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Lawyers Advising Farmers to Know their Options

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The problems faced by growers in the Central Valley are varied and formidable. Lack of affordable water, unfair tariffs, soaring production costs and falling prices have combined to create a situation where many farmers receive less money than it costs to grow the crop. Farmers know something is wrong and fear that sooner or later insolvency will be the result.

Bankruptcy is a word that conjures various images depending on whether you're a creditor or a debtor. Some see bankruptcy as an "easy-out" for private citizens and businesses living above their means. Some see it as an opportunity to start anew and rebuild after financial tragedy.

Actually, the idea of officially forgiving debts goes back at least as far as Moses. In the book of Leviticus, God commanded the Israelites to celebrate a year of jubilee every 50 years, when all debts were forgiven and all land was returned to the family from whom it was leased.

In more recent times, the U.S. Constitution provided for bankruptcy in Article I, section 8: "The Congress shall have Power to establish . . . uniform Laws on the subject of Bankruptcies throughout the United States." Having a uniform bankruptcy law throughout the nation safeguards the recovery rights of out-of-state creditors and helps the economy function more smoothly. Some famous Americans, such as Mark Twain and Donald Trump, have been able to use bankruptcy to rebuild successful careers.

Bankruptcy allows for the discharge of debt and the orderly payment of creditors. Bankruptcy usually falls into one of two categories, liquidation or reorganization. Separated into chapters, there are five ways to file bankruptcy:

Chapter 7 allows individuals to liquidate their nonexempt property and use the money to pay creditors.

Chapter 9 is used by municipalities.

Chapter 11 allows partnerships and corporations to reorganize their debt.

Chapter 12 allows for the adjustment of debts by family farmers.

Chapter 13 is an adjustment of debts filed by individuals with regular incomes.

People get ready

"This story is a much bigger story than people are letting on," said Fresno attorney Riley Walter, partner in the Walter Law Group and certified business bankruptcy specialist in agriculture. "The farm community has its head in the sand and is hoping some miracle will come about to avert a catastrophic problem that's likely to start hitting in August of this year. The human impact will be tremendous."

Walter is most concerned about the farmers who are not proactive about their financial situation and are not taking the initiative to learn their rights.

"Farmers need to be talking to their accountants or lawyers about what could happen to them. For example, if they wait until the end of this year and the bank sweeps all the money from the crops, they're totally at the mercy of the bank. If I were a farmer, I'd like to know what my rights are before I go to the lender."

If the problem is as severe as expected land values could drop 15 to 20 percent. "Now there's another whole rung of farmers whose collateral just dissipated and they're in trouble," said Walter. "When they file it's going to drive down the value of the land even further and create another ring of people in trouble. Some of the people who ought to be protecting themselves right now don't even see the train coming. I believe that in the next 10 years, one third of the farmers on the West Side won't be in business."

He says a farmer armed with knowledge has options. "They [farmers] could have the crop proceeds in their hands and ask the lender, 'Are you going to finance me next year?' If they say no, they could then file bankruptcy and possibly be entitled to use those proceeds for next year."

Tom Brown, president of the Fresno Madera Farm Credit Association (FMFCA) said, "Our members are struggling in many of the commodity groups. The basic problem is the lack of income. There's not adequate income to cover the costs, let alone generate any return on their investment."

Brown says the smaller operations have less ability to diversify and greater need for liquidity and working capital. FMFCA recently reviewed its loan portfolio and found a segment that it's concerned about. Brown says there is a high percentage of clients who have been proactive and have taken action to reduce their costs. They have also eliminated some of the procedures that in the short-run will keep them from borrowing more money when they have difficulty repaying existing debt.

Hilton Ryder, partner in the law firm McCormick Barstow said, "I've been involved with three or four growers who have Thompson vineyards. They're really in trouble. They didn't get enough from their crop in 2000 to pay their expenses, and they're not optimistic about what's going to happen this year. I

don't have a crystal ball, but I'm not optimistic either. I've seen cases where people have asked others to farm their vineyard for free. Keep it alive for a year and you get all the proceeds. I've seen that offer rejected. Even with a zero dollar lease it doesn't make economic sense to farm."

August time line

On June 26, the San Joaquin Lender's Society is sponsoring a program called, "Lending in Tough Times." The focus will be on getting the banks' problem loan programs geared up for the coming autumn when loans are typically renewed.

Chuck Hoyt, owner of Charles Hoyt Company, a Fresno-based agricultural management firm, says that 2001 is the second year of a downward ag cycle.

"Being midway through the second year, I don't think the effects have hit yet.

Things will start getting worse in late summer and on into the fall and early winter when most farmers are renewing their lines of credit for next year."

If banks are hesitant to loan more money, farmers can't prepare for the next year. For many crops in the Valley, next year's preparation starts now. Hoyt says money for open row crops for 2002 is beginning to be spent this month.

"The farmer needs to get financing for 2002. The bank won't want to loan until 2001 is finished and they can see the results. If a farmer is already in trouble from 2000, you can see the scenario setting up for a real problem."

Brown said, "When we get to the end of the marketing cycle we may see problems." Extrapolating from his portfolio, Brown estimates around 25 percent of the Valley's farmers will experience trouble. "I wouldn't say that those people are getting ready to fail or become insolvent, but they're people who are going to be in the second year of extremely negative economics and continued operating losses. There is a limit."

So far in 2001, FMFCA has had only three foreclosures in process and one active bankruptcy out of 1,600 loans. "That's good, but you can see the handwriting on the wall," said Brown. "A lot of people have enough liquidity to withstand one year. Quite a few have enough for two and very few have enough for three years. And we're in the second year."

Walter says the ripple effect of bankruptcies can lead to other problems.

"Think of the impact. If things get as bad as expected, farmers will start missing their real property tax. That will effect local schools and municipalities. I don't mean to imply that every farmer needs to run out and declare bankruptcy. It's my personal philosophy that bankruptcy should be the last alternative."

What's a debtor/creditor to do?

Is bankruptcy the best choice and what can creditors do to protect themselves if

clients aren't able to pay? "If there's not enough money to go on next year then finding ways of liquidating nonessential assets is an option," said Hoyt. "But try not to sell core productive assets. Time is a big factor. When you're in trouble you need time. Most of what you ask a bank for is time."

Hoyt says the most important thing is open, honest communication. "That's number one, communicate with the bank and offer the bank some sort of plan. Honesty and forthrightness with banks is the key. My experience is if you don't try to screw the banks they'll try to work with you. They can be real bad, don't get me wrong, but I have met compassionate bankers."

Bankers often get a bad rap during economic downturns. Mark Twain described a banker as, "Someone who will give you an umbrella when the sun's shining and ask for it back when it begins to rain."

Brown says bankers have to consider the whole picture. "We all have things that are important to us. Whether it's the Caterpillar granddad gave me or the house mother was born in. Lenders who go in and take the last mule are foolish. In this day and age that doesn't work. People go to court and file bankruptcy and stop that action. Even though I'm on the lending side, I don't want to see people lose everything. Especially if the asset doesn't matter in relationship to the entire loan. I've learned over the years that the time value of money is such that you want to get those assets back working and not go on fighting for the last penny."

Farmers have some unique privileges when it comes to bankruptcy. For instance, unlike other industries, involuntary bankruptcy cannot be filed against farmers. This provision dates back to the depression era of the 1930s. "The bankruptcy laws have taken very good care of farmers over the years," said Ryder. "That's an advantage, but there aren't that many involuntary bankruptcies filed in the real world. You're taking a chance when forcing involuntary bankruptcies. If you screw up you're taking a risk. My analogy is, 'If you shoot at the king, don't miss.'"

Brown says bankers have learned that Chapter 11 bankruptcies are not the end-all. In fact it may be more of a positive as it prioritizes new money that goes out to continue operations. That gives the farmer additional time to put forth an acceptable plan to the court and the creditors.

"It's been found to be a manageable process that protects both the debtor and the lender," said Brown. "The ones that suffer the most are the unsecured creditors, the ones that have advanced credit for supplies and fuel. The smaller business that gets caught up in a Chapter 11 filing in turn loses its liquidity.

The product's gone. If you have widespread bankruptcies in an economic area like agriculture, it spreads through the fuel dealers, parts houses, equipment and feed brokers. That's where the impact hits the agricultural support community and ripples into the rest of the community." Brown recommends that businesses

stay current in their records and keep their accounts receivable up to date. The Valley also enjoys certain advantages other areas of the country don't have. The Valley is expecting huge growth and economic stimuli from other, non-ag industry.

"I see three kinds of farmers in the Valley," said Riley Walter. There's the far-sighted, knowledgeable farmer who knows they have to be vertically integrated. If they're going to grow garlic and tomatoes, they'd better be making salsa.

"The other third are just price-takers. They belong to some co-op and market their crop by calling a broker and asking how much they'll be given. They think that by working harder they'll solve their problem. They won't. They're already working hard, and they're the most efficient, productive farmers in the world. That's not enough. In the middle third, half of them will get it and half will not. Of the half that get it, we have to wonder will they get it soon enough to save themselves?"