sweet potato grower and buyer which, according to the court's interpretation, allowed the buyer 45 days from acceptance to pay for the potatoes. Millstream Farming, Inc., Case No. 18-00284-5-SWH, 2019 Bankr. LEXIS 60 (Bankr. E.D.N.C. Jan. 8, 2019). The court concluded that these e-email exchanges satisfied any "writing" requirement of PACA and thus disqualified the grower from PACA trust protection. Id.

In contrast to pre-transactional agreements, PACA allows sellers to enter into post-default agreements and payment plans with buyers without affecting their PACA trust rights, even if those agreements allow the buyer an extended period of time after default to pay for the produce. 7 C.F.R. § 46.46(e)(3); see Spada Props. v. Unified Grocers, Inc., 121 F. Supp. 3d 1070, 1083-84 (D. Or. 2015); Epic Fresh Produce, LLC v. Olympic Wholesale Produce, Inc., Case No. 17-cv-8381, 2017 U.S. Dist. LEXIS 201904, 2017 WL 6059971 at *10 (N.D. Ill. Dec. 7, 2017). Prior to 2011, many courts held that, like pre-transactional agreements, post-default agreements extending payment terms beyond 30 days would also disqualify a seller from PACA trust protection. See, e.g., Bocci Ams. Assocs. v. Commerce Fresh Mktg., 515 F.3d 383, 388 (5th Cir. 2008); Spada Props. v. Unified Grocers, Inc., 121 F. Supp. 3d 1070, 1083-84 (D. Or. 2015). However, in 2011 PACA's regulations were amended to clarify that after a buyer has defaulted in payment the "seller, supplier, or agent who has met the eligibility requirements of paragraphs (e)(1) and (2) of this section will not forfeit eligibility under the trust by agreeing in any manner to a schedule for payment of past due amount or by accepting partial payment." 7 C.F.R. § 46.46(e)(3).

III. PACA Trust Preservation

Even if a seller satisfies the prerequisites set forth in 7 U.S.C. § 46.46(e)(1)-(2), and is thus eligible for trust protection, PACA also requires sellers to properly preserve their trust rights. See G&G Peppers, LLC v. Ebro Foods, Inc. (In re Ebro Foods, Inc.), 449 B.R. 759, 762-63 (N.D. Ill.

2011); 7 C.F.R. § 46.46(f); 7 U.S.C. § 499e(c)(3)-(4). If a seller fails to comply with PACA's preservation requirements, it will lose PACA trust protection even if initially eligible. See Derek & Matthew Bissett Farms v. Bissett Produce, Inc. (In re Bissett Produce, Inc.), 512 B.R. 528, (E.D.N.C. Bankr. 2014); Kingsburg Apple Packers, Inc. v. Ballantine Produce Co., Case No. 1:09-CV-AWI-JLT, 2010 U.S. Dist. LEXIS 146086, 2010 WL 529486, at *9-10 (E.D. Cal. Feb. 9, 2010); In re Marvin Properties, Inc., 854 F.2d 1183, 1186 (9th Cir. 1988); In re Fresh Approach, Inc., 51 B.R. 412, 423 (Bankr. N.D. Tex. 1985).

To preserve trust rights, a seller must give "written notice of intent to preserve the benefits of the trust" to the buyer "within thirty calendar days (i) after expiration of the time prescribed by which payment must be made, as set forth in regulations issued by the Secretary[.]" 7 U.S.C. § 499e(c)(3); 7 C.F.R. 46.46(f)(2) ("Timely filing of a notice of intent to preserve benefits under the trust will be considered to have been made if written notice is given to the debtor within 30 calendar days … after expiration of the time prescribed by which payment must be made pursuant to regulation."). If the seller fails to provide notice of its intent to preserve PACA trust rights within 30 days from the date payment was due, it will lose PACA trust protection. See DiMare Homestead, Inc. v. Alphas Co. of N.Y., Inc., Case No. 09 Civ. 6644 (PKC), 2012 U.S. Dist. LEXIS 48546, 2012 WL 1155133, at *23 ("Importantly, a seller must provide notice to the buyer of its intent to preserve its PACA trust benefits within the prescribed time period.") (citing 7 U.S.C. § 499e(c)(3)-(5); 7 C.F.R. § 46.46(f)).

One issue that may arise is if the seller submits its PACA preservation notices based on the belief that payment was due 30 days from delivery of the produce. This may result from an informal or oral agreement with the buyer, or through prior course of dealing, establishing 30-day payment terms. The oral agreement would not be valid pursuant to PACA's regulations requiring

pre-transactional agreements to be in writing. Instead, PACA's default payment terms apply, which may result in a 10-day payment term. Under this scenario, the seller could fail to timely submit a PACA preservation notice, believing that it was not required until 60 days from delivery based on the parties' oral agreement to 30-day payment terms when in fact the notice would be due within 40 days of delivery based on PACA's default 10-day payment terms.

Although PACA explicitly requires the notice to be provided within 30 days from the date payment was due, at least one court has concluded that a seller fails to properly preserve PACA trust rights if it sends its notice before the PACA trust is created in the commodity. See Kingsburg Apple Packers, Inc., 2010 U.S. Dist. LEXIS 146086, 2010 WL 529486, at *9-10 (E.D. Cal. Feb. 9, 2010) (concluding that seller failed to properly preserve PACA trust rights by prematurely sending the notice before the PACA trust was created); but see In re Richmond Produce, 112 B.R. 364, 369-70 (Bankr. N.D. Cal. 1990) (concluding that PACA notice was not premature when it was sent prior to default but after PACA trust had been created in the commodity); In re W.L. Bradley Company, Inc., 75 B.R. 505, 511-12 (Bankr. E.D. Pa. 1987) (same).

Not only must the seller timely submit the PACA preservation notice, but the notice must include the information required by PACA and its regulations. See 7 U.S.C. § 499e(c)(3); 7 C.F.R. § 46.46(f). The preservation notice must include: (i) the statement that "it is a notice of intent to preserve trust benefits," (ii) the "names and addresses of the trust beneficiary, seller-supplier, commission merchant, or agent and the debtor, as applicable," (iii) the "date of the transaction, commodity, invoice price, and terms of payment (if appropriate), (iv) the "date of receipt of notice that a payment instrument has been dishonored (if appropriate), and (v) the "amount past due and unpaid." 7 C.F.R. § 46.46(f)(i)-(iv).

Very importantly, one of the foregoing requirements is that the parties' payment terms must be disclosed on the PACA preservation notice if the parties have agreed to terms different from those established by PACA's regulations. 7 U.S.C. § 499e(c)(3); 7 C.F.R. § 46.46(f). If the agreed-upon payment terms are not included on the preservation notice, or if the notice contains terms that contradict the actual agreed-upon terms, then the seller will have failed to properly preserve its PACA trust rights. see C&G Peppers, LLC v. Ebro Foods, Inc. (In re Ebro Foods, Inc.), 449 B.R. 759 (N.D. Ill. 2011) (concluding that creditor lost benefits of the PACA trust because it did not properly give notice of intent to preserve PACA rights when it included a payment term on the invoices that was contradictory to payment term agreed to by parties). One potential exception, at least in some jurisdictions, may be if the parties' agreement to different payment terms is not reflected in a writing; in this scenario, PACA's default terms apply to the transaction, and the fact that the preservation notice fails to contain payment terms or contains conflicting payment terms may not be fatal to a seller's PACA trust preservation because the notice requirements only require the disclosure of payment terms if they are different than PACA's default terms. See, e.g., Stowe Potato Sales v. Terry's Inc., 224 B.R. 329, 333 (W.D. Va. 1998); Epic Fresh Produce, LLC v. Olympic Wholesale Produce, Inc., 2017 U.S. Dist. LEXIS 201904, 2017 WL 6059971 at *10 (N.D. Ill. Dec. 7, 2017) (explaining that without a pre-transaction written agreement, PACA's payment terms apply).

Finally, PACA allows a produce seller who is also a PACA licensee to give notice of its intent to preserve PACA trust rights by "including a written statement on its printed invoices to the buyer." Derek & Matthew Bissett Farms v. Bissett Produce, Inc. (In re Bissett Produce, Inc.), 512 B.R. 528, (E.D.N.C. Bankr. 2014); DiMare Homestead, Inc., 2012 U.S. Dist. LEXIS 48546, 2012 WL 1155133, at *24. This practice is commonly referred to as the "invoice method" for

preserving PACA trust rights. Id. "[P]roper notice using the invoice method 'consists of three independent requirements.'" Id. (quoting A & J Produce Co. v. Chang, 385 F. Supp. 2d 354, 361 (S.D.N.Y. 2005)). The first requirement is that the "invoice or billing statement must be 'ordinary and usual." DiMare Homestead, Inc., 2012 U.S. Dist. LEXIS 48546, 2012 WL 1155133, at *24 (quoting 7 U.S.C. § 499e(c)(4)). "Ordinary and usual billing or invoice statements are defined only as 'communications customarily used between parties to a transaction in perishable agricultural commodities in whatever form, documentary or electronic, for billing or invoices purposes." Id. The second requirement is that the invoice must disclose agreed-upon payment terms "[w]hen the parties expressly agree to a payment time period different from that established by the Secretary [in the regulations]." 7 U.S.C. § 499e(c)(3) and (4). Finally, the invoice must include the following language:

> The perishable agricultural commodities listed on this invoice are sold subject to the statutory trust authorized by section 5(c) of the Perishable Agricultural Commodities Act, 1930 (7 U.S.C. 499e(c)). The seller of these commodities retains a trust claim over these commodities, all inventories of food or other products derived from these commodities, and any receivables or proceeds from the sale of these commodities until full payment is received.

7 U.S.C. § 499e(c)(4).

IV. Conclusion

Many courts hold that "strict compliance" with PACA's eligibility and preservations prerequisites "is required to preserve one's rights in a PACA statutory trust." Paris Foods Corp. v. Foresite Foods, Inc., 278 Fed. Appx. 873, 874 (11th Cir. 2008); Am. Banana Co., Inc., 362 F.3d at 35; DiMare Homestead, Inc. v. Alphas Co. of New York, No. 09 Civ. 6644 (PKC), 2012 U.S. Dist. LEXIS 48546, 2012 WL 1155133, at *23 (S.D.N.Y. Apr. 5, 2012)); In re John DeFrancesco & Sons, Inc., 114 B.R. 335, 338 (D. Mass 1990); but see Hull Co. v. Hauser's Foods, Inc., 924

F.2d 777, 782-83 (8th Cir. 1991) (upholding trust benefits based on "substantial compliance" with regulations). Given the extraordinary protection PACA affords produce suppliers, it is critical for suppliers to carefully follow PACA's eligibility and preservation prerequisites.