



October 12, 1994

SUBJECT: Bankruptcy Cases Involving Farmer Programs Loans

TO: State Directors, District Directors,  
and County Supervisors

ATTN: Farmer Programs Chiefs

PURPOSE/INTENDED OUTCOME:

The purpose of this Administrative Notice (AN) is to provide guidance on processing primary loan service for borrowers that have filed Chapter 11, 12 or 13 bankruptcy. The intended outcome is to provide a uniform system for servicing such cases.

COMPARISON WITH PREVIOUS AN:

This AN has been issued to replace AN No. 2918, which expired on October 31, 1994.

IMPLEMENTATION RESPONSIBILITIES:

This guide may be modified to meet the special needs of complicated bankruptcy cases, as needed by the State Director with the advice of the Office of the General Counsel. Borrowers who file bankruptcy will be notified of FmHA servicing actions, in accordance with paragraph 1951.907(a) of FmHA Instruction 1951-S and paragraph 1962.47(a)(3) of FmHA Instruction 1962-A.

I. Borrowers in Chapters 11, 12, or 13 bankruptcy. (See attached example.)

A. Usually, in the reorganization of the debtor's debts under Chapter 11, 12, or 13 bankruptcy, the Bankruptcy Court disregards the FmHA loan making and servicing program requirements. Often, the FmHA debt is crammed down (written off) to the court's determined value of the security. The allowed claim for the debt may be separated into categories such as livestock, machinery, real estate, and unsecured debt. Each debt category may have a separate term for repayment with an interest rate specified by the court. Sometimes the allowed debt is a combination of security types with only one term for the repayment of the debt and only one interest rate.

EXPIRATION DATE: October 31, 1995

FILING INSTRUCTIONS:  
Preceding FmHA  
Instruction 1962-A



The bankruptcy judge's order and the confirmed plan establish the amount of the FmHA debt, the repayment schedule, the interest rate allowed, the term for repaying the debt, and the security. The confirmed plan and order may also provide for the discharge of any unsecured or disallowed claim of indebtedness. FmHA must abide by the confirmed plan and order. The discharge of debt does not apply to another joint debtor who did not file bankruptcy. That debtor is still personally liable for the entire debt. However, except upon the advice of the Regional OGC, 1951-S notices must not be sent to the nonbankrupt debtor until the regulations are revised to authorize the separate handling of joint debtors in this situation.

B. Establishing the FmHA account for the confirmed plan. The attached example illustrates the functional details of processing a case.

1. When the State Director or designee is notified of the confirmation of the plan, he/she will obtain a copy of the order along with the confirmed plan and any modifications, stipulations, or elections. If there are any questions, the State Director will request OGC's opinion for an interpretation of the confirmation action. The State Director or designee will notify the County Supervisor of the order and the confirmed plan, and request the following information.

(a) The lien priority, basic type of security, and any additional security will be identified for each loan. The security may need to be further identified by types such as chattels and real estate. Chattels may need to be specifically identified as livestock and equipment, or specified by a particular name, e.g., a brand of tractor.

(b) The remaining debt allowed by the confirmed plan and order will be secured by the security specified in the confirmed plan. The secured debt will be charged to the loans in accordance with their lien priority. (See attached example)

(c) The debt determined to be an unsecured claim (debt disallowed by the Court) will be identified. In many cases the secured claim (debt which is secured) will not be adequate to fully secure the total balance of the loan. In such a case, the loan will be separated with part of the loan identified under the secured claim and part of the loan identified as an unsecured claim.

2. After identifying the lien priority and security for each loan, the State Director or designee will notify the Finance Office by memorandum to establish the borrower's account in accordance with the confirmed plan. The terms and interest rates for each loan will be those allowed by the confirmed plan for that type of security, as specified in the Court Order. The installment payments for the loans must equal the installments allowed by the confirmed plan for that type of security. New promissory notes will not be obtained unless directed by the court. The new loan number, interest rate, term of the loan and the installment will be recorded on the management card. Any existing deferral, debt set-aside, Shared Appreciation Agreement, or Net Recovery Buyout Recapture Agreement must be concluded or cancelled prior to processing the bankruptcy order, unless it is provided for in the bankruptcy plan.

C. Non-cash credit and discharge of debt. When the unsecured claim or disallowed debt is discharged, usually by Court Order in a Chapter 12 or 13 confirmed plan, the State Director will approve the cancellation in accordance with paragraph 1956.70(b)(3)(iii) of FmHA Instruction 1956-B. In a Chapter 11 confirmed plan, the State Director will approve the cancellation of the discharged debt in accordance with paragraph 1956.70(b)(3)(ii) of FmHA Instruction 1956-B. The Finance Office will be notified of the debt cancellation and be provided a copy of the plan with OGC's interpretation. A copy of the order, the confirmed plan, and copies of the promissory notes will be placed in the borrower's file.

II. Application of payments. Any payments received after the filing of the bankruptcy will be applied in accordance with the direction of the Bankruptcy Court and/or the confirmed plan. If the account also involves a nonfiling entity or individual, those payments will be applied in accordance with FmHA Instruction 1951-A. The FmHA official servicing the account will notify the Finance Office about how to credit the payments to the various loans. In some cases, it may be necessary for the Finance Office to contact the FmHA servicing official for the application of payments forwarded to the Finance Office by the United States Attorney. The terms of many bankruptcy loans will often extend beyond the closing of the bankruptcy proceeding. However, the court order will remain in full force and effect for the full term of the account, unless there is a dismissal of the bankruptcy or the Regional OGC advises otherwise.

III. Reconstruction of the old FmHA account. The Finance Office will retain the capability to reconstruct the borrower's FmHA loan account as the date of the filing of the bankruptcy. This is done so that if the bankruptcy is dismissed or the borrower decides to reaffirm the FmHA debt or for some other reason the original account is needed, it can be reinstated. All payments made to the account (whether by the bankruptcy borrower, or other entity or individual) must be credited to the account.

IV. Servicing borrowers for Chapter 12 or 13 bankruptcies during the bankruptcy proceedings.

A. The FmHA servicing official will immediately notify the FmHA State Office when the borrower is 30 days or more past due in making the FmHA payment or is otherwise in default on a confirmed Chapter 12 or 13 plan which has not completed its term. The FmHA State Office will then notify OGC and the U.S. Attorney of the default and request a dismissal of the case. The OGC will be asked to provide guidance for further actions in the case. This will include those borrowers that also have regular program loans in accordance with confirmed plans.

B. Any additional FmHA loans made during the bankruptcy proceedings must be approved by the court and be included in the confirmed plan. However, they will be processed and recorded as regular program loans.

V. Servicing for borrowers who have successfully completed confirmed plans for Chapters 12 or 13 bankruptcies and become delinquent after the bankruptcy proceedings are closed. A borrower that has successfully completed a confirmed plan under Chapter 12 or 13 bankruptcy and the bankruptcy proceedings are closed, will be serviced in accordance with FmHA Instruction 1962.47(d)(4) if any outstanding loans become delinquent or are otherwise in default. The interest rate will be one of the following (whichever is lowest): the interest rate set by the Court, the current rate, or the limited resource rate, if applicable for that type of loan. Such loans will not be consolidated with other loans. The terms of the loans will be as set out in paragraph 1951.909(e) of FmHA Instruction 1951-S for that type of loan.

VI. Other actions for Chapters 12 or 13 bankruptcies.

A. If the court approves the release of all of the FmHA security from the bankruptcy and the borrower reaffirms all the FmHA debts, the case will be returned to normal servicing in accordance with the applicable FmHA regulations and the advice of OGC. The State Director will have the SAA flag removed from the account.

B. A borrower that has successfully completed a confirmed plan under Chapter 12 or 13 may request additional loans after the bankruptcy proceedings are closed. Such loans will be processed, recorded and serviced as regular program loans.

C. After the bankruptcy proceedings have been closed, a borrower that has successfully completed a confirmed Chapter 12 or 13 plan will be returned to normal servicing for other servicing actions including graduation and liquidation. The State Director will send a memo to the Finance Office to have the SAA flag removed from the account.

D. When FmHA debts are restructured in accordance with FmHA Instruction 1951-S of this chapter for Farmer Programs loans and the restructured FmHA loans and security are approved as part of the confirmed plan, the case will be returned to normal servicing in accordance with the applicable FmHA regulations with the advice of OGC, provided the confirmed plan is completed and the bankruptcy action is closed.

#### VII. Servicing for Chapter 11 bankruptcies.

A. Any requests for additional loans from a borrower operating under a confirmed Chapter 11 bankruptcy plan will be handled in accordance with the advice of OGC.

B. All servicing actions for borrowers operating under a confirmed Chapter 11 plan will be handled in accordance with the advice of OGC.

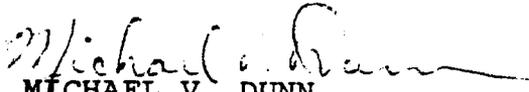
#### VIII. Chapter 7 bankruptcies.

Chapter 7 bankruptcies will be serviced in accordance with FmHA Instruction 1962-A. See Sections 1962.47(a)(3)(iv), (b)(1) and (d)(5) of FmHA Instruction 1962-A.

For informational purposes only, we are attaching an example which converts bankruptcy plan debt to FmHA debt. Because statutory authorities do not permit FmHA to consolidate various types of loans, FmHA must maintain its loan codes to determine future loan eligibility. The Finance Office may provide additional guidance for submitting any information it requires for establishing these accounts. The Finance Office will require a determination of which loans are secured in accordance with the plan's established security value, and then a separation of the amount of FmHA's unsecured claim for each loan. See steps 9 and 10 of the example which summarize how the borrower's loans will look at the end of the conversion process.

The secured loans will be given a new loan number, but the loan type will remain the same. The unsecured claim will be written off when the debt is discharged by the bankruptcy court.

If you have any question regarding this AN, contact Ed Yaxley, Farmer Programs Loan Servicing and Property Management Division, at 202-690-4021.

  
MICHAEL V. DUNN  
Administrator

Attachment

## AN EXAMPLE OF A BANKRUPT BORROWER'S ACCOUNT

The following is loan information for a borrower at the time the borrower filed Chapter 12 Bankruptcy.

Loan Code and Loan No.	Interest Rate	Interest	Principal	Date of Note	Security
SW-45-01	5%	\$17,442.70	\$ 54,695.27	11-18-76	Real Estate
FO-41-02	5%	9,575.77	35,719.54	11-18-76	Real Estate
EE-29-03	8.5%	59,426.63	110,000.00	5-24-79	Real Estate
EM-43-05	5%	8,170.20	30,016.34	6-25-81	livestock machinery Real Estate crops
EM-43-06	14.5%	7,378.50	9,442.54	6-25-81	livestock machinery Real Estate crops
EM-43-07	13.25%	39,375.31	70,700.00	6-25-81	livestock machinery Real Estate crops
FO-41-09	13.25%	37,538.52	56,200.00	5-26-82	Real Estate
OL-44-10	10.25%	22,628.13	82,568.64	4-04-84	livestock machinery crops
OL-44-11	7.25%	762.64	6,712.45	7-26-85	livestock machinery crops

Claims ordered by the Court

unsecured \$446,752.64

secured by	claim	term	int.	annual payment
R.E.	\$142,303.54	40 yrs	5%	\$8,293.45
Livestock	\$ 11,147.00	15 yrs	9 1/4%	\$1,403.41
Other Chattels	\$58,150.00	10 yrs	9 1/4%	\$9,160.89

Surrendered machinery to FmHA valued at \$4,500.00.

An amount of \$2,942.02 is to be paid on the unsecured claim in addition to the secured claims shown above.

The unsecured claims will be discharged on the successful completion of the plan. The plan is for 3 years. There is, also, the possibility of a hardship discharge.

Secured creditors will hold their liens until such time as they will be paid in accordance with the plan, at which time they will release their lien(s).

The Court has established separate claims with separate payment schedules. There is a real estate claim, a livestock claim, a machinery claim, including crops and cash collateral, and an unsecured claim.

FmHA sold the surrendered machinery and netted \$4,000. This will be applied on the unsecured claim.

The borrower's existing loans will remain on the books until the completion of the plan. Over the 3-year period of the plan, the borrower only paid \$2,000.00 of the \$2,942.02 allowed by the plan. The \$2,000.00 was applied on the unsecured claim. The remainder of the unsecured claim was discharged on completion of the plan.

Upon confirmation of the plan the Finance Office will be notified to establish the account for the confirmed plan as follows:

1. Loan SW-45-01 The major type of basic security for this loan is real estate. It is the oldest loan and has the highest lien priority on the real estate for the secured claim allowed for real estate.

Court ordered

Interest accrued - \$17,442.70	real estate value - \$142,303.54
Principal - <u>54,695.27</u>	Loan balance - <u>-72,137.97</u>
Total - \$72,137.97	Remaining claim - \$ 70,165.57

2. Loan FO-41-02 The major type of basic security for this loan is real estate.

Interest accrued	- \$ 9,575.77	Remaining R.E. claim	- \$70,165.57
Principal	- <u>35,719.54</u>	Loan balance	- <u>-45,295.31</u>
Total	- \$45,295.31	Remaining claim	- \$24,870.26

3. Loan EE-29-03 The major type of basic security for this type of loan is real estate. This was determined by checking the Form FmHA 1940-1, Request for Obligation of Funds for type of assistance code. The code was 55 which indicates it was a real estate type of a major adjustment economic emergency loan, and therefore, would have real estate as its major type of basic security. This loan has the third highest lien priority on real estate.

Interest accrued	- \$ 59,426.63	Loan balance	- \$169,426.63
Principal	- <u>110,000.00</u>	Remaining R.E. claim	- <u>-24,870.26</u>
Total	- \$169,426.63	Unsecured	- \$144,556.37

4. Loan EM-43-05 The major type of basic security for this loan is chattels. The type of assistance code for this loan indicates it was an emergency loan for an actual loss for operating purposes, and therefore, would have chattels for its major type of basic security. It has the highest lien priority on chattels. In this case, the court has separated the chattels into a secured claim for livestock and a secured claim for other chattels which includes, machinery, crops, and cash collateral. This loan has the highest lien priority on both of these types of security and the court did not select an FmHA loan for either type of secured claim. Therefore, the payment will be applied first towards the balance of this loan. We have selected the livestock claim first to illustrate that in some cases a note may have to be split. It was also secured by real estate, however, its lien priority was behind loan 29-03 and there is no equity remaining in the real estate.

Interest accrued	- \$ 8,170.20	Loan balance	- \$38,186.54
		Court ordered	
Principal	- <u>30,016.34</u>	livestock claim	- <u>-11,147.00</u>
Total	- \$38,186.54	Remaining loan balance	- \$27,039.54

5. Loan EM-43-05 has a remaining loan balance of \$27,039.54. It has the highest lien priority on the other chattels. The secured ordered value for other chattels is \$58,150.00.

Chattel claim	- \$58,150.00
Remaining loan balance	- <u>-27,039.54</u>
Remaining secured claim	- \$31,110.46

6. Loan EM-43-06 The major type of basic security for this loan is chattels. The type of assistance code for this loan indicates it was a major adjustment emergency loan for operating purposes and therefore, would have chattels as its basic security. It has the next highest lien priority on chattels. The remaining secured claim for chattels is \$31,110.46.

Interest accrued	-\$ 7,378.50	Remaining claim	-\$31,110.46
Principal	<u>- 9,442.54</u>	Loan balance	<u>-16,821.04</u>
Total	-\$16,821.04	Remaining claim balance	-\$14,289.42

7. Loan EM-43-07 The major type of basic security for this loan is real estate. The loan assistance code indicates this was a major adjustment emergency loan made for real estate purposes. The secured claim was credited to other loans with a higher priority. However, this loan was also secured by chattels and has the next highest priority.

Interest accrued	-\$ 39,375.31	Loan balance	-\$110,075.31
Principal	<u>- 70,700.00</u>	Remaining claim balance	<u>- 14,289.42</u>
Total	-\$110,075.31	unsecured balance	\$ 95,785.89

The remaining balance of \$95,785.89 is part of the unsecured claim.

8. All of the remaining loans are part of the unsecured claim.

9. The confirmed plan account is established as follows:

The secured loans will be given a new loan number, but the loan type will remain the same.

Loan Code and Loan No.	Interest Rate	Principal	Effective Date	Term	Annual Payment	Security
SW-45-01 now loan SW-45-12	5%	\$ 72,137.97	11-01-90	40yr	\$4,204.20	Real Estate
FO-41-02 now loan FO-41-13	5%	45,295.31	11-01-90	40yr	2,639.81	Real Estate
EE-29-03 now loan EE-29-14	5%	24,870.26	11-01-90	40yr	1,449.44	Real Estate
Total R.E. claim		\$142,303.54			\$8,293.45	

EM-43-05 now loan EM-43-15	9.25%	\$ 11,147.00	11-01-90	15yr	\$1,403.41	livestock
Total Livestock claim		\$ 11,147.00			\$1,403.41	
EM-43-05 now loan EM-43-16	9.25%	\$ 27,039.54	11-01-90	10yr	\$4,259.81	other chattels
EM-43-06 now loan EM-43-17	9.25%	16,821.04	11-01-90	10yr	2,649.99	other chattels
EM-43-07 now loan EM-43-18	9.25%	14,289.42	11-01-90	10yr	2,251.16	other chattels
Total other chattels claims		\$ 58,150.00			\$9,160.96	

Due to rounding-off and having to split the annual payment among three loans the total annual payment is a few cents different than the payment calculated for the other chattel secured claims.

10. The loans for the unsecured claim are as follows:

Remaining balance on loan EE-29-03	\$144,556.37
Remaining balance on Loan EM-43-07	95,785.89
Loan OL-44-10	105,196.77
Loan OL-44-11	7,475.09
Loan FO-41-09	93,738.52
Total unsecured loan balance	\$446,752.64
Sale of machinery	-4,000.00
Payments on unsecured claim during the 3-year period of the plan-2,000.00	-2,000.00
Total unsecured claim to be cancelled	\$440,752.64

At the end of 3 years, the plan is completed. The unsecured claim is discharged and the bankruptcy proceedings are closed.

The Finance Office will be notified of the cancellation of the unsecured debt of the appropriate existing FmHA accounts outlined in item 10 above. There may be some payments on the unsecured debt during the plan (\$2,000 and \$4,000 in our example) which will lower the balance as shown in item 10.

The State Director must authorize the cancellation of the debt in accordance with FmHA Instruction 1956-B.

A Chapter 13 will be processed similar to a Chapter 12 Bankruptcy.

A Chapter 11 will be processed similar to a Chapter 12 except the unsecured debt is discharged on confirmation of the plan. Cancellation of the debt would be processed at that time.