

Chapter 12 Bankruptcy – Proposing a Reorganization Plan in Good Faith

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February 2023

Agricultural Law and Taxation Blog, by Roger McEowen: <https://lawprofessors.typepad.com/agriculturallaw/>
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Overview

The USDA's Economic Research Service expects 2023 net farm incomes to decline nearly 16 percent in 2023 compared to 2022. That expectation is anticipated to be the result of lower cash receipts (projected to drop 4.3 percent), smaller government payments (down 34.4 percent) and higher production costs (particularly fertilizer, lime and soil conditioners). Interest expense is anticipated to increase 22 percent from 2022 and labor costs are projected to rise 7 percent. Net cash income is expected to drop 21 percent from last year. With high costs associated with planting the 2023 crop, if markets turn downward, the result could spell financial trouble for farmers even if yields are excellent.

That's just the farm-related economic projections. As I mentioned in a prior blog article, the expanding war against Russia being fought in Ukraine will continue to dominate ag markets throughout 2023. In addition, the general economic outlook is not good and that will have implications in 2023 for farmers and ranchers. On January 26, the U.S Bureau of Economic Analysis issued a report (<https://www.bea.gov/>) showing that the U.S. economy grew by 2.9 percent in the fourth quarter of 2022 and 2.1 percent for all of 2022. But the report also showed that economic growth in the economy is slowing. Business investment grew by a mere 1.4 percent in the fourth quarter of 2022, consisting almost entirely of inventory growth. That will mean that businesses will be forced to sell off inventories at discounts, which will lower business profits and be a drag on economic growth in 2023. Nonresidential investment was down 26.7 percent due to the increase in home prices, increased interest rates and a drop in real income. On that last point, real disposable income dropped \$1 trillion in 2022, the largest drop since 1932 - the low point of the Great Depression. Personal savings also dropped by \$1.6 trillion in 2022. This is a "ticking timebomb" that is not sustainable because it means that consumers are depleting cash reserves and living off of credit cards. Indeed, the Federal Reserve reported that credit card debt increased 18.5 percent during calendar year 2022. This indicates that spending will continue to slow in 2023 and further stymie economic growth - about two-thirds of GDP is based on consumer spending. Relatedly, the Dow was down 8.8 percent for 2022, the worst year since 2008. 2022 also saw a reduction in the pace of international trade. Imports dropped more than exports which increases GDP, giving the illusion that the economy is better off.

With all of these "rough waters" ahead for farmers and ranchers, Chapter 12 bankruptcy might be one avenue that can provide debt relief for farmers and ranchers. A recent case points out that one aspect of Chapter 12 is critical.

The requirement of filing a Chapter 12 reorganization plan in "good faith" – it's the topic of today's post.



Good Faith Filing

A Chapter 12 plan is to be confirmed if, among other things, it is proposed in good faith. 11 U.S.C. § 1225(a)(3). There have been many court decisions since the enactment of Chapter 12 in 1986 that have dealt with the issue of good faith filing. A recent Chapter 12 case from Wisconsin has again illustrated the requirement that a Chapter 12 plan be filed in good faith.

Recent Case

In re Sternitzky, No. 21-11358-12, 2021 Bankr. LEXIS 3500 (Bankr. W.D. Wisc. Dec. 23, 2021); No. 21-11358-12, 2022 Bankr. LEXIS 205 (W.D. Wisc. Jan. 27, 2022); Sternitzky v. State Bank Financial, No. 21-cv-822-wmc, 2022 U.S. Dist. LEXIS 205895 (W.D. Wis. Nov. 14, 2022).

In *Sternitzky*, the debtors operated a dairy and filed Chapter 12 bankruptcy. Other family members were listed as co-debtors along with their farming business on various debts owed to a bank, including a mortgage on the farm real estate and a perfected security agreement where the other family members pledged equipment, fixtures, crops and inventory as collateral. This case is the third bankruptcy case for the debtors' dairy operation. The first case was filed by the farming operation, and the next two filings were in the names of the debtors. The first case was dismissed, and the bank filed a foreclosure and replevin action against the debtors, family members and the farming operation. Before the notice concerning the lawsuit against the real estate was recorded, the family members transferred ownership of the mortgaged land by quitclaim deed to the debtors without the bank's consent. The debtors filed the second case just before a summary judgment hearing was scheduled in state court. The bank then filed motions for relief from the automatic stay to bar the use of cash collateral, and to dismiss the case. The parties settled, agreeing to a payment plan. The debtors then defaulted on the payment plan and notified the bank of their intent to exit the dairy business and convert to a grain farming operation. The bankruptcy court approved the debtors' sale of 160 acres of wooded land and farm personalty that was collateral of a different creditor. The case was then dismissed for the debtors' failure to timely file a plan.

The debtors filed the third bankruptcy case immediately before a state court hearing on a summary judgment motion against them based on the stipulated settlement. The proceeds from the sale of collateral were insufficient to pay the bank debt in full. There were also delinquent real estate taxes. The bank sought relief from the automatic stay, and the court determined that the bank had established the existence of practically all of the factors a court considers for relief from the stay – obligations in default for a long time; motions by the bank in the prior cases for relief from the stay; debtors' default on stipulations in the prior cases; strategic filings; repeated failure to pay taxes on collateral; the debt involved is not consumer debt; the filings and transfers of property were timed to precede events in state court foreclosure action; there were reasons for dismissal of the prior cases; strategic dismissal of prior Chapter 12 and refiled the current case; current case sought to avoid consequences of two prior agreements with the bank.

The court granted relief from the stay and waived the temporary stay of Bankruptcy Rule 4001(a)(3) to allow the bank to take action to pursue entry of judgment in state court. The bank also sought dismissal of the Chapter 12 case and the court found cause to dismiss or convert the case. The court



noted that the debtors had almost four years to put together a feasible reorganization plan but did not do so, and their motive in filing the current case was to delay any foreclosure or replevin. The court ordered that the automatic stay be lifted pursuant to 11 U.S.C. §362(d)(1), waived the temporary stay, concluded that the case was filed in bad faith, dismissed the case for cause under 11 U.S.C. §1208(c) and imposed a 180-day bar against re-filing under 11 U.S.C. §109(g). In a later action, the debtors sought a stay against any actions of creditors pending appeal. The court, based on an analysis of all of the factors, granted a conditional stay and required the debtors to pay 2021 real estate taxes on a bank's real estate collateral, pay all unpaid real estate taxes on that tract along with monthly interest payments to the bank.

The debtors appealed claiming that the bankruptcy court did not consider the totality of the circumstances; that the bankruptcy court incorrectly considered their defaults on prior stipulation agreements; and that the bankruptcy court should have held an evidentiary hearing. The district court reviewed the record for error and concluded that the bankruptcy court correctly looked at the totality of the circumstances and recognized that the plaintiffs had abused the bankruptcy process to avoid paying their debt or suffering repercussions with strategic filings. The district court also held that the bankruptcy court could consider the failed stipulation agreements, because the bankruptcy court still considered all the facts and did not consider any single fact dispositive. The plaintiffs tried to argue that the bankruptcy court did not consider the plaintiffs actions that were in good faith. The district court explained that the bankruptcy court did consider these but did not give them much weight because of all of the evidence of bad faith. The district court held that the bankruptcy court could give more weight to the bad faith evidence and the decision to find lack of good faith "is plausible in light of the record viewed in its entirety." Plausible, but not error.

The debtors argued that 11 U.S.C. §349 prevented the bankruptcy court from considering an earlier stipulation agreement. The district court explained that 11 U.S.C. §349 is meant to make the earlier stipulation agreement unenforceable but does not restrict a court from considering it in a good faith filing. Finally, the debtors argued that the bankruptcy court was required to hold an evidentiary hearing, but the district court noted that nothing in the Federal Rules of Bankruptcy Procedure, nor 11 U.S.C. § 102(1), requires an evidentiary hearing. The bankruptcy court must have an informal hearing in particular circumstances, but here the record was clear enough for the bankruptcy court to make a proper decision. The district court affirmed the bankruptcy court's decision to dismiss the plaintiffs' Chapter 12 case and granted the defendant's motion for relief from the automatic stay.

Conclusion

With 2023 projected to be a difficult year for agricultural producers, Chapter 12 filings may increase. One of the requirements to get a Chapter 12 reorganization plan approved is that be filed in "good faith."

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