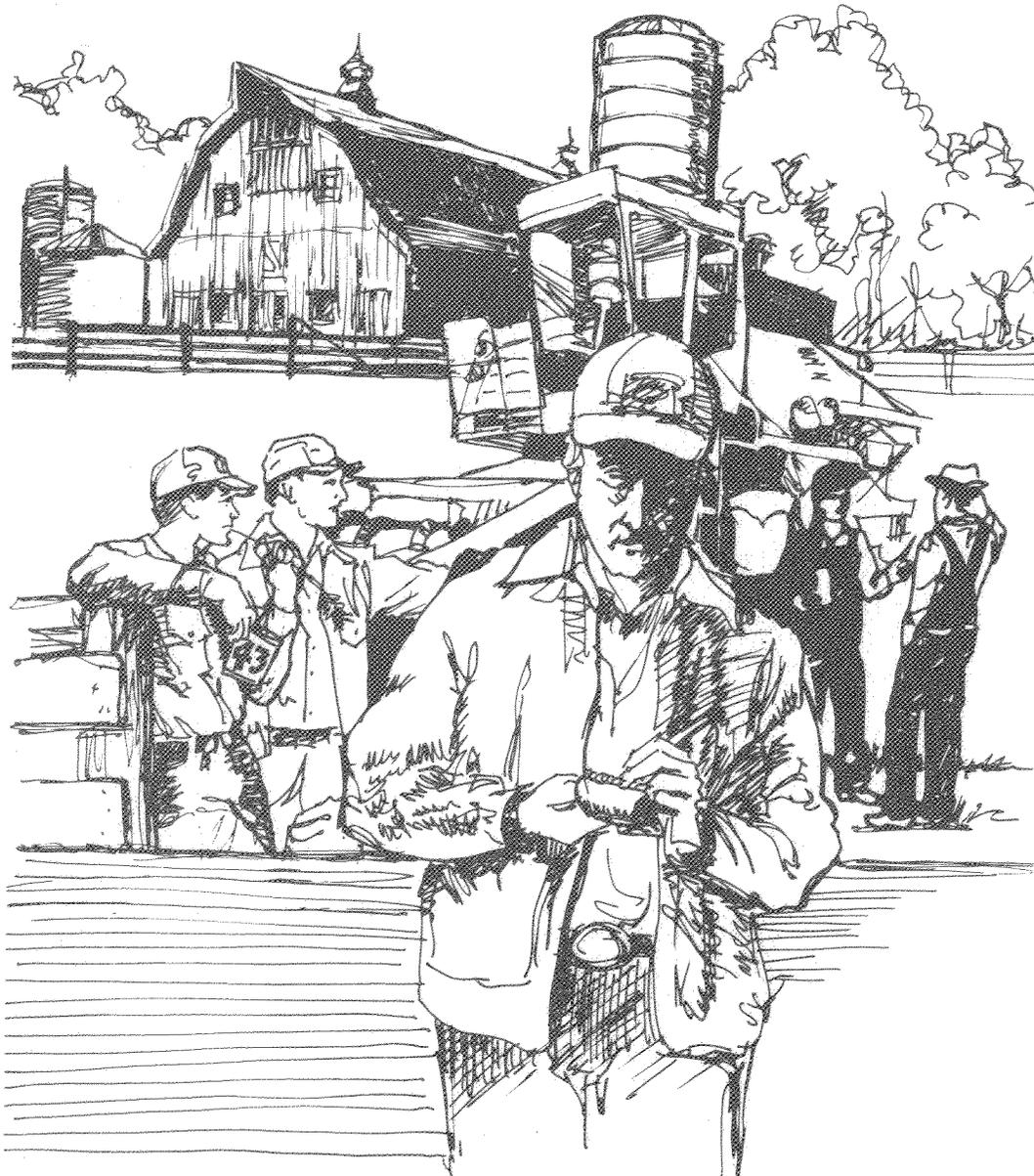


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UNDERSTANDING THE PRODUCER'S LEGAL RIGHTS

In Foreclosure, Repossession and Bankruptcy Law

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UNDERSTANDING THE PRODUCER'S LEGAL RIGHTS

In Foreclosure, Repossession and Bankruptcy

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UNDERSTANDING THE PRODUCER'S RIGHTS IN FORECLOSURE, REPOSSESSION AND BANKRUPTCY

This report answers questions Colorado farmers and ranchers may have regarding their rights under trust deed foreclosure law, repossession law and bankruptcy law. This report is a summary or overview of sections of these areas of law that appear to be of most interest to Colorado producers. The mortgage foreclosure process will not be discussed in this report, as trust deeds have virtually supplanted mortgages in Colorado as the preferred legal device for encumbering real estate.¹

FORECLOSURE

Producers who borrow money and use land as collateral to secure the promissory note generally sign a deed of trust giving the lender a lien on the land. The lien is given to the lender on the condition that it will be void or cancelled once the debt is paid off. When the debt is not repaid, the lender will take action to obtain possession of the land and to extinguish the producer's legal interest in the land. Following the foreclosure process, the lender can sell the land to someone else.

The following legal terms frequently are used in foreclosure cases:

1. Trust Deed - a legal instrument by which the producer transfers land in trust to the Public Trustee (for the county in which the real estate is located) as security for the payment of indebtedness.
2. Public Trustee - a government official (county) responsible for handling trust deeds and their foreclosure. In counties of the first and second class the governor appoints the public trustee for the county. In all other counties the county treasurer serves as the public trustee. As a general rule, the public trustee's office is located in the county courthouse.
3. Verified Response - a legal plea that describes any objections of the debtor to the foreclosure sale. It should be prepared and filed by an attorney. For example, an objection occurs when there is no default under the trust deed.
4. Injunctive Relief - a court order that prohibits a party from doing something. Colorado courts have held that in certain situations an

¹Producers or other affected or interested parties with more detailed questions should consult an attorney. Producers are cautioned against representing themselves in either a court of law or in negotiations with creditors. This publication is not intended to be a substitute for legal or tax counsel.

injunction should be issued barring the lender from having the foreclosure sale.

5. Acceleration Clause - a provision in loan documents that allows the creditor to declare the entire balance due when the loan is in default.

When can the lender start the foreclosure?

The signed promissory note and trust deed detail what conditions must be fulfilled before the lender can start the actual foreclosure. These documents vary among lenders. As a general rule, the lender cannot start foreclosure until (1) you have defaulted on the loan, and (2) the lender has given all notices and grace periods required by the loan documents. The default usually is the failure to make the payments as required in the promissory note. You generally will be given notice in writing of the lender's intent to start the foreclosure process. If there is an acceleration clause in your loan papers, the lender probably will declare the entire balance plus interest and costs, due and payable. If there isn't an acceleration clause in the loan documents, the lender can only seek to collect past due payments, not the entire debt.

What does the lender do to actually start the foreclosure?

The lender provides the public trustee with your original note, the deed of trust to be foreclosed, and a legal document called a Notice of Election and Demand for Sale. This legal document demands that the trustee give notice of, advertise, and conduct a sale of the property. The lender also provides the public trustee with a number of other documents, which the public trustee will need during the course of the foreclosure. The public trustee then will schedule the sale of the land not less than 45 days, nor more than 60 days, from the date of the recording of the Notice of Election and Demand for Sale.

Can a sale occur without a court order?

No--the district court must sign an order authorizing a sale. The lender's attorneys will file a motion asking the court to enter such an order. The clerk will set a hearing date not less than 20, nor more than 30 days, after the motion is filed. The clerk will furnish you with a written notice of the hearing. This hearing is sometimes referred to as a "120 Hearing" because it is required by rule 120 of the rules of civil procedure.

What should I do when I receive notice of the hearing?

At this point, you and your attorney should determine if you have any valid objections to the sale. If, for example, you have given the lender additional collateral based on the lender's oral promise to give you an extension of time, that may be a valid objection. If you do have an objection, you will need to file a Verified Response with the court at least five days prior to the hearing. If you do file such a response, the hearing will be rescheduled for a later date. If you don't file the Verified Response, the judge probably will enter the Order authorizing the sale. The judge at the 120

hearing will decide whether or not your objection should prevent the sale from taking place.

What should I do if I discover an objection to the sale after the judge has signed the order authorizing the sale?

You should consider asking the court for injunctive relief. This means that you file a legal pleading in court asking the judge to stop the sale. Your attorney will prepare the legal pleading and present it to the court. The judge that presided at the 120 hearing will determine if, based on your objection, an injunction should be issued. If such an order is entered, the sale will be cancelled. Some objections to the sale can't be raised at the 120 hearing. These objections can be raised in your request for injunctive relief.

Do I have a right to pay up the loan after the judge has signed the order authorizing the sale?

Yes--however, you must file a notice of your intent to pay off or "cure" the debt. This notice must be filed at least seven days prior to the sale. It is filed at the Public Trustee's office. The pay-off, or "cure", must include all past due payments, various legal costs, including the public trustee's fee, and any late charges allowed for in the trust deed. The Public Trustee will figure the exact amount. You have until noon of the day prior to the sale to make the cure payment.

If I am negotiating the terms of workout plan with my lender just before the sale, can the sale be postponed?

Yes--the lender must request postponement in writing before the sale. The public trustee will then appear at the sale and announce the rescheduled sale date.

If the sale takes place who may bid on the land?

Anyone may bid on the property. If the entire debt is bid, then your note will be cancelled. If anyone other than the lender is the successful bidder, the full amount of the bid must be paid, in cash or certified funds at the sale.

Does the successful bidder receive a deed to my land on the day of sale?

No--the successful bidder receives a "Certificate of Purchase." This document allows the holder the right to receive a deed to the land after the redemption period expires. If redemption money is paid by another party, the holder of the certificate will receive the redemption money.

Do I have redemption rights after the sale?

Yes--if the land is agricultural, the redemption period is six months. This means you have six months to redeem the property. To redeem means you pay back the party that was the high bidder at the sale. The redemption right is available to you, or anyone else who may be liable for a deficiency. Also, a

junior lienor, such as a lender holding a second lien, has redemption rights. If you redeem the land, the sale is annulled and the trust deed is discharged. If there are other liens, they reattach to your land with the same relative priority status as they had before the sale.

How much is the redemption price?

It will include the full amount of the foreclosure bid, interest from the date of sale and possibly certain expenses paid by the high bidder to maintain or improve the property.

If another creditor also has a lien on my property, how does that other creditor redeem?

A creditor with a junior lien, such as a second mortgage holder, can redeem if that creditor filed a notice of intent to redeem during your redemption period. The effect of such a redemption is that a junior lienholder will succeed to the rights of the purchaser at the foreclosure sale. If the owner redeems, a junior lienholder cannot then redeem.

Can I stay on the land during the redemption period?

Yes, under most circumstances you can remain on the farm until the trustee gives a deed to the new owner. If you want to exercise your rights as a qualified farm owner tenant, it is essential that you do not abandon the land. This will be discussed later.

Can I buy back part of my land during the redemption period?

Yes--under legislation enacted in April 1986, you have a right to buy back a part of your farm or ranch. Specifically, you can buy back a parcel of up to 40 acres, but not more than five acres without the lender's consent. The parcel will include your home and may include outbuildings.

The parcel cannot include: a) outbuildings that are necessary for the operation of the remainder of the farm or ranch; b) interfere with access to water rights on the remaining portion of the land; c) interfere with access to the remainder of the land. If you and the lender cannot agree on a fair price for the parcel, or the legal description, the court will decide these matters. You must make an offer to purchase the parcel at least 60 days prior to the end of your redemption period. In other words, you have approximately four months after the sale to exercise your rights. The offer must include a legal description of the parcel you want to keep, the amount you are willing to pay and a statement of the method of payment.

What if the lender and I cannot agree on the terms of a partial redemption?

When the parties can't agree, the matter is decided by the judge that presided over your foreclosure case. The dispute generally will be over the proportionate value of your home, compared to the value of the entire farm or ranch. It is suggested that you hire a qualified appraiser to testify on this matter.

How much should I pay for the parcel I want to keep?

A formula is set forth in The Act to help determine the amount you should pay. The formula is as follows: (partial homestead value ÷ farm value) farm redemption price = partial homestead redemption price.

For example: A 500-acre farm is valued at \$300,000. The cost of redeeming the entire farm is \$250,000. The farmer wants to redeem a 5-acre parcel valued at \$50,000.

5-Acre Parcel Value	\$ 50,000
Divided by Total Farm Value	<u>\$300,000</u>
Partial Redemption Portion Equals	16.6%
Farm Redemption Price	\$250,000
Multiply by 16.6%	
Partial Redemption Price =	\$41,666.65
(cost of 5 acre parcel)	

If you and your lender can agree on a price, you will not need to use the above formula. If you cannot agree, you should hire an appraiser to assist you in determining the value. The same appraiser can provide helpful testimony on your proposal at the hearing.

When does the public trustee issue a deed for my land?

The public trustee issues a deed after the redemption period has expired. The party entitled to the deed must apply within nine months after the redemption period ends. Issuance of the deed creates a presumption that all legal requirements have been fulfilled. The deed gives title to the party that receives it, and the title is free of all liens junior to the trust deed, which was the subject of the sale.

Do I have the right to lease back the land after the public trustee has delivered the deed to the new owner?

Yes, if you meet the requirements of a qualified farm owner-tenant. To be a qualified farm owner-tenant you must: a) have been the titled owner or equitable owner of the foreclosed property; b) have been the producer on the property at the time the lender proceeded to foreclose; c) have resided within a reasonable distance from the property and actively managed the farm or ranch operation on that property; d) have had farming or ranching as your primary occupation; e) agreed to continue the operation in a reasonable manner; and f) show that the debt that was foreclosed upon existed on January 1, 1986, and the redemption period did not expire before April 18, 1986. Debts that existed on January 1, 1986, but were later refinanced, will qualify. Also, the party

that received the deed to your land after the redemption period must be a lending institution, insurance company or government agency.

How and when do I assert the right to lease back the land?

You must remain in possession of the land after the foreclosure. Do not abandon the farm or ranch. When the lender starts an eviction case against you, assert your right to lease back the farm or ranch.

How much rent do I pay and what will the terms of the lease be?

The Act provides that you must agree in writing to lease the property on "fair and reasonable" terms. Fair and reasonable means crop rents in kind or cash equivalent to rents generally paid in your area. Note that if the lender has other farm leases in the area, you will pay the same rate the other tenants pay. Other terms of the written lease are those generally used in your area, but in no event can they be more favorable to the lender than other leases for farms held by your lender.

If a third party offers to rent the farm or ranch, and his offer is acceptable to the lender, you will have to match his offer if you want to continue operating on the property. However, you don't have to pay the rent "up front." You can pay the rent from future proceeds of your crops or livestock. Therefore, you don't have to pay any cash rent at the time you sign the lease. However, you will have to pay interest since your payment will be delayed. You cannot be denied a lease to the property for the reason that the third party's financial condition is more favorable than your financial condition.

You also will be required to provide the court with a statement of the crops you will grow and use of the land. Further, you will be required to prepare a periodic statement of income and expenses on at least a quarterly basis. Both the court and the lender are entitled to copies of these reports. The lender will have to pay whatever costs and expenses other landlords in the area are paying.

What are the lenders rights as the landlord?

The lender, who becomes your landlord if you exercise your right to lease the property, has the same rights as any landlord. In other words, if you breach the lease, the landlord can terminate it. Also, when the lease comes up for renewal, the landlord can contest your ability to properly operate the farm or ranch. If the landlord can prove that you do not have the ability to properly operate the farm or ranch, the lease will be rejected and terminated.

It also should be noted that you must act in good faith at all times. This means that you must be honest with the landlord. The landlord has a similar obligation to be honest with you.

How long can I lease the property?

You can remain on the property as a renter on a year to year basis. On or before February 1 of each year you must submit to the court your proposal to renew the lease. Such renewals may continue until the end of the 1989 crop year. If the property is sold to an independent third party, the sale will be subject to your lease. However, you will not be able to renew the lease during the next year. This, of course, assumes that you do not exercise your right of first refusal to match a third party's offer to buy the land.

Do I have the right to repurchase all of the land after the Public Trustee has delivered the deed to the new owner?

Yes--you have a right of first refusal under the new legislation enacted in April 1986. This means you have a right to buy back the land from the lender on the same terms offered by a third party. In other words, if someone makes a good faith offer to buy the farm or ranch, you will have a right to buy it back on the same terms. The lender must give you written notice of any bona fide offer to buy the property.

What should I do if the lender notifies me that the farm or ranch is being listed for sale?

If you receive notice that the lender is listing the land for sale, the first thing you should do is find a source of financing. If you have a friendly lender you should review the terms under which the property is listed with that lender. You should do this in advance so you will be prepared when a third party makes an offer to purchase the land. As noted above, you will have to match the third party's offer.

If the lender doesn't receive a legitimate offer within 120 days of the listing date, the lender must send you an additional notice if the property is going to remain on the market. You should carefully read over each of these notices, as the asking price and other terms may change. You also should provide your attorney with a copy of each notice, as well as any other documents or papers you receive from the lender.

What are my rights if the land is sold?

The lender can sell the property any time after the redemption period has expired. However, the lender must have provided you with the written notice described above. If you are leasing the land, any sale will be subject to your lease. This means you can stay on the farm until the next renewal.

Foreclosure Law in Colorado, as recently modified by H.B. 1284, provides a variety of rights for financially strapped producers who are involved in foreclosure. Producers can now repurchase their home and 5 to 40 acres after the sale and, under some circumstances, they can repurchase the entire farm either after the deed has been transferred to the new owner. Also, producers now have a right to lease back the farm following the foreclosure process, so long as they are eligible under the law.

REPOSSESSION

When you use your farm or ranch machinery, equipment or livestock as collateral for a loan, you usually sign a security agreement. The security agreement gives the lender a lien on your personal property, much like a trust deed gives the lender a lien on your land. When you default in payment, the lender will take action to obtain possession of the collateral.

The following terms are frequently encountered in repossession cases:

1. Repossession - to take back from one who has not made payments. Technically, repossession doesn't involve a court action.
2. Replevin - a court action brought to obtain possession of personal property. Lenders often bring this type of action to obtain possession of collateral.
3. Security agreement - an agreement giving the creditor a lien on your personal property.
4. Secured party - the lender or creditor who holds a lien on the collateral. This lien secures a loan made by the secured party.
5. Collateral - the personal property listed in the security agreement. In this report collateral will refer to farm or ranch machinery, equipment, livestock, feed or inventory held for livestock.

Can the secured lender repossess my collateral without first obtaining a court order?

Yes, but only if you have abandoned the collateral or have voluntarily surrendered it to the lender and signed a waiver. If you have not surrendered or abandoned the collateral, the lender cannot come onto your property and repossess it without a court order.² The lender will have to schedule a hearing before the judge and ask for a court order. You usually will receive notice at least five days prior to the hearing.

What should I do if I receive notice of the repossession hearing?

First, decide if you want to keep the collateral. If you do, you and your attorney should plan on attending the hearing. At the hearing the court must determine which party is entitled to possession of the collateral pending the final decision of the court. You will have to explain to the court why you think the lender shouldn't be given possession of the collateral. If the court determines that the lender is entitled to a prejudgement order for possession, the court will direct the sheriff to take possession of the property. This is

²This assumes you have not had a court hearing on a plan you submitted to the judge to pay your loan.

not the final say on the matter. In other words, if the court rules that the lender is entitled to a prejudgement order, this does not mean that your rights have ended. This is simply a preliminary hearing. You will be entitled to a full trial on the merits of the case.

If the lender is eventually granted possession of the collateral, will I be given notice of the sale?

Yes--the lender must give you at least 20 days written notice of the sale. The only exception is if you have surrendered the collateral and signed a waiver of your rights.

What should I do if I receive notice that the lender is going to sell my collateral?

When you receive such notice you should decide whether you want to keep the collateral. If you do, you and your attorney need to discuss which legal method is best for you. There are two basic methods. One is to prepare a payment plan. The other is redemption, which will be discussed later. The payment plan is an offer or bid to buy back the collateral with a portion of the proceeds from your crops or livestock for the current year. Your plan must be filed in court, and a copy served on the lender, not less than 10 days before the sale. You do not need to make any type of payment at this time. If the lender wants to contest the feasibility of your plan, the matter will be set for hearing before a judge. If the court finds your plan is feasible, an order will be entered declaring the amount you are able to pay. If the court finds your plan is not feasible, the lender may go ahead and dispose of the collateral without further proceedings and without further notice or court order. If another party makes a higher bid at the sale, the lender is free to sell the collateral to the other party. If this happens, your right to retain the collateral will be terminated.

If your offer is the high bid, and you are the purchaser of the collateral, you must make the payment as set forth in your plan. If you don't, the lender may dispose of the collateral without further court proceedings and without further notice. The advantage of submitting such a plan is that you do not need to pay cash. You will be repurchasing the collateral with a part of your proceeds from the sale of your crops or livestock. The disadvantage of using this method is that if the lender or another party overbids, the amount set forth in your payment plan, your rights to retain the collateral will terminate.

Do I have a right to redeem the collateral before this sale?

Yes, redemption of the collateral is the second method by which you can retain possession of the collateral. The word redemption is confusing to some people. Redemption simply means that you are getting back on track with your loan payments, or that you are paying off the loan. Redeeming the collateral differs from the offer to repurchase, described above, in that when you redeem there is no sale, thus you need not be concerned about another party making a higher bid. There are three ways to redeem. The first is by tendering a lump sum payment to the lender. This amount must include the entire balance that is

secured by the collateral with interest, as well as the reasonable expenses the lender paid in holding the collateral, and in preparing it for sale. In some cases you also will have to pay the lender's legal costs. This probably is the least attractive method of redeeming since you must pay off the entire balance of the loan prior to the sale.

The second method of redeeming collateral is by tendering to the court an amount necessary to "cure" past due payments. In other words, you do not have to pay the entire amount secured by the collateral. You only have to pay the past due payments, with interest from the date of default, plus certain costs. By paying the past due payments, with interest and costs, you will have cured the default in the eyes of the law. Thus, the lender can neither proceed with the sale, nor demand that you pay the entire balance due. In essence, you are getting back on track with the loan payment schedule set forth in your promissory note.

The third method of redeeming the collateral is to prepare an agreement with a payment plan whereby you agree to cure the past due payments with future proceeds from the sale of your crops or livestock. The payment plan is submitted to the court. If the court finds it to be reasonably fair, you will be allowed to redeem the collateral according to your plan. The plan must be accompanied by your affidavit, which shall state the facts upon which your plan and agreement are founded. These documents must be filed with the court and a copy served upon the lender no later than ten days prior to the sale. If the court finds your plan feasible, you will be entitled to possession and use of the collateral. Under this method you do not have to come up with any money at the time the plan is submitted to the court. You simply will cure the past due payments, plus interest, with your future income from your crops and livestock. Your attorney will assist you in preparing the payment plan and submitting it in court.

The law now provides Colorado producers with a variety of rights during a replevin case. For example, the law now provides the producer with a right to 'cure' a past due loan (secured by machinery, livestock, etc.) by agreeing to pay up or cure the loan with a portion of the proceeds from the sale of his crops or livestock. Alternatively, the producer can make a 'bid' prior to the sale whereby he will repurchase the collateral if his written bid is the high bid at the sale. As with the agreement to cure, the producer can pay the bid price with future proceeds from his crops or livestock.

BANKRUPTCY

On October 27, 1986, President Reagan signed into law a new chapter of the bankruptcy code, which is specifically designed to help family farmers and ranchers reorganize their debts. The new chapter of bankruptcy law, known as Chapter 12, is entitled "Adjustment of Debts of a Family Farmer With Regular Annual Income." This new law, which became effective on Thanksgiving Day, 1986, may give financially strapped farmers and ranchers an opportunity to continue operating their farms or ranches.

The purpose of this article is to answer questions that producers may have regarding bankruptcy, with the emphasis on the new Chapter 12. Producers or other interested parties having more specific questions should consult a qualified attorney.³ As a matter of convenience, the term 'producers' will be used to refer to both farmers and ranchers.

As a general rule, the producer should view bankruptcy as a last resort. He should first make an effort to voluntarily restructure his debts under a workout plan that is fair and reasonable to all parties concerned. If such a plan can be agreed upon, it should be put in writing and signed by the producer and his creditors. The advantages of a workout agreement are that it offers more flexibility than bankruptcy, it can be structured to produce the same outcome as Chapter 12 and it is less damaging to producer-lender relations.

Unfortunately, such an agreement cannot always be reached. If it becomes clear to a producer that he and his major creditors are "miles apart" and that the chances of a voluntary workout are slim, the producer should consider looking at his options under bankruptcy law. Other signals that bankruptcy may be the only viable answer to financial problems include: (a) the total amount of debt is nearly equal to or more than the total value of assets; (b) a foreclosure sale or repossession sale is going to take place within the foreseeable future, (c) many sources of credit have dried up, such as the bank, the fuel store, and the feedstore; and (d) the total amount of debt is growing every month.

Types of Bankruptcy

Although this article focuses on the new Chapter 12, a brief description of Chapters 7, 11 and 13 also will be given. It should be noted that it is not the purpose of any of the various types of bankruptcy to punish the debtor. Rather, it is the purpose of bankruptcy to either reorganize the debts, or liquidate the debtor's assets and provide the debtor with a fresh start.

Chapter 7 is a liquidation bankruptcy. Under Chapter 7 a trustee is appointed to liquidate all non-exempt assets and to transfer the proceeds from the sale of the assets to the creditors. Creditors holding trust deeds or security agreements often will receive the collateral securing their loans in a Chapter 7. The debtor in a Chapter 7 ends up with a clean slate and has a chance to make a fresh start. A Chapter 7 bankruptcy is the best choice for an insolvent producer who cannot continue to operate and manage his farm or ranch. It also may be the best alternative for those producers whose cashflow is so sporadic and meager that he/she cannot make the payments required under a Chapter 12 plan. Colorado producers who file a Chapter 7 will **not** be allowed to continue the management and operation of their farm or ranch. As a general rule, producers filing a Chapter 7 case end up with no debts, other than those few that can't be discharged, and only the assets that are exempt under Colorado State Law. A description of those assets is set forth in a separate

³Producers are cautioned against representing themselves in either a court of law or in negotiations with creditors. This publication is **not** intended to be a substitute for legal counsel.

section of this article. Under some circumstances a Chapter 7 debtor can "reaffirm" a loan and continue to make the payments after the bankruptcy to retain the collateral securing that specific loan.

Chapter 11 is a business reorganization bankruptcy. Rather than liquidating, the debtor restructures the debts. The objectives of the reorganization are to avoid foreclosure and repossession attempts, repay some or all of the debts in a manner acceptable to at least some of the creditors and to permit the debtor to continue to operate his or her business. As a general rule, producers who qualify for Chapter 12 should not file under Chapter 11 because Chapter 12 is designed specifically for producers and usually is less expensive and faster to resolve. Also, the Chapter 12 reorganization plan prepared by the producer doesn't require the consent or approval of the creditors, whereas Chapter 11 usually does.

Chapter 13 is a mini-reorganization similar to a Chapter 11, except it usually is faster and smaller. To qualify for a Chapter 13, the debtor must have no more than \$350,000 in secured debts and \$100,000 in unsecured debts. A Chapter 13 plan should be completed in three years, although the time can be extended to five years if the debtor has a good reason for such an extension of time. Many producers do not qualify for Chapter 13 due to debt restrictions. Chapter 12 is similar to Chapter 13, however, Chapter 12 is designed specifically for producers and the debt restrictions are much higher than those of Chapter 13.

Chapter 12 is similar to Chapter 11 and Chapter 13 in that it is designed to assist the debtor in reorganizing and restructuring debts. Unlike Chapter 7, Chapter 12 is not a liquidation of the debtor's assets.

Under Chapter 12 the producer can restructure his/her debts and modify the terms of the loans without consent of the creditors. Chapter 12 is limited to persons who qualify as "family farmers." A family farmer means an individual, or an individual and spouse, engaged in a farming or ranching operation whose aggregate debts do not exceed \$1.5 million dollars. At least 80 percent of the debts must be related to a farming operation owned or operated by the debtor. This 80 percent figure is calculated as of the date the case is filed. Further, more than 50 percent of the producer/debtor's gross income must have been received from the farming operation for the taxable year preceeding the taxable year in which the case is filed. If a farmer can fulfill these requirements, he/she will be eligible for chapter 12. Family corporations and partnerships also may qualify if more than 50 percent of the outstanding stock is held by one family, or by one family and that family's relatives, and if the family manages the farming operation.

Terms and Provisions Used in Bankruptcy Law

Producers contemplating bankruptcy should become familiar with certain legal terms and provisions used in bankruptcy law. Some of the more frequently used terms are as follows:

1. **Debtor**--a person or persons who have filed bankruptcy; also may be a partnership or corporation.
2. **Creditor**--an entity, often a lender, that has a claim against the debtor that arose at the time of or before the case commenced. Creditors in a producer's bankruptcy may include such entities as the PCA, the local bank, the feed store and the coop.
3. **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.
4. **Judicial Lien**--a lien obtained by a judgement or other legal or equitable proceeding.
5. **Lien**--a charge against, or an interest in property to secure payment of a debt or performance of an obligation.
6. **Security Agreement**--an agreement that creates a lien against an asset owned by the producer.
7. **Petition**--a legal document filed in the bankruptcy court. The petition commences the bankruptcy case.
8. **Bankruptcy Estate**--everything the bankrupt producer owns. This includes land, livestock, machinery, accounts receivable, and any future interest in property, such as an inheritance or a gift received within six months after the bankruptcy case is filed.
9. **Automatic Stay**--as soon as a bankruptcy case is filed, all other actions taken against the debtors are stopped. This is called the automatic stay. The bankruptcy court consolidates all disputes between the debtor and the creditors. If, for example, the PCA has filed a legal action in the state court against a producer, the filing of the bankruptcy petition would stop the state court action. The state court action cannot go any further without the permission of the bankruptcy court. The bottom line is that any actions started against the producer outside of bankruptcy are held in abeyance unless and until the bankruptcy court permits such actions to continue.

FREQUENTLY ASKED QUESTIONS CONCERNING CHAPTER 12

How do I know if I qualify for Chapter 12 bankruptcy?

In order to file a Chapter 12:

1. You must have total debts of no more than \$1.5 million; at least 80 percent of your debt must be related to a farming or ranching operation, which you own or operate.

2. You must have made at least 50 percent of your gross income from your farming or ranching operation during the tax year prior to the year you file bankruptcy.
3. You should have sufficient income to make payments under your Chapter 12 plan. However, this does not mean that you must receive a paycheck every month. You can make the payments under the plan from the sale of your crops or livestock. Some producers will have to turn over nearly all of their income to the bankruptcy court in order to make the Chapter 12 plan feasible. However, producers can retain income needed to maintain the family and pay operating expenses.

Can I continue to manage my farming/ranching operation after I file the Chapter 12 bankruptcy?

Yes--under Chapter 12 you are a "debtor in possession." This means that you can continue to manage the affairs of your farm or ranch after the case has been filed. You can make management decisions such as when to sell your crops or livestock. Also, you and your family can continue to live on the property and use the buildings and machinery. In effect, you are your own trustee. However, you should know that a bankruptcy court trustee will conduct an investigation of your operation and deliver his report to the bankruptcy court. You also should realize that your lenders can have you removed as the manager of your operation if they can show that you have engaged in **fraud, dishonesty, incompetence or gross mismanagement**, either before or after the filing of the bankruptcy case.

What is a plan and when do I need to file my Chapter 12 plan?

The plan is a written document that specifies how you are going to restructure your financial affairs. You, with the assistance of your attorney and possibly a farm management consultant, prepare the plan.

The plan must be **filed not later than ninety days** after the court grants the order for relief. In other words, you have about 90 days after you file the case to file the plan. However, you and your attorney should **prepare** the plan before you file the case. This is done to determine if you have sufficient cashflow to make a Chapter 12 plan feasible. Financial statements and cash flow statements can be helpful in designing and evaluating the plan.

What should my Chapter 12 plan include?

A Chapter 12 plan can be tailored specifically for your situation. However, there are several things that **must be included** in the plan. First, your plan must provide for the submission of your future income to the supervision of the bankruptcy trustee in an amount necessary to make your plan work. In other words, you probably will have to turn over most of your future income to the bankruptcy trustee. This money will be used to make payments to your creditors. Secondly, your plan must provide for full payment of certain types of debt, although these payments may be deferred. An example would be

wages you owe to an employee for work performed during the 90 days before the date you filed the case.

In preparing your plan, the law provides that you may:

1. Modify the terms of your loans. For example, you can extend the time for payment (reamortize) of a loan in order to reduce the amount of each installment. Another example would be to reduce the interest rate on a loan down to the rate banks are charging at the time you submit your plan. A third example would be to modify the loan to reflect the decrease in the value of the collateral. Say, for example, a producer purchased an 80-acre parcel in 1981 for \$1,500.00 per acre and borrowed most of the purchase money at a 16 percent interest rate on a 15 year loan. Assume that the current pay-off on the loan is \$100,000.00. Assume further that the land is now valued at \$700.00 per acre. Under a Chapter 12 case the producer could allocate \$56,000 ($\700.00×80 acres) to a secured debt collateralized by the 80 acres, and the \$44,000.00 balance would become an unsecured debt. The secured portion could be re-amortized over 20 years at the current market interest rate. The producer would have to make all the payments on the new secured debt, but, in most cases, would only pay a part of the unsecured portion created by the land-value deflation. These changes can be made in the Chapter 12 plan without consent of the lender.
2. Waive or cure a default. In other words, your plan may provide that you will pay a lender all past due payments, even though that lender has "called" the loan and demanded payment in full of the entire debt. This is known as "curing" the default. Under some circumstances you can simply agree to cure the default at some point in the future.
3. Provide for the assumption, rejection or assignment of an unfulfilled contract or an unexpired lease. An example would be to provide in your plan that a lease you recently signed for the 1987 crop year be rejected. In other words, you would walk away from the lease and not be legally obligated to pay the rent.
4. Provide for payment of a claim from property of the bankruptcy estate.
5. Provide for the payment of a secured loan to be extended over a longer period of time. In other words, your plan would provide you to make more payments under a given loan, but each payment would be smaller. Some loans can be extended for 25 or 30 years.
6. Provide for the vesting of property in your name upon confirmation of the plan, or at a later time.

The above list is not complete, but it does describe many of the rights you would have in molding a Chapter 12 plan to fit your needs.

Will my plan automatically be confirmed by the bankruptcy court?

No--the court will hold a hearing on your plan in order to determine whether it should be **confirmed**. The hearing will be held no later than 45 days after the plan is filed. A creditor or trustee may object to the plan at this hearing. The bankruptcy judge will determine if your plan should be confirmed.

What will it mean if my plan is confirmed?

If your plan is confirmed by the bankruptcy court, both you and your creditors are bound by the terms of the plan. At this point it makes no difference whether a creditor likes the plan or objects to it. All creditors are bound. Secondly, the confirmation of the plan vests all of the property of the bankruptcy estate back into your name, except property you want to transfer to secured creditors as payment of a loan.

When will my bankruptcy be concluded?

Your bankruptcy will be over at the time the bankruptcy court grants you a **discharge**. A discharge usually will be granted when you have made the final payments under your plan. In other words, if your plan calls for three years of payments, you will be discharged at the end of three years. There are several types of long-term debts, which you can continue to pay on after your discharge.

Are there any types of debts which cannot be discharged in my bankruptcy?

Yes--there are a number of debts that cannot be discharged or extinguished by bankruptcy. Some of the more frequently incurred non-dischargeable debts include: (1) taxes; (2) money or property obtained by false pretenses; (3) money obtained by fraud, or the use of a false financial statement; (4) debts not properly listed in your bankruptcy papers; (5) alimony and child support payments; (6) damages resulting from injury you caused to the property of another entity; (7) some student loans; (8) debts owed in connection with an accident in which you were found to be legally intoxicated; or (9) any obligation to pay a fine, penalty or forfeiture owed to a governmental unit.

Are there any disadvantages to filing Chapter 12?

Yes--the first is that you will be monitored by the trustee. He will review your management decisions to ensure that you will be able to make payments as specified in your plan. You may have to make written reports to the trustee on a periodic basis.

The second disadvantage is that it may be difficult to borrow operating money. Many lenders are reluctant to make operating loans to producers who are reorganizing debts under the bankruptcy code. However, you will be able to retain income from the sale of your crops or livestock for operating expenses and for family maintenance expenses.

The third possible disadvantage concerns taxes, a producer's taxes, in some cases, will increase. Producers contemplating reorganization under Chapter 12 should discuss the tax ramifications with a qualified accountant prior to filing the case.

Who should I contact about taking bankruptcy?

A lawyer who is competent in the area of bankruptcy. Under some circumstances this may require that you use a lawyer outside of your community. You also will need the assistance of your accountant to calculate the tax ramifications of bankruptcy. In many cases it is advisable to contact a farm management consultant. The consultant can provide valuable assistance in developing and preparing your plan.

Transfers of Assets Prior to Bankruptcy

Any transfers or payments made by the producer/debtor to a creditor within 90 days of bankruptcy can be broken or set aside if the transfer improves the creditor's position in comparison to other creditors. If, for example, a producer pays his unsecured bill at the lumber yard within 90 days prior to bankruptcy, he may have given the lumber yard a **preference**. In other words, he has given the lumber yard a preference over the other unsecured creditors. Payment to the lumber yard can be set aside by the bankruptcy court.

If a producer makes a payment or transfer of assets to a relative within one year before bankruptcy, this transaction can be set aside by the bankruptcy court. The test is whether the producer received full value from the relative for the asset transferred. If the transfer to the relative was not for the full value, or was not at "arms length", the bankruptcy court can rule that it was a **fraudulent conveyance**.

Example: Fred Farmer can see that his financial situation is deteriorating rapidly. His accountant told him to consider bankruptcy. He made an appointment with his attorney to discuss filing a Chapter 12 bankruptcy case. Fred can't stomach the idea of giving up his eight Morgan horses to his creditors, so he gives them to his son who farms south of Fred. He takes them to his son's place on December 15 and tells everyone that he is giving the horses to his son as a Christmas gift. **This is a fraudulent conveyance.** The bankruptcy court can set aside and rescind this transfer since Fred's son did not pay anything for the horses. Further, the bankruptcy court may decide to dismiss the entire bankruptcy.

Exemptions

Exemptions are those items that a producer/debtor keeps after taking bankruptcy. These items are free from the claims of creditors unless they are pledged as collateral on a loan. If the exempt asset is not pledged as

security on a loan, then the producer keeps it regardless of how much he owes his creditors. There are literally dozens of types of exempt property in Colorado. Some of the more important exempt items include:

- a. wearing apparel to the extent of \$750 in value;
- b. watches, jewelry and other such items to the extent of \$500 in value;
- c. household goods, such as furniture, desks, etc., to the extent of \$1500;
- d. fuel and provisions to the extent of \$300 in value;
- e. livestock and poultry, not exceeding a total value of \$3000 and horses, mules, wagons, carts, machinery, harnesses, implements and tools not exceeding \$2000 in value;
- f. supplies, fixtures, machines, tools, books, equipment and other items necessary for the purpose of carrying on a gainful occupation, to the extent of \$1500 in value;
- g. a motor vehicle used for the purpose of carrying on gainful occupation, in the value of \$1000;
- h. the avails of life insurance policies to the extent of \$5000;
- i. a mobile home to the extent of \$6000 in value while used as a place of residence by the owner;
- j. property that is traceable to an award under a crime victims reparation law;
- k. one trailer coach to the extent of \$3500 if used as the residence of the owner;
- l. a homestead exemption in the sum of \$20,000 in actual value in excess of any liens on the homestead property. A producer's homestead is the house he and his family reside in. Most trust deeds contain a provision that waives any homestead rights;

In planning for bankruptcy, individuals will sometimes convert non-exempt property, which is not encumbered with a lien, into exempt property. This usually is permissible and generally isn't considered fraudulent.

SUMMARY

Colorado's ranchers and farmers have been suffering through a serious financial crisis. Foreclosures and bankruptcies have been filed in numbers not witnessed since the great depression. Farmland values have fallen sharply, as has the value of agricultural machinery and equipment.

Both the Colorado general assembly and the U.S. Congress have responded to this situation with legislation intended to benefit financially strapped producers. Colorado enacted H.B. 1284 in April of 1986. It provides new rights for debtors in foreclosure and replevin.

In foreclosure cases, for example, producers can now buy back their residence and five to 40 acres during the four-month period following the sale. Further, producers can lease back, and under some circumstances buy back their land following the delivery of the deed to the new owner.

In replevin cases producers can now submit a plan whereby they 'cure' the past due loan with future proceeds from the sale of crops or livestock.

The new Chapter 12 provides financially troubled producers a new method of reorganizing debts. If a producer qualifies for Chapter 12 and has sufficient cash flow to make it work, it can be a means of surviving the current economic depression in the agricultural economy. Chapter 12 also gives financially strapped producers a strong bargaining chip in dealing with lenders prior to bankruptcy.

Producers should not view Chapter 12 as an easy solution, or an immediate cure for their credit problems. Chapter 12 reorganization takes approximately three years to complete and requires a lot of hard work and determination.

A voluntary out-of-court workout agreement entered into by the producer and his lenders can accomplish the same outcome as Chapter 12 reorganization. Therefore, producers should not file Chapter 12 unless negotiations with lenders for an out-of-court agreement are unsuccessful.