

# **A Legal Guide for Wisconsin Farmers**

## **Introduction**

This legal guide was first written in 1988 during a period of financial pressure for Wisconsin and all farmers nationwide. Economic stress in agriculture has been common during the last decade requiring Wisconsin farmers to understand their basic legal rights and responsibilities in their business relationships.

During the 1970s farmers borrowed from lenders in an improving agricultural economy. The deterioration that developed in the agricultural economy after 1980 was unanticipated and created financial distress for both borrowers and lenders. While it is assumed that lending institutions have access to advisors who may help them to prepare survival strategies, the farmer/borrower often is engulfed in the day-to-day business of operating a farm and may not have access to assistance with the development of an economic survival strategy. This publication intends to better inform the farming community about the legalities that surround borrowing and repaying loans, and the borrower and lender relationship. This publication does not intend to take sides in the adversarial relationship that sometimes develops between borrowers and lenders, nor does it promote bankruptcy as the only solution to debt. Ideally, farmers and their lenders will work together to solve the problems they share.

The information contained in this guide is important for farmers at all times. Farmers, as business people, constantly are working with different creditors and should understand fully the legal consequences of their actions and those of the creditors. This publication also can help you understand the legal system a little better and allow you to work more effectively with your lawyer.

This guide does not contain legal advice and should not be used as a substitute for the advice of a competent attorney. You should consult with a lawyer when you have a legal problem. However, while this guide does not provide all the answers, it hopefully will give you some fundamentals so you can be more knowledgeable as a farm borrower.

This publication includes a glossary to aid your understanding of legal terms used within. In addition, the following section will introduce you to the lending and court systems.

## **The Lenders**

Certain major creditors are involved with many of Wisconsin's farm borrowers. Each is controlled and regulated by different entities that explain why there are no uniform policies for dealing with farm borrowers in lending practices and forbearance during farm economic stress. Individual loan officers also may be responsible for service received by individual borrowers.

Farm Credit System. Wisconsin is part of the Seventh District of the Farm Credit System (FCS), which is a nationwide system of cooperatively owned banks, associations and certain other lenders

organized into districts. Although Congress established the organization in its present form and loaned money to help the organization, the money the system uses to finance loans comes primarily from the sale of bonds to investors.

The Farm Credit System is made up of credit cooperatives, the local federal land bank associations and production credit associations, which are owned and directed by their member borrowers, and includes you, the FCS borrower. You have obtained this ownership by purchasing stock in the bank or association, which is used for capitalization and is subject to risk, as with all stock.

As an FCS borrower and owner, you have the right to participate in elections and to have a voice in your lending institution's management. You can exercise these rights by participating in the boards of directors elections representing your beliefs as to the organization's and its member's best interests. This gives you the best opportunity to control the policies of your local association or bank.

However, the Farm Credit System does have a federal regulator to supervise the system's management B the Farm Credit Administration (FCA). Even this agency is funded by you, as a member-borrower, as the entire operating budget of the FCA is paid for by banks and associations within the system. Congress also oversees FCS and can pass laws to regulate the system.

Farm Services Agency. Unlike the Farm Credit System, the Farm Services Agency (FSA) is a government agency directly supervised by the President with approval of the U.S. Senate to carry out the laws passed by Congress involving FSA administration of agricultural credit.

As part of the Executive Branch of government, the administrator "executes" the laws passed by Congress. However, because most laws must be interpreted by regulations written by the agency such as FSA, these regulations often reflect the President's view of the law. If Congress and the President have different viewpoints, there may be a struggle as to agency policies on major issues. The courts may enter into the picture as final interpreter of the laws.

Although the FSA is further run by state and local offices, the regulations are written in Washington and must be followed by all offices nationwide. This can work both for and against the borrower. While all FSA borrowers are entitled to the same procedures, local and state FSA staff cannot help a deserving borrower by using a servicing tool not available in the regulations or subject to restrictions. Since FSA is a federal agency, the FSA borrower and all citizens have access as to how FSA will interpret the laws through Congress. By voting and contacting representatives on issues involving FSA, you can influence the FSA policy and regulations director.

Wisconsin banks. The 346 commercial banks located in Wisconsin are owned by individual and institutional investors and are part of a dual banking system. Approximately two-thirds of these commercial banks are state banks chartered by the State of Wisconsin and regulated primarily by the Commissioner of Banking of Wisconsin.

Approximately one-third of these commercial banks are national banks federally chartered and regulated by the Comptroller of the Currency (OCC). All national banks and some state banks are Federal Reserve System (Fed) members. As the United States' central banking system, the Fed provides a depository for bank reserves and a check collection system, maintains the U.S. money market and fulfills other important roles. Deposit insurance for commercial banks in Wisconsin is provided by the Federal Deposit Insurance Corporation (FDIC). Thus, in addition to the OCC and Commissioner the Fed and FDIC have regulatory authority over Wisconsin's commercial banks. Noncommercial financial institutions, also known as "thrifts" (e.g., savings and loan associations, savings banks and credit unions) are subject to differing laws and regulatory authority and are not included in this discussion of Wisconsin commercial banks.

### **The Courts**

In a dispute between a debtor and creditor, a lawsuit may result. Much of the law in this area is state law so that the lawsuit will be heard by a state judge. The one major exception is bankruptcy, which is governed by federal law so that bankruptcies are presided over in a special federal bankruptcy court. For most other disputes, however, people can find themselves in one of two types of state courts.

**Circuit court.** Wisconsin's circuit courts are organized by county with one or more judges to hear cases, depending upon the county's population. Judges are elected for six-year terms.

Most lawsuits where the value of property or money damages exceed \$5,000 will be heard in circuit court. The major exception is landlord/tenant eviction disputes that small claims courts hear exclusively. If a case goes to trial, the factfinder may be either the judge or jury.

The court's final determination is called a judgment. A judgment usually may be appealed from the circuit court to the court of appeals. However, there is no automatic right to have the court of appeals' decision reviewed by the supreme court.

**Small claims court.** Small claims court in Wisconsin is a more informal court that settles disputes for money damages or the return of property where the claim does not exceed \$5,000. Small claims court also has exclusive jurisdiction for eviction actions and replevin actions where the original loan was for less than \$25,000, pursuant to the Wisconsin Consumer Act.

To begin an action in small claims court costs much less than in circuit court. The average filing fee is around \$54 and can be added to the amount due you if you win the case. A court date will be set where both parties must appear in order to protect their rights in the case.

Sometimes the judge will try to set an informal conference between the parties to review the facts of the case. Many small claims court cases are settled at these informal conferences. If the case does go to trial, you may want to hire a lawyer to help prepare your case. This is

not a requirement and the judge will not expect you to act like a lawyer if you appear without one at the trial. However, certain legal rules and procedures still apply in small claims court. The judge will expect you to bring forward your side of the story in a straightforward manner. You should bring any witnesses or documents that are evidence for your side.

Winning a judgment does not mean you will ever get to collect the money owed you. You may have to start a garnishment action, put a judgment lien on property or obtain the services of the sheriff in trying to collect on the judgment. If someone wins a judgment against you, you will want to consult a lawyer on your exemption rights or other means to successfully avoid collection, or make a settlement on the judgment.

## **Basics of Security Law**

### **Nature of a Security Interest**

Basic to farm lending in Wisconsin and all other states is the security interest (formerly called "chattel mortgage") in farm personal property. When you give a bank or other creditor a security interest in farm personal property such as livestock, machinery, crops, or feed to contract rights (such as payments due for milk sold), you give the creditor the right to assemble and sell the collateral and apply the proceeds to your debts due the creditor if you default on any of your obligations to the creditor.

A default is a failure to live up to your part of the deal, such as not making payments when due or failing to keep as much collateral as the loan documents require. Your rights and the rights of your creditors holding security interests in personal property are governed by the loan documents and by chapter 409 of the Wisconsin Statutes. In the case of most agricultural loans of \$25,000 or less, the Wisconsin Consumer Act, chapters 421 through 428 of the Wisconsin Statutes, provides you with greater rights and the creditor with more responsibilities and duties than apply to larger loans.

Some farm debts are secured by both a real estate mortgage and a personal property security interest; in the event of a default, your rights and the lender's rights are complex and depend upon the particular circumstances of the case.

### **Creation of Security Interests**

You create a security interest in your personal property when the creditor has given value (usually by either making a cash loan or by selling property on credit to you) and you have signed a security agreement describing the collateral at least in general terms. In lieu of having you sign a security agreement, the creditor may take possession of the collateral, but that almost is never done in secured loans where farm property is involved. If the collateral includes fixtures (personal property which is or becomes attached to real estate) or growing crops, the security agreement must contain a description of the land upon which the fixtures are located or the crops are growing.

Once a valid security interest is created, you and the creditor have all the rights and duties spelled out in the security agreement and in the statutes.

In the case of loans from certain agencies of the United States government, such as the Farmers Home Administration and Commodity Credit Corporation, further rights and duties under federal law also are involved, but will not be specifically covered here.

The security agreement is one of the most important loan documents you sign. It should be discussed in detail and its terms should be negotiated with forethought. You should retain a copy for your records and refer to it when appropriate.

### **Rights of the Secured Lender Against Other Secured Lenders**

What if you give one lender a security interest in some or all of the same property after you've given another lender a security interest in some or all of your farm personal property? Which lender has first right to the property in the event of a default?

The law provides a system of public notice of security interests. A lender gives notice to the entire public by filing a financing statement in the appropriate public office giving your name and address, the lender's name and address and a general description of the property in which it has a security interest. In the case of farm property, the appropriate office is generally the Register of Deeds Office in the county of your residence. In the case of growing crops and property, which becomes permanently attached to real estate, the real estate also must be described in the financing statement.

Generally speaking, where the interests of two creditors conflict, the first to file has first right to the secured property. The major exception is the purchase money security interest, which arises when you give a security interest to the person who sells the property to you on credit, to secure payment of all or part of the purchase price. If the seller properly takes a security interest in the property and files a financing statement in the correct place before or within 20 days after you take possession of the collateral, the seller's security interest in the property sold will have priority over other security interests in the same property, even if they are filed earlier than the seller's.

If you have given security interests to several creditors, your legal rights and those of the creditors can be complex and confusing; if questions or problems arise, your attorney should be consulted.

### **Typical Provisions of Security Agreements**

Bank loans. Bank or production credit associations (PCA) loans secured by farm personal property typically are secured by all of your livestock, machinery, feed, crops, milk, other products of livestock and contract rights such as milk checks. All your debts to the bank typically are secured, whether they arise from loans made before, at the time of or after the security agreement is signed. The security agreement

typically provides that collateral of the type described in the security agreement secures all your debts to the bank whether the collateral is "now owned or hereafter acquired" by you. For example, this means that calves not even conceived at the time the security agreement is signed become collateral for your debt to the bank as soon as they are born.

The security agreement also typically will provide that no sales of collateral are permitted except as specifically provided in the security agreement or in a separate written document signed by the bank. For example, if you are a dairy farmer, a security agreement covering all of your personal property typically will permit sales of milk (but only to one particular buyer), bull calves, cull cows and possible certain other collateral. Some lenders prohibit any livestock sales if the herd is reduced below a certain size specified in the security agreement. Typically, no machinery sales are permitted without the bank's written consent. In many instances, the specific requirements of the security agreement, such as which sales are permitted and which are not, often are ignored by both the bank and you, due to the administrative problems of getting a written release every time a healthy animal is sold or a piece of machinery is traded. This can lead to many legal problems if you default on the debt and the bank's collateral is inadequate to pay off the debt at the time it is sold. Some of these problems are dealt with later in this booklet.

Because of the typical broad scope of a bank's security interest, which "covers" most or all of your collateral, such security interests often are often called "blanket" security interests. In addition to the collateral specifically listed, blanket security agreements generally also cover "products" of the collateral (e.g., a cow's milk), and "proceeds" of sales of the collateral (e.g., the milk check or money collected for the sale of animals or machinery).

Purchase money security agreements. When a seller is a machinery or livestock dealer and takes a security agreement in a particular item of collateral sold to you to secure part or all of the purchase price, the security agreement generally will be much simpler than the blanket used by financial institutions. The property sold and its products and proceeds generally are the only property involved. As mentioned previously, the seller must file a financing statement before or within 20 days after the buyer takes possession of the property to maintain the seller's first lien, if there also is a properly filed blanket security interest to another lender at the time of the sale.

### **Secured Creditor's Rights Upon Your Default**

The statutes permit a creditor with a security interest in farm personal property to take possession of the collateral after you default on the debt, to sell the collateral at public or private sale in a commercially reasonable manner, and to apply the proceeds of the sale to the costs of sale and the debt. This can be done without a court's judgment only if you consent. If you are requested to surrender collateral voluntarily, you should get your attorney's advice before surrendering the collateral or taking any action. If the creditor cannot obtain possession of the collateral without committing a breach of the peace, the creditor must seek a court's judgment before taking possession and selling the

collateral.

If the proceeds of the sale of collateral more than cover the debt plus the selling costs, you receive the remaining funds, unless another lender has a second security interest in the collateral. If there is a deficiency, you remain liable for that amount.

Occasionally, disputes arise as to what constitutes a "commercially reasonable" sale after a repossession. You have the right to recover certain losses if the sale is ultimately found by a court to be less than commercially reasonable. The details of such disputes vary considerably from case to case and are beyond the scope of this discussion.

### **Unauthorized Sales of Personal Property Subject to a Security Agreement**

Liability of transferee. Until very recently if you sold or transferred farm property that was subject to a security interest and the transfer was not authorized in the security agreement or in some other manner, the secured creditor could sue the transferee to regain the property or its value, even though the transferee may have paid you in full for the property. The statute of limitations during which the secured creditor could pursue such an action usually is six years from the date of transfer. The transferee might be sued successfully even though the transfer was made by you regularly, such as sales of grain or other feed, heifers or breeding livestock or routine machinery trade-ins.

The buyer's only legal defense is that the secured lender somehow "authorized" the transfer, even though the security agreement involved usually would specifically prohibit such transfers without the lender's express written authorization. The issue usually arises after you liquidate and perhaps file bankruptcy, the lender still is not paid in full and the people with whom you had done business during the prior six years are the lender's best and perhaps only source for paying the debt's balance.

The equities of such disputes often favor the property's transferees. The lender would not want to handle a telephone call or written authorization every time you sold a bushel of grain, a heifer or traded some machinery. Nonetheless, some banks and production credit associations have attempted to collect the balance of their debts from farmers who have liquidated in the manner described above. These attempts have met with limited success, depending upon the case.

The Wisconsin Legislature has made several attempts to modify this law that deals with sales of farm products, but none has passed. The same problem was going on nationwide, and in response to it the United States Congress enacted federal law on the subject as a part of the Food Security Act of 1985, which went into effect on Dec. 24, 1986. The federal law provides that a buyer of farm products is free and clear of any security interest in the property unless the security holder actually notified the particular buyer in writing of its security interest within one year prior to the transaction. Simply filing a financing statement at the Register of Deed's Office no longer permits the secured party to pursue the buyer of farm products. Various civil and criminal penalties were enacted to protect lenders; you can be penalized

the greater of 15 percent of the value of the farm products sold or \$5,000 for unauthorized sales, but the purchaser is in the clear if no actual notice is given to him by the lender within one year prior to the sale.

The actual notice provision does not apply in states that have a certain type of central filing system, but as yet Wisconsin has no such system.

However, the new federal law applies only to "farm products," which does not include farm machinery and equipment. Farmers and machinery dealers still must be wary of filed financing statements, even if no actual notice is given. Farm products include just about everything that is raised or grown on the farm and everything produced by or from crops or livestock.

Criminal and civil liability of farmer. If you transfer or conceal secured property without the lender's permission, or refuse to pay the proceeds of such a sale to the lender, you can be convicted of a felony if the transfer was done with intent to defraud. Possible penalties include a fine of up to \$10,000 or imprisonment of up to two years, or both. This criminal provision of the Wisconsin Statutes frequently is not invoked because of the requirement of intent to defraud, but such cases occasionally are prosecuted.

Furthermore, if you transfer property subject to a security interest without the creditor's consent you continue to be liable on the debt and may have difficulty obtaining a discharge of such debts in bankruptcy if unauthorized transfers have been made.

### **Obligation of Good Faith; Fiduciary Duties of Lender**

The law imposes a duty of good faith in the performance of each contract by a secured lender and you. The obligation applies to the lender as well as yourself.

The obligation of good faith becomes difficult to apply when the actual customary dealing between you and the lender does not conform to the written loan documents, particularly the security agreement, as is very often the case. The two of you may come to a whole series of oral agreements during many years, none of which is contemplated by the literal terms of the security agreement. Should the relationship go sour, the lender may pull back to the literal words of the security agreement. Whether such belated reliance on the security agreement violates the lender's obligation of good faith is the topic of numerous court cases throughout the farm belt in recent years, and it is impossible to give any general answers because the circumstances vary considerably from case to case.

Some security agreements used by farm lenders give the lender almost dictatorial power over your business. In such circumstances courts have sometimes found the lender has what is known as a fiduciary duty to you; this means the lender must put your legitimate interests ahead of its own. A fiduciary relationship does not arise from every relationship between you and your lender, but it may be found if the lender's powers over you are great enough.

You have the obligation of good faith toward the lender also, and may be found to have breached that obligation as well as the literal security agreement if you do not make reasonable efforts to follow through with his/her obligations regarding the collateral and loan.

In this era of low commodity prices and high farm debt, the exact boundaries of the farmers and lenders' legal duties are becoming more clear, but there are many gray areas in almost any farmer/lender relationship. The obligation of good faith should be uppermost in the minds of you and the lender as you try to work through these difficult times.

## **Unsecured Debts**

Unsecured debts often create a dilemma for farmers. Most farmers have both secured and unsecured debts. The secured debt generally is with institutional lenders who carefully and completely protect their interests. However, the unsecured debt may be incurred over coffee at the local cafe with a neighboring farmer or the town's co-op manager.

Thus, the farmer may wish to pay the local-based unsecured debt while deferring or contesting payments to the secured creditors. At the other extreme are those unsecured creditors who hold questionable claims and yet relentlessly pursue the farmer demanding payment.

Familiarity with the major concepts regarding unsecured debts and collection steps will help farmers deal with both extremes. For purposes of this discussion, it is presumed the creditor is a "merchant" who regularly deals in property, services, money or credit.

### **Incurring an Unsecured Debt**

Unsecured debts can come into existence as the result of a written or an oral agreement. While business in the agricultural sector historically has been done on a handshake basis, misunderstandings are common with oral agreements. When significant purchases are being made, or sums of money exchanged, a written document should be prepared regardless of the relationship of the parties.

Creditors are limited regarding the amount of interest they can charge on an account when there is no written agreement or promissory note stating an interest rate. Farmers can take legal steps to have an excessive rate lowered, reduce the total amount that must be paid on the account or raise such improper rate as a defense in a collection action.

Under Wisconsin's marital property law most debts incurred by a farmer will be a joint obligation with the farmer's spouse regardless of who actually contracted for the debt or whose name appears on any written documents. Under the act any debt incurred for a family purpose is a marital debt. The "family purpose" concept is broadly construed, and since most farm debts eventually accrue to the farm family's benefit, such debts generally will be marital debts.

If collection efforts are pursued, and the nonfarm spouse has an

off-the-farm job, such nonfarm income also may be subject to seizure, in whole or in part, by the creditor.

### **Default**

Before a merchant can commence formal collection attempts, the farmer must first default on the obligation. Default is a technical term defined by the Wisconsin Consumer Code and depends upon the nature of the under-lying obligation.

If a single payment is scheduled, a default occurs if the obligation remains unpaid 40 days after the due date.

When the debt is part of an open-end plan, such as a credit card account, a default occurs when payments are not made when due at two separate times during any 12-month period.

If the transaction is not an open-end plan and payments are scheduled at intervals of two months or less, a default occurs when the farmer fails to pay any installment within 40 days of the due date. When the interval between payments is more than two months and one payment is missed for more than 60 days a default occurs.

Once a default has occurred the farmer must be given a notice of default and given the right to cure the default by paying within 15 days all of the past due installments. Sending only partial payments will be insufficient to prevent further action if the merchant wishes to proceed after proper notice is given. If the default is not cured the creditor can demand payment in full and commence a law suit.

When the creditor is not a merchant or if a farm corporation or partnership incurs the debt rather than an individual farmer, then the pre-collection procedure is simpler. If payment is not made in the manner agreed, a default has occurred, and the creditor generally can start a collection action without any further notice.

### **Monetary Judgment**

The legal action a creditor takes depends upon the debt's size. If the debt is under \$5,000 the creditor can begin a small claims action, with a small claims summons and complaint, without an attorney's assistance. The summons will set a return date when the farmer must appear in court. If the farmer contests the matter on that date, the case is rescheduled. If the farmer does not appear on the return date, or at the trial, a judgment against the farmer will be entered for the amount of money requested in the complaint. Thus, it is crucial to appear at the time and location indicated on the summons.

If the debt is greater than \$5,000, then the small claims procedure is not available, and a regular civil action must be started. The civil suit procedure is complex, and the farmer/debtor should hire an attorney to fully protect the farmer's rights. It is crucial that a formal written answer to the summons and complaint be filed with the court within 20 days of service after such documents are served. Failure to answer within such time will result in a judgment against the farmer for the amount requested. Thus an attorney should be consulted as soon as

possible after papers are served. (Additional discussion of civil procedure is contained in other chapters of this handbook.)

If a judgment is entered, the judgment amount will accrue interest at 12 percent per year and if docketed, it is a lien against all real estate owned by the farmer. The judgment is valid for 10 years and can be renewed at the end of such time. Even though a creditor may have a judgment, the farm has statutory exemption rights that will protect certain assets, including the homestead up to a total equity of \$40,000 from collection action by the creditor. Other assets that are exempt include \$1,200 of equity in a motor vehicle, household goods worth \$5,000. Farm equipment, inventory and farm products are exempt up to \$7,500 for each spouse.

The exemption statutes are not a protection against collection actions by a creditor who has a legitimate secured interest in the asset that would otherwise be exempt. In addition, if a debtor attempts to convey property to someone else in an attempt to protect such property from creditors, the conveyance can be invalidated as fraud upon creditors.

### **Post-judgment Collection Steps**

Once a judgment is entered, a creditor can take steps to force payment of the judgment including execution and garnishment. The debtor is required to fill out a financial disclosure statement showing if there are any assets that may be seized to pay the debt.

In an execution, formal papers are presented to the sheriff who then determines whether there are assets to seize to satisfy the judgment. Assets that are collateral on secured loans or are covered by the exemption statutes cannot be seized, and since it is common that most of the farm assets are collateral, successful executions are fairly rare.

A judgment creditor also may start a separate garnishment action in an attempt to seize money in bank accounts, milk check payments, wages or other money sources. Another summons and complaint is required and must be served on the farmer and the party holding the money to which the farmer is entitled. As mentioned previously, under the Wisconsin Marital Property Act, a garnishment could be commenced against a farmer's spouse to seize wages even if the judgment solely is against the farmer. A marital agreement entered into between the farmer and the spouse may alter this marital obligation if executed before the debt is incurred and if the creditor is notified of the agreement prior to the debt's creation.

Many of the above procedures will be used by creditors who are unwilling to work with the farmer. However, the farmer also must exercise some caution when working with family creditors or the neighbor creditors who the farmer wants to pay. If a farmer has made the decision to file bankruptcy, any preferential payments made to creditors can be invalidated by the bankruptcy court, and the creditor can be ordered to reimburse the money paid. Attempts to transfer assets or cash "under the table" to such creditors also can result in denial of bankruptcy protection, plus potentially severe sanctions.

## **Conclusion**

When a farmer is in financial trouble, the unsecured debts may often seem less crucial than the delinquent secured debt. However, in the short term, the existence of unsecured debts can be equally troublesome for the farm operation since suppliers usually won't extend supplies or services if there are unpaid bills. In this age of declining prices and land values, and increasing costs, more care must be taken when incurring debt or resolving delinquent obligations. Cautious review of all obligations and a vigorous defense of rights will need to be part of the present farmer's perspective.

## **The Wisconsin Consumer Act**

In 1971 the Wisconsin Legislature enacted the Wisconsin Consumer Act. This law regulates consumer credit transactions and thereby protects both consumers and merchants. The law applies to persons who obtain goods or services for a personal, family, household or agricultural purpose.

The Wisconsin Consumer Act is made up of several different sections. It provides protections to consumers in addition to those provided by the federal consumer protection statutes. The act regulates many different consumer transactions including: installment loans, sales and leases; consumer approval transactions (door-to-door sales); sale of credit insurance; and debt collection harassment. The law also specifies remedies and penalties for violating the act.

### **Consumer Credit Transactions**

An installment loan is a loan that you agree to repay over a period of time with fixed payments. An installment sale is similar, except the repayment agreement is for the purchase of a specific item. Consumer leases also are regulated including rent-to-own contracts.

Before you sign a repayment agreement for an installment loan or sale, the creditor must provide you with a Federal Disclosure Statement. This statement explains exactly what you will be obligated to repay. This disclosure must tell you: the loan amount; the annual percentage rate of interest you will be charged; the total amount of interest you will pay over the life of the loan; and the total number of payments, which includes the amount borrowed plus the finance charge.

The amount you actually borrow is made up of several charges. These charges may include official fees and taxes, and under some circumstances, consumer insurance. However, if the creditor assesses these additional charges in a way not permitted by the statute, the creditor may be liable to you for penalties and damages.

If you fail to make your payment within 10 days of the due date, you can be charged a delinquency charge. This charge is \$10 or 5 percent of the late installment, whichever is less.

If you cannot pay the installments as they come due, the creditor may grant you a deferral on one or more of the installments.

If the creditor grants a deferral, he/she can charge a deferral charge equal to the amount of interest due for that payment.

If you are a cosigner on a note, you are entitled to many of the same protections as the original signer. As a cosigner on a note, the creditor must either give you an exact copy of all of the papers you signed, or a notice explaining your obligations as a cosigner of the note. Remember, as a cosigner, the creditor may sue you upon default without first demanding payment by the original debtor. This is true even if you did not benefit from the transaction.

There also are other restrictions against creditors. The creditor cannot require you to pay its attorneys fees upon default (except for first lien security interests in real estate). Also, you only can be charged for actual expenses for reselling repossessed collateral.

Creditors are regulated as to what property they can take a security interest in. There are different rules for sales, leases and loans. In a consumer sale, a creditor may only take a security interest in the property sold or property attached to it; goods that were secured under a previous agreement that is now being refinanced or consolidated with the same creditor; or agricultural products and equipment. In a consumer lease, a creditor may take a security interest in the property leased.

Finally, in a consumer loan, a creditor may take a security interest in property you already own. However in a loan situation, a creditor cannot take a security interest in clothing, wedding rings, one radio and one television, stove, refrigerator and various pieces of furniture.

### **Open-end Accounts**

Open-end accounts are accounts where a creditor allows you to make purchases from time to time and then pay in full or in installments. A good example of an open-end account is a credit card account. Open-end accounts have their own special rules.

Before opening the account, you must be given certain information. You must be told when finance charges are imposed (i.e. after 30 days), the annual percentage rate, whether or not there is an annual fee charged, and what if any other fees may be charged.

If a creditor wants to change the terms of an open-end credit account, it only can be done for future charges, not existing ones. For example, a creditor cannot increase the minimum payment due or the finance charge for current balances. The creditor must give you a new notice of these terms in advance of the change.

Any debtor who has an open-end account jointly with another person may stop his/her liability for future charges by notifying the creditor in writing. You will then only be responsible for charges made before the creditor receives the notice, and any charges made for 15 days after the creditor receives the notice.

## **Consumer Approval Transactions**

Consumer approval transactions commonly are referred to as door-to-door sales. This includes sales that are made in person, or by mail away from the seller's usual place of business, and more than \$25. It does not cover catalogue sales, real estate sales, sales of items at an auction, sale or lease of goods for an agricultural purpose, or a loan made to finance the sale of items at auction for an agricultural purpose.

All transactions that do fit into the definition of a door-to-door sale give buyers certain protections. The seller must give the buyer a notice that he/she has three business days to cancel the transaction. Once you cancel the sale, the seller must, within 10 days, return any down payment or property given to him/her and release any security agreement. The buyer must take care of the property for 20 days to allow the seller time to retrieve the property. If the seller does not come and get the property, it belongs to the buyer.

## **Consumer Credit Insurance**

Consumer credit insurance only applies to insurance sold by a creditor to a debtor in relation to a consumer debt. Life and disability policies to pay off the loan are two types of consumer credit insurance. The creditor can sell this type of insurance so long as it is optional and you specifically request it. If you pay off the loan early, you are entitled to a refund of the insurance premium.

In general, the amount of the insurance cannot be more than the amount of the loan. Also, the term of the insurance should be equal to the term of the loan. The premiums and forms for this type of insurance must be approved by the commissioner of insurance.

Another type of consumer credit insurance is property insurance. A creditor may require insurance be kept on secured property, but you have the option of purchasing the insurance anywhere you choose. If insurance is required, and you purchase it directly from the creditor, it cannot be for an amount in excess of the secured property's value or for a term longer than the loan itself. If the creditor does not require property insurance, it cannot even offer to sell you the insurance unless both the amount of the loan and the value of your collateral exceed \$800.

## **Debt Collection**

The federal Fair Debt Collection Practices Act regulates only third party collectors, such as collection agencies or collection lawyers. The Wisconsin Act also regulates collection activities by the creditor itself.

There are several activities that a creditor cannot do in an effort to collect its debt. A creditor may not use or threaten to use force or violence against you, your dependents or your property. The creditor cannot threaten criminal prosecution or spread false information about your credit worthiness. A creditor may not disclose information about you to your employer (except garnishments) or to anyone else who does not have a legitimate business right to the information. A creditor may not communicate with you so often or in a way that is threatening or

harassing you. The creditor cannot use obscene or threatening language to you. The creditor cannot threaten to do an illegal act nor send a communication that looks like a legal document when it is not.

### **Conclusion**

The remedies provided in the Wisconsin Consumer Act are to be liberally administered. If you ever have problems or are sued on a consumer agreement, consult an attorney. The Wisconsin Consumer Act is a very detailed piece of legislation. It is very specific as to what creditors' and debtors' obligations are to each other. If a creditor violates your rights, he/she may be liable to you for substantial penalties. In addition to any actual damages suffered by you, you may be entitled to recover statutory penalties from the creditor of \$100 to \$1,000.

Also, any time a debtor can prove a violation of the Wisconsin Consumer Act, your attorney can recover fees directly from the creditor.

## **Basics of Landlord and Tenant Law**

Today more farmers than ever are parties to agricultural rental agreements, either as landlord or as tenant. Although the relationship essentially is contractual in nature, certain provisions in the Wisconsin Statutes can and will become part of the rental arrangement. The following discussion briefly explains the rules affecting agricultural rental arrangements.

### **Types of Rental Agreements**

Wisconsin law divides rental agreements into two categories: leases and other informal rental arrangements. Leases are oral or written agreements, transferring possession of real property, or both real and personal property.

#### **Leases**

Leases are distinguishable from other rental arrangements because they are for a definite period of time. Although oral leases for a year or less are enforceable, it is much better to have a written lease for many reasons:

Without a written agreement, a court will have to determine what the agreement between the parties was.

A written lease will help resolve disputes since the parties can refer to the written instrument when questions arise.

Certain provisions in the Wisconsin Statutes automatically become part of the oral lease, even though the parties may have agreed otherwise.

Wisconsin law requires that a lease for more than a year, or a contract to make such a lease, is not enforceable unless it is in writing and meets certain other requirements. For example, if a

landlord and a tenant enter into an oral lease for two and one-half years, but one party later decides to back out of the deal, the aggrieved party may be unable to hold the other party to that agreement because the law says the oral agreement is unenforceable.

Leases for more than a year must identify the parties, identify the land by a "reasonably definite description," set forth all material terms of the lease and state the start and end of the lease and the amount of rent or other consideration. In the farming context, a written lease also should provide for such things as taking and perfecting a security interest in crops to secure payment of the rent; terms for renewal; special provisions relating to machinery and livestock; the planting and plowing of the lands; improvements and repairs to be undertaken by the parties; the farming methods to be used; the treatment of timber, gravel pits and fruit that may be on the land; what ought happen in the event of floods, fire or drought; and on what conditions the lease will be terminated prior to its expiration. Several of these provisions are discussed below. A written lease is essential when the compensation method is anything other than a straight-cash arrangement.

### **Lease Provisions Unique to Farming**

Farm leases can be divided into two categories, the straight-cash and the crop-share lease.

**Straight-cash arrangements.** The straight-cash lease calls for periodic cash payments. Such a lease, however, also should contain many provisions that are unique to farming.

**Good husbandry provision.** This provision requires the tenant to farm the premises in a manner consistent with reasonable farming expectations in the community. A tenant who fails to farm in such a reasonable manner may become liable to the landlord for any damages resulting from this failure. Even in the absence of an express good husbandry provision in the lease, a court may hold that this provision is implied in any agricultural landlord-tenant relationship.

**Improvements clause.** This clause should set forth the improvements the tenant is responsible for. It also should state the landlord's responsibility for supplying any needed materials for improvements. If the tenant anticipates making any major improvements during the term of the lease, the lease should discuss whether the tenant will receive any compensation for the improvements. In the absence of such a provision, the tenant generally will be unable to recover the costs of improvements.

**Growing crops.** This clause typically provides that the landlord will obtain a security interest in the crops to assure payment of rent. In order to protect the landlord's security interest in the crops, the tenant must sign a "security agreement" and a "financing statement." The landlord then must file that financing statement in the county of the tenant's residence as well as in the county where the crops are grown. If landlords do not take these steps, they generally will have no legal right to the crops, nor will

they have the right to interfere with the tenant's harvesting and use of the crops.

The farmer-tenant should be aware that some preprinted form leases grant the landlord the right to seize and sell a tenant's property. Such a provision is contrary to Wisconsin statutory law. Because a lease relationship is contractual in nature, however, such a provision may be upheld by a court.

Crop-share leases. Share leases hold several advantages over straight-cash arrangements. These advantages benefit the tenant and the landlord.

The crop-share lease apportions crop returns between the landlord and tenant. The most important advantage of the crop-share lease is that it takes into account variations in price and production. This protects the tenant against sharp decreases in prices or production and allows the landlord to share in increased profits during economic upswings. The crop-share lease also provides for uniform returns over different types of crops, thereby taking into account variations in output. The main disadvantage of the crop-share lease is crop delivery disputes between the tenant and the landlord. The share lease can be used for livestock, dairy and grain.

Traditionally, crop-share leases provided for a 50 percent-50 percent return between the tenant and the landlord. Because of the increasing complexity of farm operations, however, this division is no longer strictly adhered to. In order to arrive at an equitable distribution, many factors should be considered. For example, the parties should consider the application of weed control measures and lime or corrective fertilizer. The tenant and landlord should decide who will provide the necessary inputs for crop production.

Other inputs to negotiate include: 1) grain harvesting and handling changes; 2) irrigation costs; and 3) livestock facilities. The parties also should discuss whether they will divide the benefits resulting from government-support programs.

In determining a fair return to the landlord and the tenant under a crop-share lease, take into account the anticipated inputs contributed by each party. Often, only fixed costs are considered in this calculation; to arrive at a truly equitable determination, however, variable costs such as repairs, fuel and fertilizer, also should be considered.

In calculating the contributions of landlord and tenant, the use of a worksheet is particularly helpful. (The University of Wisconsin Agricultural Extension has included sample worksheets as well as other helpful information in its publication No. A2852.) The worksheet should include the landlord's contributions such as land and buildings, taking into account depreciation and taxes; the tenant's contribution of labor; and the contributions of each with respect to management, machinery, variable costs and the various improvements outlined earlier in this chapter. The landlord's and tenant's contributions are then divided by total contributions to arrive at a percentage, representing the return each should realize from the farm's output.

Absent an express agreement on the division of livestock, Wisconsin courts generally award any increase in livestock numbers to the tenant at the end of the leasehold. Crops to be grown and any agreed rotation patterns should be included in the lease agreement.

Remember that the final agreement constitutes a binding contract.

### **Informal Rental Arrangements**

What happens if the parties don't have a valid, written lease stating the duration of the tenancy? In these instances, the law usually will classify the tenancy either as a "periodic tenancy" or a "tenancy-at-will."

Periodic tenancies. A periodic tenancy is one in which rent is payable at regular intervals. If the tenant rents property and agrees to pay rent by the month, but there is no agreement to stay for any definite period, the tenant would be a tenant from month-to-month.

Perhaps more common to agricultural rentals is the situation where there is tenancy under an invalid lease, such as where the parties have agreed orally to a lease for more than a year or where the written lease fails to comply with Wisconsin law. In the case of agricultural use, the tenant becomes a year-to-year tenant without regard to the rent payment periods. The landlord and tenant are stuck with one another for an entire year, and the tenancy can be terminated only upon 90 days notice given before the end of the year. This situation, perhaps more than any other, highlights the importance of having a valid written lease.

A periodic tenancy also arises when a tenant under a lease "holds over" (that is, fails to move out of the premises) after the lease expires. The landlord then can elect to hold the tenant as a periodic tenant or evict the tenant. The acceptance of rent from the "holdover" tenant normally will be regarded as an election by the landlord to hold a tenant to a periodic tenancy. If the premises were leased for a year or more for agricultural use, the lease will be renewed on a year-to-year basis, binding the landlord and tenant by the terms of the lease as if it had been extended for a year. The arrangement then can be terminated only at the end of the year and only after 90 days prior notice.

A periodic tenancy does not end with the death of a party. Unless the tenancy is a year-to-year, periodic tenancies are not assignable by the tenant.

Tenancies-at-will. A tenancy-at-will is one where a person is in possession without any definite agreement for regular payment of rent. An example of a tenancy-at-will would be where a father permitted his son to take possession of the farm, and the son made payments as he could on the underlying mortgage. Such a tenancy is nontransferable and ends with the death of either party.

### **Rights and Duties of the Parties Where No Written Agreement Exists**

The Wisconsin Statutes set forth certain provisions that govern the landlord's rights and duties in the event the premises are damaged by fire, water or other casualty, which is not the result of the landlord's

negligence or intentional act.

If the premises are damaged (by any means) by the tenant's negligence or improper use, it is the tenant's duty to repair the damage and restore the premises. The law requires the tenant to keep the premises, machinery and equipment furnished in reasonable working order if the repairs can be made at a cost that is minor in relation to the rent.

The law also allows a tenant to leave the premises if it becomes unlivable because of damage by fire, water or other casualty, other conditions hazardous to the tenant's health, or if there is a substantial violation of the landlord's duties materially affecting the health or safety of the tenant, unless the landlord promptly proceeds to repair, rebuild or eliminate the health or safety hazard. In addition, the tenant may leave if the nature and period of repair, rebuilding or elimination of health or safety hazards causes tenant undue hardship. If the tenant remains in possession, the rent is reduced to the extent the tenant is deprived of the full normal use of the premises. If the tenant justifiably moves out under these provisions, the tenant is not liable for rent after the premises became unlivable. In addition, the landlord must repay any rent paid in advance apportionable to the period after the premises became unlivable.

Generally, the landlord should purchase insurance to protect against accidental loss of buildings and machinery provided by the landlord. The landlord also should purchase personal liability insurance to protect against persons who might bring suit for accidents that occur on the premises. The tenant should acquire insurance against loss of personal belongings and his own machinery and livestock. The tenant also may want to purchase personal liability insurance.

The law prohibits the tenant from making any physical changes to the premises, including removing, altering or adding to the structures thereon, without the landlord's prior consent. The tenant cannot use the premises for any unlawful purpose.

At the termination of the tenancy, the law allows tenants to remove any fixtures installed by them if they restore the premises to its prior condition or pay the landlord the cost of such restoration.

Wisconsin law requires the landlord to make necessary repairs, unless the repairs are due to the tenant's negligence or improper use of the premises. The landlord must:

- keep in reasonable repair those portions of the premises over which the landlord maintains control;

- keep in reasonable repair all equipment under the landlord's control necessary to supply services that the landlord has expressly or impliedly agreed to furnish to the tenant; and

- make all necessary structural repairs and to undertake major repairs or replacements of any machinery or equipment furnished with the premises and no longer in reasonable working condition. If the parties desire a different allocation of responsibilities, a written lease should be drafted.

## **Termination of Informal Rental Agreements**

In the absence of a written contract, the Wisconsin Statutes will govern the notice necessary to terminate tenancies for failure to pay rent or for other breaches by the tenant. Consult a lawyer for an in-depth explanation of rights and remedies under these provisions.

Periodic tenancies and tenancies-at-will have no definite termination date. Such tenancies can be terminated by either the landlord or the tenant by giving to the other party written notice complying with certain statutory requirements unless:

The parties have agreed expressly upon another method of termination, and such agreement is established by clear and convincing proof;

Termination has been accepted by the landlord; or

A periodic tenant vacates the premises.

## **Conclusion**

Under the rental arrangement, a tenant actually acquires the right to use the landlord's land, buildings and possibly equipment for a period of time. Because of potential for disagreement, the rental arrangement should be approached with the same degree of seriousness as a purchase of land. A written agreement defining the responsibilities of the landlord and tenant will force the parties to consider what is fair and serve to avoid future disputes.

## **Negotiations**

Negotiation is a process and implies several things: both parties must be willing to meet, talk and work toward a compromise. This implies you are willing to make an effort to talk, work together and give something up.

There are no hard and fast rules in negotiating; anything the parties agree on is fine. You begin the process by working together to solve a problem. Do not play the "blame game": the banker did not reduce the price of milk. In order to try and work out a solution, you must assume some responsibility for the problem, no matter how many factors caused it.

Before negotiating, several things are necessary. All parties must have an understanding of each other's positions, their respective rights and responsibilities, the legal process and a good feel for what they have to win and lose. Armed with this information you negotiate effectively.

Lenders are in the business of lending money and collecting interest; they do not want to own farms. Lenders want to collect money. When payments fall off or cease, especially if the borrower hasn't given them a reason why, the lenders get scared. Without payments coming in, they must look to their security as a source of cash. While most lenders have

some flexibility and can wait for a while, they can't wait very long. Banks are responsible to their shareholders and depositors because it was the depositor's money that was loaned out. Federal and state examiners also play a role. They review loans and can demand the lender take action to collect the debt. All of us are accountable to someone else. The lender can no more sit and wait for you to make a payment than you can wait for a cow to decide to produce milk.

Equality of knowledge is important. If letters have arrived demanding payment in full and you aren't sure what happens next or when you must move, it is a good time to start negotiating. The lender knows the farm probably won't be up for sale for at least 14 months so they are in a position to want to negotiate.

Call your lender to set up a meeting. When you go to the meeting, be prepared for it. Take with you a current cash flow statement, current appraisals, if you have them, accurate production records and a cash flow projection for the upcoming year. If you have a reasonable plan, bring it along and be prepared to defend it. A lender will be favorably impressed if you do this; but it must be workable. You can't reasonably expect a lender to go without payments for a year, but the lender might accept interest at a reduced rate. If you expect a secured lender to make a concession like this don't treat unsecured lenders (your gas supplier) any better. Your lender may want more control or strings on your checkbook. There is a hidden message in these conditions. It is based on the lenders' assumption that farmers facing foreclosure haven't managed their cash flow well and the lenders want them to. Therefore, a lender may ask for financial information they think you need, even if they don't.

Negotiation is a method of settling disagreements. Once you have reached an agreement, put it in writing. If it appears negotiations are going nowhere, then it is time to look at some of the alternatives discussed elsewhere in this booklet. Once your agreement is in writing, have an attorney look at it and review it with you. Do not sign anything before your lawyer has reviewed it.

Some people may not feel comfortable negotiating themselves, especially if they don't understand the potential consequences or feel they don't have enough knowledge. If this is the case, you can use a lawyer to negotiate for you. A good lawyer is skilled at negotiating and can do it if you are uncomfortable.

Negotiation is the process of seeking a mutually satisfactory solution to your mutual problems; it takes agreement from both sides. If done well, the solutions are generally far more successful and tolerable than legal battles. If negotiations are successful, everyone stands to gain, everyone will save time, money and aggravation. It is an alternative worth pursuing and if it doesn't work you haven't lost anything except your time. So in general, you stand to win far more than you can lose through negotiations.

## **Working with a Lawyer**

Choosing a lawyer is an important decision for anyone who may be experiencing some type of financial problem. For farmers this is particularly true because farming is a complex business that also may involve the home and, often, extended family. In many ways, choosing a lawyer is similar to deciding on a variety of corn to plant. Each is different in what it will yield and the quality of its output. Some produce as they promise, some just promise without delivering and some aren't worth the price. However, having the right lawyer for your needs is just as important as having the proper variety of corn.

### **When to See a Lawyer**

In general, you should talk to a lawyer in two types of credit situations. Whenever you are putting together an agreement that may affect your legal rights or require some obligation on your part, you should understand what you are signing and make sure it says what you want it to say. A lawyer can help you understand the meaning of the language in the agreement and can help protect your rights. It is cheaper and easier to have a lawyer protect you before you sign an agreement rather than after you sign!

When you have problems meeting your credit obligations, a lawyer can help you sort out what your legal rights and responsibilities are. Ignoring the problem won't make it go away. The longer you wait to seek help, the fewer choices you may have for you and your family's future.

Some nonlawyers represent that they can help you with your problems. They may tell you that they are cheaper than a lawyer or that you have "rights" that lawyers won't tell you about or won't work with you in asserting. Be very careful before you agree to let such people help you. A good advisor usually will tell you that you need to work with a lawyer to protect your legal rights. You also may find that no court will honor those rights that the advisor claims you have.

Creditors also may tell you that you don't need to involve a lawyer in your dealings. They may tell you that lawyers just complicate things and cost a lot of money. Remember that the creditor's interests and yours are not the same. You may believe the paper they asked you to sign will protect you until you have a disagreement. Then you may discover the paper only protects the creditor. This doesn't mean that all creditors are trying to hurt you, but they are in the business of looking out for their own interests. An honest creditor is not afraid of having you represented by a lawyer.

If you are not sure whether you need to talk to a lawyer, two services are available to help you. The Farm Crisis Hotline (800-942-2474) provides confidential information and referrals for farmers. A lawyer is available on the Hotline to answer general legal questions. The Hotline has a list of lawyers who have volunteered to answer questions at little or no cost for the first consultation with farmers. Also, the State Bar sponsors a Lawyer Referral Service (800-362-9082) for answering basic legal questions and can refer you to a lawyer in your area who works on cases similar to yours, if you need further assistance.

## **Selecting a Lawyer**

Once you have decided you need legal assistance, the next step is selecting a lawyer. The most common way of finding a lawyer is to ask for recommendations from family members, friends and other people whose opinion you respect. Use the referral services to help you. However, none of these methods can guarantee you'll have a lawyer who is competent with the problems you'll bring to them or be a person you believe you can trust.

You'll have to do some work yourself in order to find the lawyer you're most comfortable with. Remember, your lawyer may become part of your life and you must believe that he/she will protect your privacy and really listen to your concerns. They may be going through all your financial papers, advising you and representing you at times that are critical to your farming operation. You must be able to trust your attorney so pay attention to your feelings about this person.

You should start by making an appointment for a first consultation. This is the time to get as much information as possible so you can make an informed decision on whether to hire this lawyer to represent you. Remember you do not have to hire the first lawyer you talk to! You are hiring this person to work for you so don't be afraid to ask questions. Write down questions you have ahead of time so you won't forget to ask them. Always bring a pad of paper to take notes for your own benefit.

You should ask the lawyer if he or she has experience helping farmers. Farming is a complicated business and lawyers need to really understand this before trying to represent a farmer. They should be willing to give you names of other clients as references. You should ask them to put you in touch with other farm clients. Call these people to find out if they were satisfied with the lawyer's work. You also may want to ask whether the lawyer consults with other lawyers who are experienced in farm law. A good lawyer will be honest and tell you he/she may not have all the answers. Be wary of the lawyer who acts as if he/she has all the answers.

You may want to ask if the lawyer if he/she represents creditors as well as farmers. Particularly in smaller communities, lawyers may do work for farm creditors. If the lawyer represents one of your creditors, it is likely to be a conflict of interest for the lawyer to represent you. The lawyer should explain this conflict to you and not get involved with your case any further. However, just because a lawyer does work for other creditors doesn't mean they cannot represent farmers fairly. In fact, having a lawyer who understands creditors and their strategies may prove to be very helpful when representing you, the farmer. But you must make the decision whether you are comfortable with this lawyer.

## **The Cost of Legal Services**

You should always discuss with your lawyer what the charges are for their services. In credit situations, lawyers usually charge either an hourly rate, billing you for the amount of time spent on your case, or use a flat charge. They may require you to pay an amount of money, called

a retainer fee, before beginning work on your case. The retainer fee pays for at least the first part of the services your lawyer performs. Generally, if you expect your case to be fairly straightforward, the hourly charges will be a better deal. If you expect a battle with your creditors, a flat rate may be better but lawyers also know this and may set the rate higher to cover the unexpected.

Lawyers should explain to you how they set their fees for a particular case. Ask them if there are cheaper alternatives to explore. If they are unwilling to do so, you may want to find another lawyer. However, lawyers may not be able to predict how expensive a case may become if they have to deal with complications. You should ask your lawyer to periodically review your options and the costs with you if the case takes unexpected turns.

### **What You Can Expect From a Lawyer**

Lawyers were not born in three-piece suits with all the answers to your questions. They don't have a crystal ball that will predict exactly what will happen in your case. They also don't have a magic wand that will give you the price of milk, perfect weather, good yields or the cash flow you need. But they do have the skills to handle paperwork from wills to leases. They know a variety of legal procedures from real estate purchases to foreclosures. They know the courtroom procedures and rules. Often, they can serve as a resource on where to look for assistance.

Part of a lawyer's livelihood is working out problems by negotiations. There is a chapter on negotiations in this booklet and you may wish to hire a lawyer to assist you in this process. They have handled negotiations before and can give you an idea of what to expect. They may have dealt with your creditors before and may know their attitudes and what approaches may work in finding resolutions to your problems. If you are handling negotiations yourself, a lawyer can assist you as a source of information and help prepare you for the creditor's questions and negotiating strategy.

You can expect and should demand certain things from your lawyer.

- 1.They should return your phone calls. If they are too busy to do that, they may be too busy to handle your case properly.
- 2.They should send you copies of all correspondence pertaining to your case and keep you informed of any progress. They should consult with you on all agreements made on your behalf.
- 3.They should keep you regularly informed of work they have performed and billing for that work.

### **What a Lawyer Can Expect From You**

While this booklet has emphasized what to look for in a lawyer you can trust, that trust must run both ways. A lawyer cannot help you very much unless you also follow some rules.

When going to see a lawyer, you should bring in all available papers

about your credit situation. These will include:

1. Financial statements and cash flow projections.
2. Your farm and home plan if you're an FmHA borrower.
3. Tax returns for the past three years.
4. Documents of indebtedness, including: a) promissory notes; b) CCC agreements; c) installment sales agreements; d) accounts payable; e) stated accounts; f) judgments; g) liens; and h) contracts.
5. Documents of ownership and security, including: a) titles; b) deeds; c) mortgages; d) trust deeds; e) contracts; f) financing statements/security agreements; and g) leases.

You need to be honest with lawyers. You have to let them know about all your credit dealings and what actions you have taken about your property that may involve a creditor. If you can't do that, you might as well not hire this person to try and represent your interests because he/she can't do an effective job without all the information. Don't hold back because you think it may not be important; let the lawyer decide whether the information is important.

If you are negotiating directly with your creditors, keep in touch with your lawyer. You want to plan strategies together so you make sure you are working in tandem and not at cross purposes with each other.

### **If You're Dissatisfied With Your Lawyer**

Even if you do everything suggested, you still may be dissatisfied with your lawyer. Start by talking with your lawyer. It may be a problem with communication that can be cleared up by discussing the problem. If you are concerned about the advice the lawyer is giving you, you may want to get a second opinion. A reputable lawyer is not offended if you tell him/her that you wish to consult someone else. If you are still unhappy, look for a different lawyer.

You hired the lawyer, you can also fire him/her.

If you still have a serious disagreement with your lawyer about the fee you are being charged, you may want to submit your dispute to the State Bar of Wisconsin for arbitration. You should know that this service is voluntary; a lawyer cannot be compelled to participate. However, if you were referred to a lawyer by the State Bar Lawyer Referral Service, the lawyer must agree to arbitration if there is a fee dispute.

For information on this program, please write to: State Bar of Wisconsin, P.O. Box 7158, Madison, WI 53707-7158, (608) 257-3838.

If you find yourself seriously questioning your lawyer's conduct in representing you, the Board of Attorneys Professional Responsibility investigates grievances against lawyers. If you believe your lawyer engaged in unethical conduct and you cannot clear up the matter with

the lawyer, you should file a grievance. The grievance must be in writing and addressed to the board. Although no special form is necessary, an optional form may be provided by the board. The board puts out a pamphlet that explains in greater detail the service that it provides.

For information on this program, please write to: Board of Attorneys Professional Responsibility, Suite 410, 110 E. Main St., Madison, WI 53703, (608) 267-7274.

Finally, you should remember that lawyers are human. You can't expect them to be perfect, although they should be willing to admit if they made a mistake and should try to correct the mistake to the best of their ability. At the same time, you should remember that they can't perform miracles. They have to deal with the laws as they're written, creditors who may not negotiate and judges who may not side with you. But with these suggestions, you may find a lawyer you can trust, where you both listen to each other and work together to find some answers to your problems.

### **Basics of Farm Foreclosure**

Foreclosure is a legal action brought by a creditor to obtain a judgment and sale of real property to satisfy a debt. Foreclosure actions are not simple legal actions and no one should attempt to handle one without legal advice. Do not ignore the process or try to solve it by deeding the property back to the lender without legal advice. You could end up owing a substantial amount of taxes and you may waive legal defenses that would have prevented the foreclosure action. Contact an attorney!

Before the lender begins the foreclosure process, they may contact you with a letter demanding that you must "cure your default." This means you must pay the amount you are behind within a certain amount of time. Otherwise, the creditor will accelerate the note and mortgage, meaning that they will demand the entire debt due. You may stop the acceleration by paying the amount due or it might be possible to contact the creditor to begin negotiations. You may want to seek the advice of a lawyer.

The creditor will begin the foreclosure action by filing a summons and complaint with the court and delivering these documents to you. After you have been served with the summons and complaint, you have 45 days to file a response, called an answer, with the court. If you do not respond within 45 days, you may be found in default and lose your rights to protect your property. Additionally, you may be monetarily responsible for a deficiency judgment above and beyond the value of your property. Contact an attorney as soon as possible so they can study your papers and research the options available to you.

The creditor may ask for the appointment of a receiver, usually a bank officer, although the debtor may object to the appointment of a particular person for a justifiable reason. The receiver's job is to maximize the income from the real estate during the redemption period, which is explained below. The receiver may rent out the land and buildings but, in all but the most rare case, not the house. If you wish to

continue using the land and buildings, you may have to rent them from the receiver. Additionally, foreclosure actions sometimes are accompanied by restraining orders limiting your ability to use or dispose of your property. In these instances, the action usually involves not only the land but possibly the crops, timber, livestock, equipment or fixtures on the land. You must read these documents closely and discuss them fully with your lawyer. Be sure you are aware of what is going on in your case.

When going to see your attorney, bring all your lending papers and any correspondence between you and the creditor. This will make the case more manageable for your lawyer and may reveal possible defenses to the foreclosure. Do not panic or act hastily.

Patience is the word in the civil court system. Foreclosures are lengthy lawsuits and, for that reason, creditors often will negotiate acceptable resolutions. Discuss this possibility with your lawyer.

Your attorney will assert your defenses, if any, for you at the trial. If, after a trial, a foreclosure judgment is entered against you, a redemption period begins. No one else may obtain clear title to your property during this time. During the redemption period, you may free the property from the judgment by paying the amount of your debt, accrued interest and costs to the court by obtaining financing from other sources. It may be possible to negotiate a lesser amount that the creditor will agree to take for refinancing. It also is possible prior to judgment or during the redemption period for you to choose other remedies available through federal bankruptcy law (discussed in other parts of this guide). These options may enable you to keep parts of your property or restructure your debts and should be discussed with your attorney.

How long a redemption period you are granted will depend upon the creditor involved. If the creditor is a regular lending institution, such as a bank or farm credit services, you usually will have a one-year redemption period, as required by state law. FSA (formerly FmHA) usually sues in federal district court where they are routinely requesting and getting a two-month redemption period. However, if the court determines that you have abandoned the property, the redemption period is shortened to two months.

This determination might be made if you do not answer the summons and complaint. The period also may be shortened to six months if the creditor waives its right to a deficiency judgment on parcels of 20 acres or less.

If the creditor is a land contract seller, your redemption period may be as short as two months. The time period is set by the court when the creditor receives the judgment. It may be possible for a land contract seller to ask for a strict foreclosure.

This means that buyers will waive their right to a redemption period and, in return, sellers will agree to waive their right to any deficiency judgment and obtain title to the land immediately.

If you cannot redeem your land, are unable to work out a compromise with your creditor or do not file for protection in the bankruptcy courts,

then your land will be sold at a sheriff's sale. The sheriff's sale will occur after notice is given to the public and to you, as required by state law. You may bid on the land and it will be sold to the highest bidder. Generally, the creditor will bid either the amount it is owed or the amount from a current appraisal, whichever is less, to ensure the property is sold for a reasonable price.

The debtor also may request that the property be sold in parcels if the creditor is owed less than the total value of the property.

However, the creditor can object by saying that the property cannot be sold in this way without injuring its interests in the property. You also should remember that the homestead exemption, discussed in the chapter 7 bankruptcy section, only is available if the debtor has equity in the property.

After the sheriff's sale, a confirmation hearing will be held in court. At this hearing a debtor can object to the amount bid, usually if the only bidder is the creditor. If the judge believes that the bid is so low as to "be shocking to the judicial conscience," the judge can order the property to go back to sale or reduce the deficiency. A deficiency is the difference between what you owe and what was bid for the property at sale. This deficiency becomes an unsecured judgment debt which can be collected by the creditor against other property which you own.

Usually, at the confirmation hearing the receiver will give an account of the income collected on the property during the redemption period minus the expenses the receiver incurred in caring for the property. The balance will be subtracted from the amount you owe.

Once the property is sold and the sale is confirmed, you must vacate the premises, absent some agreement with the buyer. If you do not leave, the sheriff will forcibly remove you with a writ of restitution. This should be avoided.

It is possible at any time during a foreclosure action to reach a compromise. These foreclosure actions are long and costly for the lender, too. They usually are willing to negotiate an acceptable deal for all parties. You need to keep a clear mind and be fully advised of all your options. With this in mind and with trained legal help, the best results may be obtained from a bad situation.

## **Replevin**

An action in replevin is one that is brought by an individual, known as a plaintiff or claimant, for the return of personal property they believe was wrongfully detained or taken from them.

The typical situation in which replevin is sought is when a debtor is in default on payments and the creditor seeks return of the collateral securing the debt.

There are two important aspects of the definition for replevin that must be met in order for a creditor to have that remedy available. First, the creditor must feel that they have a right to the possession of certain

property, and secondly, the property must be personal property. For example, if you are holding machinery, livestock, crops, vehicles, equipment or other chattels that are not permanent fixtures to the real estate that a creditor feels belong to them, then the creditors can use the replevin action to try and gain their possession.

Before beginning an action in replevin, a creditor may approach you and demand that you turn certain personal property over to them. When the creditor approaches you with this demand, you should tell them that you will not turn over the property and immediately consult your attorney. You do not have to provide the property to the creditor, and, in fact, if you do give the personal property to the creditor, you may waive certain rights that you have in the property and defenses that you have against the creditor. If the original loan amount was for less than \$25,000, the creditor usually has no right to ask you to turn over the property, pursuant to the Wisconsin Consumer Act. Again, find out what rights and defenses are available to you before acting on the creditor's demand. Also, if you relinquish possession of the property to the creditor, you will no longer be able to resolve any of your differences informally.

After you deny the creditor possession of the property, there is a good chance they will commence an action in replevin by filing a summons and complaint because the creditor must go through the courts to get permission to repossess the property. The summons and complaint will state you are wrongfully possessing certain personal property that belongs to them. Upon receipt of the summons and complaint, you will have 45 days in which to admit or deny the allegations contained therein. However, you may be asked to appear in small claims court if the original loan amount was for less than \$25,000. While you don't have to provide a written answer, you must appear in court on the date shown or you will automatically lose. Once again, you should contact an attorney to assist you in answering the summons and complaint so that you do not waive any of the rights and defenses available to you. Also, it is absolutely necessary that you act on the summons and complaint immediately since you only have 45 days in which to respond. If you do not respond within 45 days, you will be admitting all of the allegations contained in the complaint.

After the action has been commenced, the creditor may submit an affidavit and post bond to secure the value of the personal property that is in question, and then ask the court to order that the personal property be delivered to them. If you wish to retain the property, you also may have to post bond. The bond is posted to secure the property's value should there be any damage resulting from either party's wrongful possession.

Finally, a trial will be held at which time either the court or a jury will determine who has the legal right to possession of the property in question. If the creditor prevails at trial, the property will be placed in the creditor's possession. If possession of the property is not possible, the creditor can demand the value of the property. Also, if the creditor prevails, it may recover for any damages incurred as a result of the wrongful detention of the property or its depreciation in value. If these damages are awarded, the judgment may, in fact, be greater than the value of the property, at which time you would be responsible for the

deficiency. In other words, you would have to make payment for that amount awarded to the creditor over and above the value of the property.

If you should prevail after the trial, then you have several options to consider. If you still possess the property, you can keep it and ask for the expenses you have incurred in defending the replevin action. If you no longer possess the property, you can either regain possession from the creditor or demand the property's value. Also, you are entitled to any damages resulting from the replevin action from the posted bond.

Replevin actions often present many difficult legal questions that should not be attacked without the aid of an attorney. You should, at no time, act without being fully aware of the consequences of that action.

## **The U.S. Bankruptcy Code**

### **What is a Chapter 11 Reorganization?**

Chapter 11 of the Bankruptcy Code is the chapter Congress designed to allow business debtors to reorganize their affairs while continuing to operate their own businesses. While originally designed for large corporate debtors, in 1977 Congress extended the chapter's provisions to partnerships, real estate developers and sole proprietors. Chapter 11 differs from Chapter 7 in that usually no trustee is appointed to run the case. Rather the debtor, in conjunction with the creditors, designs a plan of repayment from future earnings of the business to repay debtors. Chapter 11 differs from Chapter 13 in that there are no asset or debt limits on who can qualify for Chapter 11. The ultimate goal of a Chapter 11 is the approval of a plan reorganizing any or all of the debtor's business affairs, including management changes, asset sales and purchases and debt restructuring.

### **How Does the Chapter 11 Process Begin?**

As with other proceedings filed under the Bankruptcy Code, a Chapter 11 is commenced by filing a one-page petition, a list of the 20 largest unsecured creditors and a mailing list containing the names and addresses of all parties who may have an interest in the proceedings. Shortly thereafter, or at the time the petition is filed, schedules of all assets owned by the debtor and all debts owed by the debtor must be filed. The petition must be accompanied by a \$500 filing fee.

Once the petition and other documents are filed and the fee is paid, the court enters an order which, among other things, institutes a stay against all creditors from taking any action against the debtor. This "automatic stay" prohibits the continuation of any lawsuit by a creditor, prohibits the enforcement of any lien or mortgage owned by a creditor, and even prohibits the creditor from writing letters or calling the debtor on the telephone.

Within 30 to 45 days after the petition is filed, a meeting is held, at which time the debtor can be asked questions under oath by his or her creditors. The meeting is conducted by the debtor's attorney and is scheduled by the court. The debtor must appear at this meeting for the

proceeding to continue.

### **The "Cash Collateral" Battle**

A provision of the Bankruptcy Code applicable under all chapters provides that a debtor may not, after filing its petition, use or spend the collateral of a secured creditor if that collateral is termed "cash collateral." This includes not only cash but also includes accounts receivable, inventory and the cash proceeds of any tangible property claimed by a creditor as security for its loan.

This probably will include a milk check in most farm cases. The only circumstances under which a debtor may use this cash collateral are if the creditor agrees to its use or the court orders its use.

In most cases under Chapter 11, the first item upon the agenda will be to get the creditor's permission to use the cash collateral. Ideally, this should be done by agreement right after the petition is filed. If an agreement cannot be struck within a day or two after filing, the debtor should file an application with the court to receive permission to use cash collateral. The outcome of this battle generally will determine whether the case continues under Chapter 11 or whether it goes into liquidation under Chapter 7.

### **Removal of the Automatic Stay**

Assuming the cash collateral battle is waged successfully by the debtor, the Chapter 11 process moves to its preliminary reorganization phase. The automatic stay noted above provides the creditor with some breathing space to sit back, take stock and determine how it wishes to restructure its asset and liability picture.

The automatic stay will not run indefinitely though. Creditors who own security have the right to petition the court to have the stay removed so they can repossess their collateral. If such a motion is filed, it must be acted upon by the court within 30 days. If the court takes no action to affirmatively enforce the stay within the 30-day period, the stay will be removed automatically.

The only ways a debtor may keep the stay in place is to:

1. Prove that it has sufficient equity in the property over and above the creditor's lien to protect that creditor's interest in the collateral against accumulating unpaid interest;
2. To show that despite not owning any equity, the item of collateral is so essential to the reorganization of the debtor that the reorganization would be impossible without it; or
3. Provide cash payments to the creditor sufficient to protect that creditor's interest in the collateral.

The goal of the automatic stay provision is to protect the debtor from losing its property while giving protection to the creditor that its position will not be prejudiced by the passage of time, deterioration of the asset or accumulation of interest beyond the pledged assets.

### **Time for Filing a Plan**

While the cash collateral and automatic stay battles are being fought, the time for filing a plan is running. The Bankruptcy Code provides a 120-day period from the date of filing the petition. The debtor has the exclusive right to file a plan within that time. No creditor or other party may propose a plan during this period. Therefore, despite the other battles being fought, the debtor must persevere in putting together its plan if it wishes to take advantage of the exclusive proposal period.

If the debtor does file the plan within 120 days, it has until the 180th day after filing to have the plan approved. That is, the exclusive period is extended automatically to 180 days if the plan is proposed within the 120-day period by the debtor.

While what the Bankruptcy Code provides is the ideal, few plans are ever proposed within these time periods if the case is complex. The court has the ability to extend the exclusive time periods for good cause shown by the debtor so long as the extension is requested within the initial 120-day period.

### **Proposing a Plan**

As can be seen, getting to the point of proposing a plan is not simple. In addition to fighting the cash collateral and automatic stay battles, the debtor must be prepared to take a hard, long look at the way its business affairs were run in the past. Changes must be made to ensure that the mistakes which put the debtor into bankruptcy are not repeated or continued in the reorganization.

The debtor should first determine what assets are absolutely essential to the ongoing business and what excess assets could be sold. In most instances, all of the debtor's assets have been pledged as collateral. Selling excess assets usually will bring about immediate debt reduction that should bring about reduced cash flow requirements. The analysis of what assets are essential should be done on a cost/benefit analysis, and not on the basis of sentiment or "seat of the pants" estimates.

Next, the debtor must determine what the remaining assets are worth. The value of the assets will determine how much debt must be paid to the secured creditor and how much of that creditor's claim will be compromised.

In conjunction with the debt analysis, the debtor should realistically project its future cash flow abilities and compare this with the essential costs of remaining in business and paying the expenses of the Chapter 11.

The sale of excess assets, valuation of remaining assets, analysis of projected cash flows and the costs of the ongoing operation will dictate the terms of the plan. As a rule, if the debtor is able to maintain its costs of operation on a current basis, pay adequate protection to its secured creditors, pay all post-petition taxes current and pay its lawyers, accountants, appraisers and U.S. Trustee fees as they become due, the debtor has a good chance for success. If these ongoing post-petition

costs of operation cannot be kept current, there virtually is no chance that any reorganization plan will succeed.

### **The Process of Disclosure**

The Bankruptcy Code provides that no plan of reorganization may be presented to creditors until a disclosure statement, approved by the court, has been prepared and distributed. The disclosure statement will generally include:

1. The description of the debtor and the kind of business activity in which the debtor has been engaged;
2. The debtor's financial history including the debtor's books and records;
3. The steps taken by the debtor in the preliminary reorganization phase to expand or diminish the assets to reorganize the management team, to pay taxes and other post-petition expenses and to adequately protect its secured creditors;
4. The debtor's expected asset and liability picture after the plan is approved; and
5. A summary of the plan of reorganization to be presented to the creditors.

The length, depth and sophistication of the disclosure statement will vary from case to case, but in no case is it an easy or inexpensive document to draft. The disclosure statement is both informational and a sales tool to get creditors to go along with the proposed plan.

A hearing must be held by the court before approval of the disclosure statement can be received. Once approved, the statement is sent to all parties with an interest in the bankruptcy along with a copy of the plan.

### **Approval of the Plan**

Approval of the plan by the court is called "confirmation." Confirmation can be obtained either through the assent of a majority of the creditors or by court order over the objection of creditors.

The Bankruptcy Code requires that the plan of reorganization establish classes of creditors whose interests in the estate are similar. For example, in most cases, there will be more than one creditor who has received a security interest in the debtor's property. Each of these secured creditors will form its own individual class. Unsecured creditors (those with no collateral) usually are placed all in the same class because their interests are usually very similar.

If the debtor is a sole proprietor or a married couple owning a farm, they will be placed in a class separate from any of the creditors. If the debtor is a partnership, all partners are placed in one class together. If the debtor is a corporation, the shareholders will usually form one large class.

When the plan is sent to creditors and other parties, a ballot also is sent. The ballot will designate the class in which that individual creditor will be voting, the amount of that creditor's claim, will provide a place for the creditor to vote for or against the plan and will provide instructions for how the ballot is to be submitted.

The ballots are to be returned to the debtor or his attorney within a time specified in the ballot. After the time for voting has expired, the votes are tallied on a class-by-class basis. There are two aspects to this vote tally.

First, the raw number of votes in favor or against the plan are noted in each class. The Bankruptcy Code requires that a simple majority of the votes cast in each class must be in favor of the plan. If not, the debtor must either restart the process by filing a new plan or must resort to the court to seek approval of the plan over the negative vote.

Second, assuming a majority have voted in favor of the plan in each class, the ballots are recalculated to determine the amount of claims voting for the plan and the amount of claims voting against. To meet this second test, two-thirds of the total amount of claims voting must have voted in favor of the plan.

Both the majority in number and two-thirds in claims tests must be met in each class for it to be said that creditors have given their consent to the plan. If either test is failed in any single class, the plan is voted down. At this point the debtor may start over or resort to the court to uphold the plan despite the negative vote. Such a procedure has been termed "cram down."

A favorable vote in all classes usually means confirmation by the court will follow in short order.

### **"Cram Down"**

As long as several other technical tests of the Bankruptcy Code are met, a debtor may take a plan, previously rejected by creditors, before the judge to seek its confirmation. Such a court battle can be very expensive and time consuming. The tests for confirming a plan in this fashion are strenuous and sometimes quite technical.

Perhaps of greatest interest to farmers is the problem created by the Bankruptcy Code's "absolute priority rule." This rule states that no creditor in a lower class may be paid anything or retain any of the debtor's property until a class with a higher priority has been paid in full. This test is invoked only where the vote on the plan has been unfavorable.

The Bankruptcy Code places the owner in the lowest priority class behind unsecured creditors. In its strictest interpretation, this means that if unsecured creditors vote against the plan, the only way the court may "cram down" the plan is if the owners divest themselves of all ownership of their property. To the farmer, this means the only way he or she may "cram down" a plan on the unsecured creditors is if he or she agrees to give up the farm; an outcome completely opposite of why the Chapter 11 was first filed by the owner.

## **Conclusion**

For most distressed farmers, Chapter 11 is not a viable tool. The legal, accounting, appraisal and other expert costs can be staggering. They will be beyond the means of most farm debtors. The process is extremely cumbersome, complicated and loaded with potential lawsuits. It is a process designed for large corporate debtors who can afford the protracted time it takes to get a plan approved and whose business affairs are better suited to a sophisticated procedure. Most importantly, the process, in a farm context, is skewed to favor the creditor because of the farmer's overriding interest to maintain ownership of the land and other assets that comprise the business.

Unlike most corporate debtors, the farmer's business also is his or her home, heritage, legacy and way of life. This puts the farmer at an immediate disadvantage with his or her creditors because walking away from the business is not a viable option. The principal difference between Chapter 11 and Chapter 12 is the recognition in Chapter 12 of this significant difference between farm businesses and other kinds of businesses. Thus, Chapter 11 should be used by farmers in very limited instances and only when Chapter 12 is not available.

## **What is a Chapter 12?**

Chapter 12 of the U.S. Bankruptcy Code is a reorganization procedure specifically designed to allow farmers to continue running their farming operations while reorganizing their financial affairs. Congress responded to the farmer's economic plight caused by the extraordinary agricultural economic recession of the 1980s by enacting this procedure, which became effective on Nov. 26, 1986. Chapter 12 blends some of the more favorable options of a Chapter 11 with those of a Chapter 13. This leads to an administratively streamlined form of reorganization with high enough debt limits to realistically reflect normal farm indebtedness.

The court appoints a trustee who has the responsibility to recommend approval of the plan and to administer plan payments.

The farm debtor remains in control of the day-to-day management of the farm business.

## **Who May File a Chapter 12?**

An individual farmer may file a Chapter 12 if the farming operation does not have an aggregate indebtedness exceeding \$1.5 million and if the gross farm income is more than 50 percent of the individuals and their spouses' gross income. The term "aggregate indebtedness" means the total debt excluding the amount attributed to the homestead.

A corporation or partnership may file a Chapter 12 if more than 50 percent of the outstanding stock or equity is held by the farmer or the aggregate farm family, and more than 80 percent of the value of its assets are related to farming. The "aggregate farm family" means the farmer and all his immediate relations involved in the farming operation.

## **The Chapter 12 Process**

A Chapter 12 petition must be accompanied by required schedules outlining all the assets, debts and financial information of the farming operation. The petition immediately evokes the "automatic stay" that prevents any creditors from taking action to collect on their debt, from the farm debtor or any co-debtor. As with other bankruptcy proceedings, the debtor is required to attend a meeting within 30 to 45 days of the cases' filing at which the debtor and spouse or partners and stockholders may be examined under oath by any of their creditors. Attendance at this meeting is required.

Upon the petition's filing, the trustee is appointed. The debtor must provide the trustee with any information requested regarding the farm operation.

The Chapter 12 process requires, however, that the trustee's fees are 10 percent of all plan payments. Simply stated, if plan payments in a year equal \$100,000 the trustee's fees in that year will equal \$10,000. This often provides a good bargaining tool. If the debtor can agree with his creditors, the amount necessary to pay trustee's fees can be paid to creditors.

In the alternative, the 10 percent fees can make a proposed reorganization unfeasible.

## **The 'Cash Collateral' Battle**

As with a Chapter 11, the Bankruptcy Code provides that the debtor may not use assets defined as "cash collateral" without the secured creditor's permission or without court approval. Typically in a farming operation, "cash collateral" is the milk check and/or government payments. If an agreement with a secured creditor for the use of at least part of the cash collateral is not reached within a few days after filing the petition, a motion must be filed to receive permission from the court for such use. Generally, a court will allow the debtor to use at least part if not all of the cash collateral, knowing that refusal to do so would deny the debtor any ability to continue the farming operation and would ultimately prevent any reorganization.

## **Lift of the Automatic Stay**

Once the debtor has the right to use cash collateral, another battle often arises. The filing of a bankruptcy petition involves the "automatic stay" which is an order of the court prohibiting any creditor from attempting to collect on their debt. The automatic stay may be "lifted" upon application of a secured creditor who is trying to execute against its collateral.

A motion to lift the stay can be based upon the secured creditor's assertion that the debtor has no equity in the collateral.

The motion to lift the automatic stay may be defeated if the debtor can prove:

1. The debtor does have sufficient equity in the property; or

2.If there is no equity in the property, the item is essential to the reorganization of the debtor and reorganization would be impossible without it; and

3.The debtor has an ability to provide adequate protection for the creditor's interest.

Typically, the secured assets are the livestock, farm equipment and real estate. Obviously a farming operation cannot continue without any one of those items. Therefore, motions for the relief of stay under Chapter 12 often are successfully resisted under provisions 2 and 3 listed above. Furthermore, the time for filing a plan of reorganization under a Chapter 12 is short; hence the time in which to provide adequate protection is short.

### **Adequate Protection**

Absent agreement, another line of battle may be "adequate protection." Adequate protection has been redefined under Chapter 12 as "cash payments... to the extent... the automatic stay results in a decrease in value of property ..." (emphasis added). Simply put, a creditor needs compensation for the amount of decrease in value of its collateral during the period the stay prevents the possession and sale of the collateral. A wide range of interpretation as to the actual amount of "decrease" in the value of farming assets that occurs in the 90-day period between the filing of the petition and the filing of a plan can be argued.

### **Time for Filing a Plan**

The Chapter 12 plan of reorganization must be filed within 90 days after filing the petition. Unlike Chapter 11, where an extension of time to file the plan is liberally granted, an extension of time to file a Chapter 12 plan will be granted only if the extension can be substantively justified, or all creditors consent. Substantive justification is difficult to prove, and, it is difficult to get all creditors to consent. Therefore, a plan generally must be filed within the 90-day period. Failure to do so will result in dismissal of the Chapter 12.

The code requires a confirmation hearing be held within 45 days after filing a plan. Therefore, the entire process of filing a Chapter 12 proceeding will fail or succeed within 135 days after filing the petition.

### **Proposing a Plan**

Drafting a successful Chapter 12 plan is complex. Typically the plan proposes payments for three years. Upon completing the plan payments, the debtor receives a discharge for any indebtedness not paid under the plan proposal. Therefore, in order to draft a successful Chapter 12 plan, feasible financial projections must be made for three years. Proposed plan payments that are unrealistic will result in failure to make plan payments and in the dismissal of the Chapter 12. The farm debtor will be denied a discharge of indebtedness.

Key factors for a successful plan are:

1. Good pre-petition planning;
2. Accurate farm records;
3. Realistic, conservative farm income projections; and
4. Full and accurate communication between the debtor and his/her attorney.

Because the period for filing a plan is short and because the attorney's attention may need to be focused on cash collateral, lift of stay and adequate protection issues, pre-filing financial planning is a must.

Under a Chapter 12 plan, secured creditors must be paid the value of their collateral, although the terms of these payments may be altered. The debtor determines the necessary operating expenses. All income in excess of secured payments and farm operating expenses must be paid pro-rata to unsecured creditors.

The projected secured creditors payments, cash to operate the farm and payments to unsecured creditors must be based upon realistic income projections.

The plan is then submitted to the court-appointed trustee. The trustee determines the plan's "feasibility." If the trustee can be convinced the plan is realistic, a favorable recommendation for approval will be made to the court. Court approval is based on the trustee's recommendation. Creditors do not vote on Chapter 12 plans.

### **Valuation and the 'Cram-Down'**

A "cram-down" is available under a Chapter 12. Secured creditors are paid in full; however, they are secured only to the extent of their collateral's fair market value. The balance of their indebtedness is unsecured. Because creditors cannot vote to reject a plan, they may instead battle over the value of their secured collateral.

Debtors try to value their assets as low as possible because they then are required to pay less secured debt. Creditors attempt to prove higher values to increase the amount of secured debt required to be paid. The value of the farm real estate may be the most frequent dispute. Absent agreement, value may be determined by the court based upon appraisals and testimony. The same is true of personal property.

The valuation of the real estate and other farm assets is needed to finalize proposed plan payments. Plan payments are made to the trustee who then pays creditors. These payments must include an additional 10 percent for the trustee's fees. Typically, unsecured creditors are paid very little.

### **Conclusion**

A Chapter 12 proceeding is very favorable for distressed farmers.

Simply the threat of filing a Chapter 12 is frequently a good negotiating tool to achieve a voluntary reorganization and/or a write-down of farm

indebtedness. Absent an agreement, a Chapter 12 presents a feasible alternative because the streamlined process works for the advantage of both debtors and creditors.

A Chapter 12's success depends upon the managerial and financial astuteness of debtors. Insolvency may be the result, in part, of poor management and business practices and, in part, of our agricultural recession. A successful Chapter 12 depends upon a debtor with good managerial and agricultural skills who simply got "caught" by the agricultural recession. Inexperienced, unskilled and/or poorly managed farm operations are not good Chapter 12 candidates.

### **What is a Chapter 13?**

Chapter 13 of the U.S. Bankruptcy Code is entitled "Adjustment of Debts of an Individual with Regular Income." It provides for a sort of court-supervised budget plan that allows you to pay back your obligations at a rate that you can afford over a three- to five-year period. Unlike a Chapter 7 bankruptcy where creditors are paid (or not paid as the case may be) out of liquidated assets, creditors in a Chapter 13 receive payment out of your future income. If you successfully complete the Chapter 13 plan, you are entitled to a discharge of your debts that is much more sweeping than the discharge available under Chapter 7 or Chapter 12.

### **Who May File a Chapter 13?**

Only an individual with regular income who owes, on the date of filing, less than \$100,000 in unsecured debt and less than \$350,000 in secured debt may be a debtor under Chapter 13. These restrictions preclude many farmers from considering Chapter 13 as a viable alternative since many farmers are incorporated and hence are not "individuals" under the Bankruptcy Code. Furthermore, depending upon the farm's size it may be that the total secured debt exceeds the allowable limit. You must keep in mind, however, that depending upon the value of the collateral, the amount of the secured debt may be something less than what was originally believed.

### **How Does Chapter 13 Work?**

Upon the filing of a Chapter 13 petition the Bankruptcy Code imposes an automatic stay on all creditor activity. This essentially means that no creditor may take any action to commence or further collection efforts without prior permission from the bankruptcy court. So, although the filing of a Chapter 13 petition cannot guarantee protection from your creditors for an indefinite period of time, it at least enables you to force the creditor into a different forum, the bankruptcy court, where you may have more latitude in your attempts to deal with creditors.

After your Chapter 13 petition is filed a trustee is appointed to administer your Chapter 13. Although you must provide the trustee with information regarding your family and farm income and expenses, you will be allowed to remain in possession of your property and continue to operate your farm.

Within 15 days of the filing of your petition, you must submit a repayment plan. You have the exclusive right to file the plan. However, if you fail to do so within the required time limits, and if you do not obtain an extension of time, the Chapter 13 case will be dismissed and possibly cannot be refiled for 180 days.

The plan itself essentially is your proposal for how you intend to deal with your various creditors. Typically it involves the submission of all of your disposable income over the course of the plan to the trustee, who then disburses those funds to your creditors according to the terms of your plan. Your disposable income means the amount of money that is left at the end of each month after you have paid all your normal living and operating expenses. Depending upon your asset/liability structure and the amount of disposable income that is available, it may be possible for you to pay something less than 100 percent of your unsecured obligations and have the unpaid portion discharged at the conclusion of your Chapter 13.

The debts you pay through paying the trustee typically include all obligations with the exception of certain long-term secured obligations such as your farm's mortgage. In those cases you would include arrearages owing on those debts through the filing date of the Chapter 13 petition, and then you would resume your regular payment the following month. This monthly payment is considered in your family/farm budget at the time that your payment to the trustee (your disposable income) is determined.

Shortly after your plan is filed, a hearing is conducted during which your trustee reviews your proposed plan and asks various questions so that he/she can decide whether the plan conforms to Chapter 13's requirements. More specifically, the trustee wants to know whether your plan really is your best "good faith" effort; that is, are you treating your creditors as fairly as you can afford to treat them. They also will be looking to see that your unsecured creditors are receiving at least as much under your plan as they would in the event of a Chapter 7 liquidation case. They will want to make sure that secured creditors are receiving at least the value of their security; that mathematically the plan can feasibly be completed within the allowed time limitations; and finally, that the \$90 filing fee has been paid.

If the trustee believes your plan meets all of the necessary requirements, they will recommend the bankruptcy court confirm your plan. Although creditors can object to this confirmation, if your plan properly conforms to the Chapter 13 requirements as the trustee will indicate in their recommendation to the court, it is very likely that your plan will be confirmed.

Once your plan is confirmed, your financial obligations will include monthly payments to your trustee (for disbursement to your creditors), your regular monthly mortgage payments (keeping in mind that the pre-petition arrearages are being paid by the trustee) and your normal living/operating expenses. Although under a Chapter 13 you are not supposed to incur any new debt during the term of the Chapter 13 plan, approval to do so may be obtained under the appropriate circumstances.

If you make all of the required payments under the terms of the

confirmed Chapter 13 plan, you become entitled to a discharge at the conclusion of the Chapter 13. This discharge is much broader than that received under a Chapter 7 or a Chapter 12. If you successfully complete your Chapter 13 you are able to discharge all of the debts provided for under the plan with the exception of certain long-term obligations, such as the mortgage on your farm and any obligations that you may have that are in the nature of alimony, maintenance or support.

### **Why a Chapter 13?**

Until the advent of Chapter 12, Chapter 13 offered a more practical solution to the farmer than what was available under the very cumbersome Chapter 11. However, because of the limitations on who may be a debtor under Chapter 13, Chapter 11 was often times the only remaining option. Chapter 12 offers an alternative that was created specifically with the family farmer in mind and in most situations may be the best route to pursue, particularly considering the tremendous leeway the debtor has in dealing with secured creditors.

Nonetheless, for the smaller, unincorporated farmer and especially the tenant farmer, Chapter 13 should be closely examined and considered. It may prove to be more manageable than a Chapter 12, may produce similar results and if successfully completed, would mean a discharge of your obligations that is much broader than you would receive under the Chapter 12.

### **What is a Chapter 7?**

Chapter 7 of the U.S. Bankruptcy Code is more commonly known as a "liquidation bankruptcy." It sometimes is referred to as a straight bankruptcy which in theory involves the collection and distribution to creditors of nonexempt assets by a trustee. In reality, nine out of 10 Chapter 7 cases are known as "no asset" cases, meaning there are no nonexempt or nonsecured assets the trustee needs to collect and distribute to creditors.

Filing a Chapter 7 ultimately discharges all indebtedness and provides a fresh start without the worry or future harassment of creditors. Chapter 7 can be a very valuable tool in a farm reorganization for the following reasons.

Virtually any individual farmer or farm corporation has the ability or eligibility to file for relief from creditors under Chapter 7. About the only limitation placed on such a filing is that you must not have filed for protection under Chapter 7 within the past six years.

Other than that restriction, Chapter 7 is available as a tool to virtually every debtor in the reorganization process. While Chapter 7 seems to indicate that all assets will be liquidated, in reality with careful pre-filing planning, a Chapter 7 may merely wipe out all the unsecured debt leaving only secured creditors. You must not lose all your property to the trustee in Chapter 7, and in fact in most cases you do not.

## **The Reality of Chapter 7**

A Chapter 7 is commenced by filing a petition with the bankruptcy court. The bankruptcy court is the federal court, and in Wisconsin is located either in Madison or Milwaukee for the western and eastern districts respectively. Since bankruptcy is a federal matter, a filing of a petition supersedes any action that may be pending in state court. In fact, filing a bankruptcy petition stops any kind of creditor action that may be pending in a state court proceeding. Any collection or repossession action will be stayed by the petition's filing. Further, any other activities intended to collect a debt are prohibited by this stay. This would include a creditor attempting to pick up assets from the farm, phone calls from creditors or other activities intended to harass or otherwise collect a debt from you.

Once the petition is filed with the bankruptcy court, a trustee is appointed to administer the particular case. Generally speaking, the trustee gets a copy of the petition and all the schedules that disclose your assets, liabilities and business affairs. The trustee generally will review these schedules immediately and quickly determine whether any assets need administering at the outset. The trustee generally assumes that the secured creditor will make arrangements to protect its security. In a farm case this security consists of machinery, equipment, livestock and growing crops. Usually, you and your attorney will have negotiated prior to filing with the secured creditor, and you will stay on your farm after the petition's filing and run the day-to-day affairs of the operation.

About 30 days after the petition's filing in bankruptcy court, you are required to appear before the trustee at what is known as "the first meeting of the creditors." All creditors named in the original petition and schedules will be notified of this hearing and have the opportunity to question you about your assets. You (and your spouse if you file as co-debtors) must be present at this hearing. This is known as a Section 341 hearing.

The trustee asks questions that satisfies him/her of the various assets' disposition. In most cases assets will be pledged almost to the full extent of their value to various creditors or claimed exempt by you. If any assets are not fully secured or claimed exempt by you, the trustee will attempt to take possession or control of such an asset and liquidate it to cash for the ultimate distribution to various creditors. Any creditor who appears at this hearing is entitled to question you about your assets. Normally questioning is limited to a very short period of time and in quite a few cases there are no creditors who have questions.

## **Exemptions Under Chapter 7**

Exemptions under federal bankruptcy law. An exemption is created under Wisconsin or United States law. An exemption is the selection of certain property that the creditors or trustee may not claim. Exemptions allow you to claim certain property as exempt from the collection efforts of either the trustee or his/her creditors. Exemptions are intended to provide you with the ability to live after the bankruptcy. They are part of the theory that gives you a "fresh start" after the bankruptcy process is complete.

You may select either the federal or the state exemptions but cannot mix and match. Each debtor, in the case of you and your spouse filing, is entitled to their own set of exemptions. In the case of a husband and wife filing, also called a joint filing, you both must take either the federal or state exemptions. You cannot take the federal while your spouse takes the state.

### **Exemptions available under the Bankruptcy Code**

**Homestead.** You each may exempt up to \$16,150 in equity in the homestead or a burial plot. If you and your spouse are joint petitioners, the exemption may be "stacked" making the exemption \$32,300.

**Vehicle.** You each may exempt up to \$2,575 in equity in one vehicle. Remember that this is equity over and above any balance of a loan against which the vehicle is pledged.

**Household furnishings, goods, wearing apparel, appliances, books, animals, crops, musical instruments.** If these items are held primarily for personal or family use, they may be exempted up to \$425 in value for each item (that is \$850 if owned by you jointly), up to \$16,150 for both. It should be noted that when placing values on these goods, you should use the rummage sale or actual cash value of the property rather than replacement value. An example of this would be a couch that you paid \$1,000 for but have had for six months. Generally speaking, such an item of furniture is probably worth less than \$500 if it has been used by a family after purchase. You should look carefully at the property's actual value before claiming the exemption.

**Jewelry.** Each of you may claim jewelry limited to \$1,075 in aggregate value.

**Wild card.** This exemption may be used against any type of property up to \$850 in value for each of you, plus up to \$8,075 of an unused homestead exemption allowing a possible wild card exemption of up to \$8,925 for each against anything. This could be used to exempt milk check proceeds or to increase the exemption of any other asset such as a motor vehicle or household goods. This can be a valuable strategic planning tool.

**Implements, tools of the trade, professional books.** You may exempt up to \$1,625 worth of these items that are not encumbered.

**Life insurance.** You may exempt up to \$8,625 of any unmaturing life insurance other than a credit life insurance contract.

**Benefits/future earnings.** You may include, without dollar limit, any amount received from social security or unemployment compensation, local public assistance, veterans benefits, disability or illness benefits, unemployment benefits or an award under a crime victim compensation. You may further exempt, to the extent necessary to support you and your dependents, alimony, support, maintenance, payment under a stock bonus, pension, profit sharing, or annuity on account of illness, disability, death, age or length of service. Further, a payment on account of an individual's wrongful death of whom you were a dependent, a payment on a life insurance insuring a life of a person on whom you were a

dependent or a payment for loss of future earning also may be exempted to the extent necessary for the support of you and your dependents. A payment on account of personal injury is limited to \$16,150, not including pain and suffering or compensation for monetary loss.

### **Exemptions under Wisconsin law**

If you choose to use Wisconsin exemptions, and if you are a joint debtor, then your spouse also must join in this choice. Then the following exemptions apply:

**Homestead.** You may exempt a total equity of \$40,000 over and above any mortgages or other encumbrances. This exemption cannot be stacked so the maximum available to both of you also is \$40,000.

**Bank accounts.** Each spouse may exempt \$1,000 in a bank account or accounts.

**Vehicle.** Each spouse may exempt \$1,200 in vehicle or vehicles. In addition, each may use up any unused portion of the amount exempted for consumer goods.

**Cemetery lot.** There is no limit to the lot's value that may be exempted.

**Business and farm property.** Equipment, inventory and farm products may be exempted up to \$7,500 for each spouse.

**Consumer goods.** Each spouse can exempt household goods, apparel, appliances, books, jewelry, musical instruments, firearms, sporting goods and animals held primarily for the use of the debtor, not to exceed \$5,000 in value.

**Insurance.** Life insurance policy and loan values up to \$4,000 are exempt if the policy insures the debtor and is owned by him/her.

**Benefits or income.** Future income, assets held or amounts payable under any retirement, pension, disability, death benefit, stock bonus, profit sharing plan, annuity, individual retirement account, individual retirement annuity, Keogh, 401-K or similar plan or contract, are exempt.

### **Exemption Planning**

In most situations you should transfer nonexempt assets to exempt assets prior to filing bankruptcy. You are permitted to convert nonexempt property into exempt property shortly before the bankruptcy. However, if you fraudulently obtain money and convert it to exempt assets, then such a conversion will not be permitted. An example of this would be selling cows that are pledged to a secured creditor and using the money to buy an exempt homestead. Since the proceeds from the sale of cows were rightfully pledged to a secured creditor, you cannot convert them to an exempt asset and then file bankruptcy expecting to retain this money. In all cases, it is a wise idea to carefully consider the exemptions that are chosen and the shifting of assets into exempt

property prior to filing bankruptcy.

It should be noted that there are certain types of liens on consumer goods that can be avoided regarding certain secured creditors. The Wisconsin Consumer Act also can impact whether a valid security interest is attached to the debtor's property.

An attorney should be consulted specifically regarding consumer-type debt where your household goods or personal belongings have been pledged as security for a loan. It sometimes is the case that the security interest can be set aside in your favor.

### **Why a Chapter 7?**

Chapter 7 can be a very valuable strategic planning tool in a farm's reorganization . It also can be an excellent tool if you want to get out of the business and be free from debt but retain certain assets. As a strategic planning tool, you and your attorney sometimes can negotiate with the secured creditors prior to the filing of the Chapter 7 to secure certain concessions in payments or interest rates post-bankruptcy. The Chapter 7 effectively wipes out all unsecured debt such as amounts owed to suppliers, veterinarians, feed mills and other trade creditors.

In most farm cases, the remaining secured creditors will have as security all the real estate, machinery, equipment and livestock.

The Chapter 7 in effect eliminates a whole class of creditors that you do not have to deal with post-petition. It often is possible to make a bargain with the remaining secured creditors to keep the farm operation intact.

Generally speaking, secured creditors may accept through negotiations a limited write-down to the fair market value of their security and possibly amortize the loan balance over the customary time period at the market rate of interest. If you and your attorney have a viable plan of production and can demonstrate a sufficient cash flow to make payments under the post-bankruptcy plan, a secured creditor has every incentive to go along with you. The chance of a forced sale bringing an inadequate amount of money, as is so often the case, is eliminated.

It is necessary for you to have adequate appraisals of both personal property and real estate in order to begin negotiations with the secured creditors prior to filing the Chapter 7. You must know your property's value in order to strike a deal, if one is available, with the secured creditor for post-bankruptcy plans.

Generally speaking, you and your attorney should carefully analyze the situation and be prepared for all questions that a secured creditor may have. You also should be aware of prevailing interest rates, what the particular secured creditor has done in the past with other debtors and your own operation's history. If a deal can be struck, you normally will "reaffirm" the particular debt at the terms and conditions that can be agreed upon between you and your secured creditor. These reaffirmation agreements are binding if they are approved by the court and can be enforced, despite the bankruptcy against you. There are many options available through Chapter 7 if careful planning is done

prior to the petition's in bankruptcy. If there are excess assets beyond the property that is mortgaged or claimed exempt, then the trustee plays a role in such negotiations after the fact.

Each situation is different and each individual debtor has a different personality that will affect the outcome, options and proposals available for any individual debtor. Any information in this discussion of Chapter 7 will apply differently to each case and should be analyzed in light of this. You, the debtor, should know that Chapter 7 can be a powerful tool in the reorganization process, and may be the beginning of any reorganization analysis that is done with regard to your situation.

### **General Tax Considerations of Farm Workouts and Bankruptcies**

Every distressed farm situation holds the potential for significant and often adverse tax consequences. The most common tax effects of a farm bankruptcy or nonbankruptcy workout include income from discharge of indebtedness, income from the sale or surrender of property to creditors or other third parties, and collection problems with the Internal Revenue Service for existing tax liabilities.

If not planned correctly, the farm bankruptcy or nonbankruptcy workout can result in a financial disaster where you have no property and significant tax liabilities that survive the bankruptcy or nonbankruptcy workout. For this reason, if you are considering a bankruptcy or debt workout, you should be advised by tax attorneys or certified public accountants. They should be thoroughly knowledgeable in the special tax rules applicable to farm bankruptcies and nonbankruptcy workouts.

#### **Discharge of Indebtedness**

Whenever a debt is forgiven or discharged, there is the potential for taxable income to you. This is because under the Internal Revenue Code (IRC), the general rule is that a discharged debt is taxable income to the debtor to the extent of the forgiven indebtedness. Obviously, the last thing you need is to replace one debt with another to the federal government for taxes on the income that is "deemed" to be generated when a debt is forgiven.

Fortunately, the IRC also contains exceptions to the general rule that debt discharge income is taxable to you. The most important exceptions apply if you are in bankruptcy, if the debt was "qualified farm indebtedness," if you are insolvent after the debt discharge or if the debt was seller financing. A more detailed description and application of the specific exceptions is beyond this summary. Before you engage in any transaction generating discharge of indebtedness, seek competent tax advice.

#### **Sale and Surrender of Property**

The most significant tax liability generated in a farm bankruptcy or nonbankruptcy workout usually results from the sale or surrender of property. If you are contemplating a sale of property, a surrender of property or are subject to a foreclosure, you should be aware that

taxable gain can result from the sale, surrender or foreclosure. The basic rule to remember is that surrendering property to creditors to satisfy the indebtedness or the property's foreclosure will be treated as a sale of that property for the amount of the debt forgiven and can generate taxable gain to you irrespective of whether any cash is received in the transaction.

This problem most often comes up when the property being surrendered is subject to secured indebtedness.

When you sell property, your gain will equal the difference between the price (called consideration) received and the "tax basis" of the property. Tax basis is the property's cost plus the cost of improvements minus depreciation taken on the property.

In the case of surrendering property to satisfy indebtedness, your gain from the surrender will equal the difference between the amount of debt satisfied by the surrender and the tax basis of the property, if recourse debt (the debtor is personally liable) is involved. In foreclosure, your gain from the foreclosure will equal the difference between the foreclosure sale price (usually the amount of debt or current appraised value bid in by the creditor) and the property's tax basis, unless nonrecourse debt is involved.

If your property is sold and the buyer assumes or takes subject to pre-existing indebtedness, the gain from the sale will equal the difference between the value of all consideration received and the property's tax basis. For this purpose, the amount of debt assumed or taken subject to will constitute consideration received in the sale.

In situations involving property surrenders or foreclosures where the debt's amount exceeds the property's value, income from debt discharge may be confused with gain from the deemed sale of the property. This confusion can result in imposition of unnecessary tax liability against you because debt discharge income is often tax-free, while gain from the sale of property is not. Therefore, great care should be taken to avoid the mischaracterization of debt discharge income as gain from the sale of property. If secured recourse debt is involved in the surrender or foreclosure, the debt amount included in computing gain cannot exceed the fair market value of the property. Any debt in excess of fair market value that is discharged or forgiven is debt discharge income. Because of this rule, it is important to establish the lowest reasonable value of the property possible. Since the creditor involved in the transaction is required to report a value to the IRS, it is important that you and the creditor agree on value.

If the secured debt is nonrecourse (no personal liability for you), the entire debt would be treated as consideration received in the surrender or foreclosure regardless of the property's value.

Because of the effect of debt in a property surrender, the surrender can result in significant tax liability even though no cash is generated by the surrender. For example, if property worth \$50,000 with a tax basis of zero but subject to a recourse mortgage of \$100,000 is surrendered to a creditor to satisfy the debt, you will have gain from the "sale" of the property equal to \$50,000 and will have income from discharge of

indebtedness of \$50,000. If you are in bankruptcy, the debt is qualified farm indebtedness, the debt is seller-financing indebtedness, or if you are insolvent after the discharge, the debt discharge income will be tax free. The \$50,000 gain on sale, however, will be taxed to you. Using a 28 percent tax rate, this would result in a tax liability of \$14,000 with no cash available to pay for the liability. Mischaracterization of the \$50,000 of tax-free debt discharge income as gain from the sale could result in an additional unnecessary tax of \$14,000 in this example.

If you are facing a property surrender or foreclosure situation, you should carefully consider how the transaction will be reported for tax purposes and how any resulting tax liability will be paid. Often, careful planning can result in significant tax savings. The most important planning objective should be establishing the lowest possible reasonable value for the surrendered or foreclosed property, whether by appraisal, agreement with the creditor or otherwise. The lower the value that is reasonably established, the less gain that will result and the less taxes paid.

### **Bankruptcy Considerations**

The tax effects of bankruptcy on your tax liabilities often are misunderstood because special tax rules come into play in a bankruptcy situation. Some of the special considerations and rules include:

Tax liabilities are rarely discharged in a bankruptcy. While there are some limited exceptions to this rule, they seldom apply in real life. This means that any tax liabilities incurred by you prior to or during the bankruptcy that are not paid out of the assets of the bankruptcy estate will survive the bankruptcy, and the IRS can pursue you after the bankruptcy debt discharge has been given.

Interest on unpaid taxes does accrue during a bankruptcy proceeding. While post-petition interest in a bankruptcy is rarely paid, it does accrue and will survive the bankruptcy as a liability against you.

A bankruptcy filing is an effective tool that can stop the taxing authorities, including the IRS and the Wisconsin Department of Revenue, dead in their tracks. If a tax lien is filed or a milk check or other property is seized by the IRS, a bankruptcy filing can prevent further liens or seizures and previously seized property sometimes can be recovered.

The IRS can pursue you once the debt discharge has been granted. At that point, the automatic stay is lifted and you can be subject to IRS collection actions for unpaid taxes.

Your bankruptcy results in a new taxable entity separate from you. Any tax liabilities incurred by the bankruptcy estate are not your tax liabilities and care should be taken to insure that the IRS does not seek to assert these liabilities against you.

Your bankruptcy involves special elections about short taxable years for you, a new taxable year for the bankruptcy estate, offsets of debt discharge income against tax attributes and allocation of tax liabilities between you and the bankruptcy estate. Proper tax planning in

a bankruptcy, especially if you have significant tax liabilities in the calendar year of the bankruptcy, can result in significant tax savings.

Certain IRS penalties cannot be asserted against you if you file bankruptcy. Penalties for failure to file a federal tax return or pay federal tax due cannot be asserted if they are attributable to a taxable year ending prior to filing. The return for such year is due on or after the filing.

### **Dealing with the IRS**

Most individuals unnecessarily fear the IRS, restricting their ability to effectively deal with IRS personnel. As a result, they seek the assistance of persons experienced in dealing with the IRS. The most stubborn IRS representative often can be mollified or bypassed by the skilled tax advocate.

The most important thing to realize is that even if an IRS liability has become final, it often can be renegotiated, cut down or paid over an extended period of time if the proper approach is used. It is not uncommon for tax liabilities to be reduced by as much as 50 percent or more in certain circumstances. The moral is, even if you have a significant tax debt that has become final, you can negotiate some breathing space with the IRS if you make a reasonable attempt to do so.

### **Post Farming: A New Beginning**

You and your family do not have to consider yourselves friendless, hopeless and relegated to status as second-class citizens after a foreclosure, replevin or bankruptcy proceeding. Many public and private resources are available to you and your family as the dust settles. It also helps to have some pioneer ingenuity.

Your primary concern for your family after bankruptcy is providing shelter and food. Recent liberalization and clarification of state guidelines on the food stamp and fuel assistance programs make it much easier for farm families to qualify. Also many Wisconsin communities have subsidized rental units available for farmers with limited or no income. The Department of Social Services and the local housing authority are valuable resources for economic assistance as is the Rural Economic Community Development Service (RECD) for housing assistance.

If you are in good health, you may consider work in another aspect of agriculture that is not production related. Hundreds of jobs exist in Wisconsin for agriculture services and manufacturing.

Your experiences may provide opportunities to secure employment as tenant managers of farms for absentee farm owners. Also, you and your family may seek the assistance of the Wisconsin technical college in your immediate area of the state. The Wisconsin Technical College System (WTCS) offers career options and retraining.

A list of WTCS districts is found under "Sources" immediately following

this chapter. You can obtain financial assistance for these programs.

If you are not in good health you may qualify as disabled under the Social Security Act. There are five fundamental questions to be answered in the sequential process to determine disability:

1. Is the worker engaged in significant work activity for pay? (a/k/a Substantial Gainful Activity-SGA)
2. Does the worker have a severe impairment? (Farmers lung is an example of an impairment which may be severe in individual cases.)
3. Does the impairment meet the listings? (Technical medical terms that must be determined by a physician before acknowledged by the Social Security Administration.)
4. Does the impairment prevent past relevant work?
5. Does the impairment prevent other work?

The Social Security Administration may appear to be a paperwork jungle, but most office personnel are friendly and understanding and will help you and your spouse through applications. Of significant note are the vocational rehabilitation benefits and Medicare benefits available to you and your family if you qualify for Social Security disability. For the extremely unfortunate the Social Security Administration operates an SSI (Supplement Security Income) program. Its objective is to provide a minimum floor of income for the aged, blind and disabled who have little or no income and resources.

In addition to the Social Security Administration, you may seek assistance through the Division of Vocational Rehabilitation (DVR) operated as a division of the Wisconsin Department of Health and Social Services. The two eligibility requirements for DVR services are:

1. There must be a physical or mental disability that presents a substantial handicap to employment; and
2. There must be a reasonable expectation that DVR services will help an individual obtain employment.

Medical, psychological and vocational evaluation, counseling and job placement assistance all are provided without regard to financial need. The DVR offices are available at convenient locations statewide.

Should you or members of your family suffer from depression or thoughts of suicide, seek help through the local mental health center. All state counties are required by law to maintain or contract out services for the mentally ill. These services are maintained under what is known as the "51.42 board" for the county. Services are provided at a fee dependent upon the person's ability to pay.

Should you need legal help for bouncing checks or selling encumbered property, the State Public Defender's Office should be contacted for information as to whether you or your family members qualify for free

legal assistance. Also, many legal clinics provide low cost or free legal services in the areas of family law (divorce), probate, etc. Simple questions can be directed to the Lawyer Referral and Information Service at 800-362-9082. Also, many attorneys in private practice will not charge for an initial consultation.

Many private foundations, church groups and charities have money available to help you get started after foreclosure and/or bankruptcy has been completed. Lutheran Social Services administers a program called Project Hope whereby farm families are relocated in the state for job retraining. Some private colleges offer free or reduced tuition college courses for displaced farmers. Addresses and contact persons for some private farm aid resources also are listed at the end of this chapter. Most counties have Farmer's Resource Guides available at the County Agriculture Agent's Office. The guides address both public and private sources of assistance.

Many farm credit advisors trained by the Wisconsin Department of Agriculture and Consumer Protection can steer you toward the services you need to survive the trauma of bankruptcy or foreclosure.

These people are farmers themselves who have an empathetic understanding of farming and can help identify options.

You can obtain the name of a farm credit advisor by contacting the Wisconsin Department of Agriculture and Consumer Protection at 800-942-2474.

Farm families always have shared a pioneer spirit that has been admired by Americans. The sources listed below are just some of the ways you can survive the trauma of a break with your agricultural heritage and preserve that pioneer spirit.

### **Sources**

(Consult your county's Farmer's Resource Guide or telephone directory for more complete information)

Financial analysis and counseling. Farmer's Assistance Program, 800-942-2474; University of Wisconsin Extension Service; county extension office; and Wisconsin Technical College System farm instructors,.

Financial assistance. FSA, Farm Credit Services, local banks, Farmland Preservation Program, clerk of township, county veterans officer, Wisconsin Community Action Program, local Social Security office, local department of social services.

Legal information and assistance. Farmer's Assistance Program, 800-942-2474; State Bar of Wisconsin Lawyer Referral and Information Services, 800-362-9082; legal aid offices, Wisconsin Judicare, Legal Action of Wisconsin.

Stress management and mental health counseling. Local clergy, local mental health services, local department of social services, public elementary and secondary school personnel.

Basic human and family needs: food, fuel, shelter, clothing and medical. Town or village clerk, department of social services, community action programs, housing authorities, social services office, Social Security office, clergy and church affiliate organizations, Commission on Aging.

Job counseling, training and education. Farmer's Assistance Program, Job Service, WTCS, Wisconsin Job Training Partnership Act (JTPA), private industry councils, county veterans office, college and high school guidance offices.

## **Glossary**

### **A**

Acceleration clause - A provision in a credit agreement that allows a creditor the opportunity to immediately demand repayment of an entire amount of debt owed because of a debtor's default.

Answer - A written statement by a defendant in a lawsuit stating the reasons for their defenses to the statements made by the plaintiff.

Attachment - Process of seizing a debtor's property in order to secure the debt or claim of a creditor in the event that a judgment is taken against the debtor.

### **B**

Bankruptcy - A condition where a debtor cannot pay debts now or as they come due and uses the protection of the law to either liquidate property or reorganize his or her financial affairs.

Bankruptcy Code - Federal law that governs bankruptcy proceedings.

Bankruptcy court - Special courts under federal law that deal exclusively with administering bankruptcy proceedings, presided over by a bankruptcy judge.

Bankruptcy estate - The property of a debtor that comes under the jurisdiction of the bankruptcy court and trustee when a person files for protection under the Bankruptcy Code.

Bankruptcy trustee - A person appointed by the bankruptcy court to take charge of the bankruptcy estate and handle any actions on behalf of the estate.

### **C**

Chattel - Movable property; see also personal property.

Circuit court - In Wisconsin, the courts named by county, where most civil actions are begun.

Civil action - Lawsuit dealing with controversies between individual

parties, in contrast to a criminal action.

Collateral - Property which a debtor agrees to pledge as security for the repayment of a debt.

Creditor - One whom is owed money or other thing by obligation or promise.

## D

Debtor - One who owes a debt.

Default - A failure to perform an obligation imposed by law or contract.

Deficiency - Unpaid balance of a debt on property for which there is a security agreement, where the sale of the property has failed to pay the full amount of the debt owed.

Deficiency judgment - Court order for personal liability of the debtor on a deficiency.

Discharge - The cancellation of an obligation.

## E

Equity - The value of property belonging to an owner above the amount of all mortgages.

Eviction - The action of depriving a person of the possession of land or rental property which the person has held or leased.

Execution - Legal process of enforcing a judgment. On a money judgment, it usually is handled by seizing and selling property of the debtor.

Exemption - Privilege allowed by law to a judgment debtor that they may hold certain property from all liability to being seized or sold on execution or by any other court order.

## F

Foreclosure - Process by which a creditor with a mortgage can force a debtor to give up their interest in the property because of default and have the property sold to satisfy the debt. Also may be referred to as foreclosure by sale or performance foreclosure. See also strict foreclosure.

## G

Garnishment - A process under law where a debtor's property, money or credits under another party's control are applied as payment of a debt to a creditor.

## H

Homestead - In Wisconsin, a building which can be used for a home

and an amount of land of at least one-quarter acre, if available, and not exceeding 40 acres.

## I

Interest - Right or legal share in something.

## J

Judgment - Determination of law as the result of an action in court whether a legal duty or liability does or does not exist.

Judgment creditor - A person who has obtained a money judgment in court and can now enforce the judgment by execution.

Judgment debtor - A person who has a money judgment taken against them which has not been satisfied.

Judgment lien - A lien which can be filed by a judgment creditor against real property of a judgment debtor in order to satisfy the judgment.

## L

Land contract - Installment agreement for the purchase and sale of land.

Lien - An interest in collateral which provides that the collateral may be taken and sold in order to pay a debt if a debtor defaults. See also security interest.

## M

Mortgage - A lien on real property.

## P

Personal property - Movable property. See also chattel.

Purchase money security interest - A lien which is created when a debtor uses money loaned by a creditor to make a purchase and gives the creditor a lien on the property purchased with the creditor's money.

## R

Real property - Land, real estate.

Redemption - The right of a debtor to regain title to property under a foreclosure judgment by paying the judgment or fulfilling other conditions.

Replevin - An action to recover personal property by a party with a lien or security interest on the property.

## S

Secured debt - Debt subject to a security interest.

Secured party - A creditor, seller or other person who holds a security interest in property of a debtor.

Security agreement - A written document which creates or provides for a security interest.

Security interest - An interest in collateral which provides that the collateral may be taken and sold in order to satisfy a debt if a debtor defaults. See also lien.

Small claims court - In Wisconsin, a special court which provides quicker, more informal and inexpensive judgments in actions for evictions; replevin of property valued at \$1,000 or less and money judgments for \$1,000 or less.

Strict foreclosure - Process by which the creditor receives title to real property without a period for redemption or sale of the property in exchange for having no right to obtain a deficiency judgment.

Summons and complaint - Documents used to begin a civil action.

## U

Unsecured debt - Debt not subject to a security interest.

Unsecured party - A creditor, seller or other person who is owed a debt without having obtained a security interest through a security agreement on property of the debtor.