

Protecting Your Harvest: Mitigating Risks in Buyer Bankruptcies

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Have you heard this one before? The farmer delivers product to a buyer and expects payment 30 days later. A check arrives in the mail a month later; the farmer cashes it. And then....bankruptcy. The next thing our farmer pulls out of the mailbox is a clawback letter, demanding that she give the money back!

Can this outrageous scenario possibly be legal? It's as alarming as it is legal. But, farmers don't have to be the victims. There are proactive steps a farmer can take to mitigate the impact a buyer bankruptcy might have on their operation. Let's explore the legal details through a different story.



Knowing your defenses in the case of a partner's bankruptcy will give you more options in the aftermath.

Let's say Jill owns a specialty butcher shop where she retails fresh cuts and sausage products to high-end restaurants. Business has been rough. Jill considers her debt for processing equipment, low profitability, and a declining customer base and realizes

bankruptcy is her best option. Her neighbor Bob dropped off \$4,000 worth of meat about a month ago as did another farmer, Sue. Their invoices need to be paid. But Butcher Jill only has enough money to pay one vendor. She writes a check to Bob, he's her neighbor, after all. A few days later, Jill files for bankruptcy. After the bankruptcy court looks at her case, the trustee issues a "clawback letter" to Bob telling him to return the payment for the meat.

When Bob reads the letter, he sees red. From his perspective, the court is either stealing his product or asking him to donate it to Butcher Jill! Sue is angry, too. Why does Bob get 100% payment of his invoice while she gets nothing? She thinks Jill shouldn't be allowed to favor her neighbor in matters as serious as this.

As the saying goes, "a good compromise leaves everyone mad," and it describes bankruptcy processes perfectly. The intention of the bankruptcy process is good: it's designed to protect the public's interest in an orderly and fair resolution when businesses can't pay their bills. That means the court is especially sympathetic to people like Sue. The bankruptcy court wants to be sure that no creditors have received unfair "preferential treatment" in the 90 days leading up to the bankruptcy filing. Preferential treatment involves actions like making sure favorite vendors or people with influence get paid back the most. One of the first steps a bankruptcy process often takes is to demand a return of every payment made to creditors in the 90 days before the filing. The court starts by assuming all payments were preferential. After all, people like Jill know their business is struggling well before they file. The court's goal is to take the clawed-back funds and split them evenly between Bob, Sue, and anyone else who extended credit to Jill in the 90 days before she filed.

If Bob were to take his clawback letter to an attorney, the first thing the attorney might do is explore an "**ordinary course of business**" defense. This defense allows Bob to say, "Hey, I was not being treated preferentially!" If Bob can show this, he may be able to keep his payment. One way Bob might win is by showing that the payment for his meat near to the time of bankruptcy was exactly as it was well before the bankruptcy was filed. Ideally, Bob would provide documentation showing that he was paid via the same method, form, and timing as he had been in every other instance. This gets harder if Bob only has a couple of transactions with Butcher Jill, perhaps because he's a new vendor or because he only delivers his product once per year. In that case, Bob could try to show that his transaction was in perfect accordance with industry standards. But, this is an expensive proposition as Bob will need an expert witness who can testify as to how meat producers and butchers normally do things. Bob might burn more money getting the expert's testimony prepared and admitted than his invoice with Jill is worth.

Bob's attorney might also argue that Bob never extended credit to Butcher Jill. This is called a "**contemporaneous exchange**" defense. It allows Bob to say, "Wait a minute, I was never a creditor of Jill! You can only do a clawback from a creditor!" For Bob to prove this, he'd need to show that Jill paid him on delivery (or close to it). Bob might also need a signed sales contract showing Bob and Jill agreed that their sales were a contemporaneous

exchange, along with a copy of the voided check that Jill sent and Bob cashed shortly after he left her shop. Some courts allow a small amount of time to pass between delivering the product and getting paid, while other courts insist the payment be made on delivery to make it a “contemporaneous exchange.” The contemporaneous exchange can be challenging as many large-scale commodity buyers simply won’t negotiate on their terms. They buy on credit and that’s it.

Time and again over our history, many small farmers have rallied to confront buyer business practices that aren’t working for them, and today’s bankruptcies are no different. State governments have responded to farmers’ vulnerability by creating things like bond programs and indemnity funds. Thirty states have a program like this. Many require that farmers submit a claim to the fund or program within a certain timeframe. Some programs may also limit the total amount they’ll give the farmer. Farmers who know the details of their state’s programs can protect themselves. They can make sure that they file on time, and they can limit total sales to any single buyer to the total amount the state will provide in compensation, should that buyer go bankrupt. Farmers may also consider filing a lien. Filing a lien has the effect of making the farmer a secured creditor: secured creditors get made whole first and they aren’t subject to clawback in bankruptcy. The process is usually simple, but states with bond and indemnity programs that cover grain farmers don’t also allow a lien. The law usually provides one or the other but not both.

Playing the long game, farmers can and should continue to work with each other to discover what isn’t working and advocate for what will work. Uniting with advocates and allies, farmers can continue to push for change that protects them. After all, bankruptcy and government programs resulted from democratic decision-making, and farmers can be full participants in that process.

Some Helpful Tips

In the event of a bankruptcy clawback letter:

	Defense	What it Means	What to Do
Clawback Letter	Ordinary course of business	I was not given preferential treatment! This was a normal transaction.	1. Show that you were paid the same way you were previously (method, form, timing) 2. Show payment is in accordance with industry standards

Clawback Letter	Contemporaneous exchange	I was never a creditor of this business. You can only trigger a clawback from a creditor.	1. Show that you were paid on delivery (or close to it in some states) 2. A signed sales contract showing buyer and seller agreed that their sales were a contemporaneous exchange, along with proof that the money was received shortly after delivery
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What farmers can do about it:

1. Find out if your state has an indemnity or bond program. (30 states do!)
 - Only sell up to the amount an indemnity or bond program will cover in each instance.
 - Know the rules of the indemnity or bond fund (filing timing, amounts, etc.) to protect yourself.
 - Find out what the period is to file a claim. Some states have a limited window when you can file a claim. Minnesota passed new legislation in 2023 with a long indemnity claim period of 36 months to file a claim. Ask your state legislators to match Minnesota's indemnity claim period to cover clawbacks that could be issued up to two years after a filed bankruptcy.
2. Join an OFA Working Group on Fair Contracts, where we can find solutions to these sorts of challenges and more. Email julia@organicfarmersassociation.org to get connected.

If you don't have an indemnity fund and you want to start one, please contact us!

3. Read more about the aftermath of a recent clawback bankruptcy case in OFA's Organic Voice magazine (Pages 11 & 21).

United States Department of Agriculture
 Agricultural Marketing Service
 National Organic Program
 Transition to Organic Partnership Program



This article was written by Rachel Armstrong for OFA.



As the founder and Executive Director of Farm Commons, Rachel Armstrong has led dozens of webinars and workshops for thousands of farmers nationwide and created the organization's innovative approach to farm law risk reduction. Rachel believes that farmers have what they need to be expert legal risk managers and that the right tools can awaken that capacity. As a leading authority on direct-to-consumer farm law, Rachel has authored many publications on farm law matters for farmers, published academic and trade articles for attorneys, and teaches university classes in farm law. She is a graduate of the University of Denver Sturm College of Law and the University of Wisconsin Madison, she lives in Northern Minnesota (where she grew up) with her family. She is licensed to practice law in Wisconsin and Minnesota.