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WHY MCA?
ADDING HAVOC TO CHAOS

CO-AUTHORED BY:
BARBARA M. BARRON AND STEPHEN W. SATHER
BARRON & NEWBURGER, P.C.

Thirty-Three Years of Asking, "Are We There Yet?"
BY JOSEPH A. PEIFFER

Forum Shopping On A Global Scale
BY BILL BRANDT

Thirty-Three Years of Asking, "Are We There Yet?"[1]

Joseph A. Peiffer

Shareholder, AG & Business Legal Strategies

Joseph A. Peiffer has focused his practice on business bankruptcy for more than 30 years, and established Ag & Business Legal Strategies (formerly Peiffer Law Office, P.C.) in 2016.

www.ablsonline.com

With no fanfare regarding the topic of this article, on August 23, 2019 President Trump signed H.R. 2336, the Family Farmer Relief Act of 2019, now enrolled as Pub. L. 116-51. This law increased the debt limit for Chapter 12 from $4,411,400 to $10,000,000 while continuing the pre-existing inflation adjustments.[2] This is the second major change to Chapter 12 in the past two years. On October 26, 2017 Pub. L. 115-72 was enacted. Buried at the end of that law was a significant change regarding how family farmers could utilize Chapter 12 to de-prioritize tax claims resulting from the sale of farm assets used in the farming operation, treating them as unsecured claims. Pub. L. 115-72 prevented tax authorities from blocking confirmation of Chapter 12 plans that did this. Understanding the seismic nature of these changes requires reviewing the bankruptcy options available to family farmers beginning with the Farm Crisis of the 1980s.

The Problem of Family Farm Bankruptcy

For family farmers, the 1980s were a time of crisis unparalleled since the Great Depression. Beleaguered family farmers (BFFs) shared story after story with Senator Chuck Grassley (R-IA) relating how Chapter 11 failed to help them save their farms. The problems cited were the absolute priority rule,[3] the expense of creditors' committees, and the two-part class votes.[4] Senator Grassley and other concerned lawmakers listened. Chapter 12 was drafted in the waning hours of the 99th

1 By Joseph A. Peiffer of Ag & Business Legal Strategies, P.C. of Cedar Rapids, IA. The author thanks Austin Peiffer for his valuable editing suggestions.

2 11 U.S.C. § 104. Increasing the debt limit in Chapter 12 cases was first suggested to Congress by the author in 2008.

3 11 U.S.C. § 1129(b)(2)(B)(ii).

4 The confirmation requirement in a Chapter 11 for approval from greater than half the class votes and over two-thirds in amount of the creditors voting for the plan allowed a single under-secured creditor to defeat many farm Chapter 11s. 11 U.S.C. § 1126(c).

Congress October of 1986. Congressional staffers holed up in a conference room of the Hart Senate Office Building with smoke billowing out the doors, listening to various constituent groups make pitches for what should be included in the legislation.[5] Chapter 12 was passed and enacted with an effective date of November 26, 1986.[6] After Chapter 12's enactment, much like a child on a car trip, BFFs asked, "Are we there yet?" referring to a workable bankruptcy solution to save their farms. Congress and bankruptcy attorneys believed the answer to the question was, "Yes."

The First Hurdle: Taxes

Early Chapter 12 cases raised a significant question: How would the income taxes occasioned by BFFs' sale of farm assets, both pre- and post-petition, be satisfied? The sale of assets to "right-size" the farming operation during the case generated significant capital gain taxes payable as a second-priority administrative expense.[7] BFFs' cash flows were insufficient to pay these taxes in full. The plans were not confirmable, and the answer to the BFFs' question was, "We're not there yet."

LEGISLATION, ROUND 1

Congressmen said they forgot to address the tax problem. Given Congress' rush to leave Washington, the drafters lacked time to run the proposed legislation by the Senate Finance Committee to consider tax questions. The 1986 election saw the balance of power in the Senate change, and the new Senate leadership had little desire to fix the tax problem faced by BFFs.

The tax problems faced by BFFs rendered Chapter 12 far less effective than originally envisioned by its drafters. Even after the 99th Congress, progress on a better solution for BFFs was slow. One early idea was to reduce secured creditors' claims to pay tax claims. The bankers' lobby rejected that approach. Thirteen years passed before Senator Grassley and co-sponsors introduced a bill to address the tax problems with Chapter 12, S. 260, Safeguarding America's Farms Entering the Year 2000 Act. S. 260 resulted from a suggestion that tax claims of BFFs arising from "right-sizing" be de-prioritized,[8] which Congress implemented by adding § 1222(a)(2)(A). However, the language introduced was imprecise, and Senator Grassley's Judiciary aide was advised the proposed language would not survive a Supreme Court review. Despite that, the answer to the BFFs' question was, "I hope so."

S. 260 was incorporated in H.R. 833, the Bankruptcy Reform Act of 2000. At a breakfast in the spring of 2000 Senator Grassley answered questions from thirty people about H.R. 833, without notes. The attendees offered many suggestions, but the only one adopted came when one attendee reminded the Senator that many BFFs needed immediate relief from the tax burdens of "right-sizing" their operations. Senator Grassley responded by instructing his Judiciary staffer to change the bill making the tax provision effective upon enactment. The provisions of H.R. 833 were eventually incorporated into H.R. 2415, and Congress passed it by a veto-proof margin. Unfortunately for BFFs, President Clinton pocket vetoed it. The answer to the BFFs' question was, "Not yet."

However, this was not the final answer. Five years later, in 2005, President Bush signed the Bankruptcy Abuse Protection Consumer Protection Act of 2005 (BAPCPA), Pub. L. 109-8. To the relief of BFFs, BAPCPA included § 1222(a)(2)(A) from H.R. 2415, so the special deprioritization tax provisions of § 1222(a)(2)(A) were immediately available to BFFs.

ADJUDICATION, ROUND 1

The first BFFs to utilize § 1222(a)(2)(A) were the Knudsens, in the Northern District of Iowa.[9] The questions surrounding § 1222(a)(2)(A) were daunting. Since neither debtors' counsel nor the IRS' counsel had faced litigating a new statute, they collaborated to identify potential issues. An IRS attorney, an IRS Special Procedures Agent, and debtors' counsel met and spent the afternoon whiteboarding potential issues, including:

Which "farm assets" qualified for the special tax provision?

What did it mean for farm assets to be "used in" the farming operation?

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5 Drafters considered and discarded requests by creditor groups to include a provision like § 1111(b) and shared appreciation in favor of a modified Chapter 13 on steroids to help save BFFs. Senator Grassley's Judiciary Committee aide from that time, Sam Gerdano, provided valuable insight into the drafting of Chapter 12.

6 Pub. L. No. 99-554, titled Bankruptcy Judges, United States Trustee, and Family Farmer Bankruptcy Act of 1986.

7 11 U.S.C. § 507(a)(2).

8 This suggestion came from the author in December of 1999. The legislative drafters were unwilling to consider allowing Chapter 12 debtors to utilize a short tax year allowed by 26 U.S.C. § 1398(d), which would have ensured that post-petition tax claims would be administrative expense claims easily de-prioritizeable by changes to § 1222(a)(2).

9 *In re Knudsen,* No. 05–03136M (Bankr. N.D. Iowa, July 1, 2005). The author had the privilege of serving as debtors' counsel.

What was the debtor's "farming operation?"

How was the tax to be de-prioritized to be calculated?

While they did not agree on the answers to these questions, they outlined the parameters of their disagreements. The primary difference was the methodology used to calculate the tax that could be de-prioritized. The IRS proposed utilizing a proportional methodology, while debtors' counsel proposed using a marginal methodology adapted from special use valuation used in estate tax. The proportional method valued each type of tax proportionately, resulting in a higher priority, non-dischargeable tax. The marginal methodology resulted in a lower priority, non-dischargeable and a much higher de-prioritized, dischargeable tax.

In *Knudsen,* debtors' counsel also faced the question of ensuring that the IRS would be forced to litigate its issues with the plan at the confirmation hearing rather than attacking the plan after confirmation. The plan delineated the marginal methodology for the assets sold in the tax year before filing. The plan was feasible without the further sales of assets; however, if the income taxes could be deprioritized and discharged in the Chapter 12 it was more feasible if additional land was sold. Given debtors' counsel's belief that § 1222(a)(2)(A) would not survive a strict statutory interpretation to de-prioritize taxes on post-petition sales, the plan provided there would be no post-petition sales without a final court ruling that the tax occasioned by the post-petition sale of land would qualify for de-prioritization and discharge.

In July of 2006 Judge Edmonds held a three-day confirmation hearing in *Knudsen* and denied confirmation of the plan.[10] Judge Edmonds held that the debtors could only use § 1222(a)(2)(A) for capital gains taxes owing on the disposition of capital assets of the farm, not market hogs; the tax claims subject to § 1222(a)(2)(A) would be discharged upon completion of the payments under the plan; and the debtors could sell assets post-petition and have the taxes qualify for treatment under § 1222(a)(2)(A). After this ruling the answer to the BFFs' question was, "I'm not sure."

The Knudsens and the IRS both appealed Judge Edmonds' ruling. District Court Judge Bennett heard the three-and-a-half hour appellate argument and reversed the bankruptcy court's ruling denying plan confirmation.[11] Judge Bennett held among other things that the portion of the federal tax debt to be paid in full as a priority tax claim and the portion to be treated as a mere unsecured claim was to be determined utilizing the "marginal method" of allocation; post-petition sales of farm assets qualified for treatment as an unsecured claim; and taxes on income earned by the debtors during their Chapter 12 case were taxes "incurred by the estate," even though the Chapter 12 estate was not a separate taxable entity. After this ruling the answer to the BFFs' question was, "Yes, we have arrived."

The IRS appealed Judge Bennett's decision to the Eighth Circuit Court of Appeals. The Circuit Court ruled on several issues, including that § 1222(a)(2)(A) was not restricted to pre-petition claims owed to creditors and that taxes on post-petition sales qualified for de-prioritization.[12] After this ruling the answer to the Eighth Circuit BFFs' question was, "Yes, we certainly have arrived."

ADJUDICATION, ROUND 2

Unfortunately for BFFs, dark clouds were on the horizon in the Ninth Circuit, where the Bankruptcy Court in *In re Hall*[13] held that the post-petition sale of the Halls' farm, which generated significant taxes, did not qualify for de-prioritization. The Bankruptcy Court relied on *In re Brown,*[14] a Chapter 13 case in which the debtor sold his interest in rental real estate to his ex-spouse after confirmation of a Chapter 13 plan providing for payment of 100% of the unsecured claims. If the Chapter 13 Trustee were required to pay the capital gains taxes due to the Commonwealth of Massachusetts and the federal government, there were insufficient funds to pay the balance of the unsecured claims in full.

10 *In re Knudsen,* 356 B.R. 480 (Bankr. N.D. Iowa 2006).
11 *In re Knudsen*, 389 B.R. 643 (N.D. Iowa 2008).
12 *Knudsen v. Internal Revenue Service,* 581 F.3d 696 (8th Cir. 2008).
13 376 B.R. 741 (Bankr. D. Ariz. 2007)
14 No. 05-41071, 2006 Bankr. LEXIS 3156 (Bankr. D. Mass. Nov. 20, 2006).

The Bankruptcy Court in *Hall* adopted the *Brown* court's reasoning in determining that the analysis in *Knudsen* was flawed regarding the post-petition applicability of § 1222(a)(2)(A). On appeal, the District Court reversed the Bankruptcy Court.[15] The IRS appealed the District Court's decision to the Ninth Circuit, which reversed the District Court and affirmed the Bankruptcy Court's decision.[16] . After this ruling, the answer to the Ninth Circuit BFFs' question was, "No."

With a split in the circuits regarding the post-petition de-prioritization of governmental claims, the Supreme Court granted *certiorari* to *Hall v. United States.*[17] On May 14, 2012, in a 5–4 ruling containing a strong dissent, the Supreme Court affirmed the Ninth Circuit's decision.[18] The Court held that the taxes arising from the post-petition sale of the Halls' farm did not qualify for de-prioritization because no separate bankruptcy estate[19] was created in a Chapter 12. The Court stated:

> Certainly, there may be compelling policy reasons for treating post[-]petition income tax liabilities as dischargeable. But if Congress intended that result, it did not so provide in the statue. Given the statute's plain language, context, and structure, it is not for us to rewrite the statute, particularly in this complex terrain of interconnected provisions and exceptions enacted over nearly three decades. * * * As the Court of Appeals noted, "Congress is entirely free to change the law by amending the text."[20]

After the Supreme Court ruling in *Hall*, the answer to all the BFFs' question was, "No."

LEGISLATION, ROUND 2

Suggestions to amend the Bankruptcy Code to rectify the effects of *Hall* were presented to Senator Grassley the afternoon it was decided. Beginning in June of 2012, Senate staffers, Susan Freeman (the attorney who argued *Hall*), and the Knudsens' counsel discussed drafting a bill to address the holding in *Hall* and other issues. However, Senator Grassley chose to address only *Hall* in his corrective legislation. In September of 2012, Senators Grassley and Franken (D-MN) introduced S. 3545, which was referred to the Senate Finance Committee, where it died when the 112th Congress adjourned.

In December of 2012, the National Bankruptcy Conference sent its comments regarding S. 3545 to Senator Grassley. The comments were very insightful and assisted the drafters in revising and crafting a better bill for the 113th Congress.

On August 1, 2013, Senators Grassley and Franken introduced S. 1427, the Family Farmer Bankruptcy Clarification Act of 2013. This bill was not merely a reintroduction of S. 3545. Rather, it was a redrafted bill designed to avoid the death that S. 3545 experienced in the Senate Finance Committee. Its goal was to provide a legislative basis to allow family farmers to utilize Chapter 12 to de-prioritize taxes incurred on the disposition of farm assets and treat them as pre-petition general unsecured claims. S. 1427 was initially assigned to the Senate Finance Committee and later reassigned to the Senate Judiciary Committee. Unfortunately, it did not progress from there.

On January 20, 2015, Senators Grassley and Franken introduced S. 194, a reintroduction of S. 1427. It was assigned to the Senate Judiciary Committee and suffered the same fate as its predecessor.

On May 25, 2017, Senators Grassley and Franken introduced S. 1237, the Family Farmer Bankruptcy Clarification Act. It was assigned to the Senate Judiciary Committee. However, it avoided the fate of its predecessors. In the two prior Congresses, the "give" required of Senator Grassley had been deemed too great for the "get" of progressing a statutory reversal of *Hall* out of committee. This time, in early August 2017 Senators Grassley and Coons (D-DE) discussed their legislative wants. Senator Coons wanted the House-passed bankruptcy judges bill making the temporary bankruptcy judgeships in Delaware permanent and Senator Grassley wanted *Hall* reversed. They compromised — Senator Coons received a five-year extension of the Delaware temporary bankruptcy judgeships and Senator Grassley received the statutory reversal of *Hall.* Finally, the "give" was not too great for the "get."

After Congress's August recess, S. 1107, the Senate version of the bankruptcy judges bill with the anti-*Hall* language included, passed the Senate by unanimous consent. However, the Administrative Office of the United States Courts found issues in the judgeship language. To address these problems the Senate used H.R. 136, which had passed the House earlier. The Administrative Office's

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15 *In re Hall,* 393 B.R. 857 (D. Ariz. 2008).
16 *United States v. Hall,* 617 F.3d 1161 (9th Cir. 2010).
17 564 U.S. 1003 (June 13, 2011).
18 *Hall v. United States,* 132 S. Ct. 1882 (2012)
19 A separate bankruptcy estate is established for debtors that can have a short tax year by 26 U.S.C. § 1398(d).
20 132 S. Ct. 1893 (citiation omitted)

preferred language was added, S. 1107 was passed, and it was sent to the House for action. On October 12, 2017, H.R. 2266 passed the House. The House used S. 1107 as a vehicle to attach the hurricane and wildfire supplemental appropriations bill. It was then sent to the Senate, which passed it on October 24, 2017, by an 82–17 vote after significant parliamentary gamesmanship. Two days later President Trump signed the bill into law. Interestingly, the White House Press Release referred to the disaster relief appropriations and the bankruptcy judges' provisions and ignored the Chapter 12 provisions of the bill. However, the answer to the BFFs' question, "Are we there yet?" was only, "We've overcome this hurdle, but another has arisen."

The Second Hurdle: The Debt Limit

When Chapter 12 was created it was estimated that 86% of farmers would satisfy its debt limits. However, as time passed the size of family farms grew much faster than inflation, while Congress only raised the Chapter 12 debt limit sporadically until 2005, when the limit was indexed merely to inflation as part of BAPCPA. This led to more and more farmers being ineligible for Chapter 12 because they exceeded the debt limit.

On December 6, 2018, Senators Grassley and Klobushar (D-MN) introduced S. 3721 to increase the Chapter 12 debt limit to $10,000,000. It died without action in the 115th Congress. On March 27, 2019, Senators Grassley, Klobushar and ten other bi-partisan Senators introduced S. 897, the Family Farmer Relief Act of 2019. That bill did not progress to the full Senate. However, its companion bill, H.R. 2336, was introduced by freshman Congressman Delgado (D-NY). It was marked-up on July 11, 2019, debated on July 25, 2019 and passed by the House.

In the Senate H.R. 2336 faced a hold from Senator Durbin (D-IL), who had taken the position that no bankruptcy bills would pass the Senate unless issues regarding student loans were addressed. Farm-era supporting the legislation brought significant pressure on their senators to pass the it and request that Senator Durbin remove his hold. During the last week of July Senator Durbin announced that he would he would release his hold on the three Democrat bankruptcy bills, including H.R. 2336, but would not release his hold on H.R. 3311, the Small Business Reorganization Act of 2019, sponsored by Representative Ben Cline (R-VA). The Republican-controlled Senate refused to bring any bankruptcy bills up for passage unless all four bankruptcy bills—the Democrat-sponsored H.R. 2336 Family Farmer Debt Relief Act of 2019, H.R. 2938 HAVEN Act, and H.R. 3304 National Guard and Reservists Debt Relief Extension Act of 2019; and the Republican-sponsored H.R. 3311 Small Business Reorganization Act of 2019—were considered at the same time. Public pressure from the farm sector and the military sectors was immense. Ultimately Senator Durbin released his hold on H.R. 3311, all four bills passed on August 1, 2019, and President Trump signed them on August 23, 2019.

Conclusion

While continued farm size growth at rates exceeding inflation may necessitate future debt limit increases and other issues may arise from court decisions or changed farm circumstances, at least for now the answer for BFFs asking, "Are we there yet?" with a workable bankruptcy solution to save their farms is, "Yes." ■