The National Agricultural Law Center

University of Arkansas
System Division of Agriculture
NatAgLaw@uark.edu • (479) 575-7646

An Agricultural Law Research Article

A Guide to Borrower Litigation against the Farm Credit System and the Rights of Farm Credit System Borrowers

Part 2

by

Christopher R. Kelley & Barbara J. Hoekstra

Originally published in NORTH DAKOTA LAW REVIEW
66 N.D. L. REV. 127 (1990)

www.NationalAgLawCenter.org

VI. *THE FARM CREDIT SYSTEM'S FIDUCIARY DUTY TO* ITS MEMBER-BORROWERS

In several reported actions, Farm Credit System borrowers have advanced claims premised on the assertion that the FLBA or the PCA of which they were a member owed them a fiduciary duty. The alleged sources of that duty have varied. For example, in *Boyster v. Roden*,[300] the plaintiff-borrowers sought to sustain federal question jurisdiction on the assertion that the White River PCA in Newport, Arkansas, owed them a fiduciary duty as a matter of federal common law.[301] The borrowers in *Boyster* alleged that the fiduciary duty was breached when the PCA disclosed confidential information about the borrowers to a third-party.[302] In support of their claim, the borrowers argued that the various Farm Credit Administration regulations specifying the standards of conduct for System officers and employees coupled with the "pervasive involvement of the federal government" in the creation and operation of PCAs established that the federal interest was of such a nature as "to require that the fiduciary responsibilities of production credit association officers and directors be governed by a body of federal common law rather than state law."[303]

In rejecting the borrowers' claim, the Eighth Circuit held as follows:

> We are not persuaded that the substantial federal interest in successful operation of the Farm Credit System will be impaired by application of state law to appellants' claims. Even if the fiduciary law varies somewhat from state to state, no burden to the System is perceived; each production credit association is a separate entity with a local situs, and its business transactions are with farmers and ranchers in its locale.[304]

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advanced by the borrowers in each of these cases overlooked the fundamental premise that tort duties are created by the law, not a lender's internal policies. For a properly developed negligence claim, see Jacques v. First National Bank of Maryland, 307 Md. 527, 515 A.2d 756 (Md. Ct. App. 1986). *But see* Nelson v. Production Credit Ass'n of the Midlands, 729 F. Supp. 677, 686-88 (D. Neb. 1989) (applying Nebraska law and noting that even if the Nebraska Supreme Court were to adopt the *Jacques* reasoning, it would not apply in the case before it).

300. 628 F.2d 1121 (8th Cir. 1980).

301. *Id.* at 1122.

302. *Id.* at 1123.

303. *Id.* at 1123-24.

304. *Id.* at 1125. *See also* Federal Land Bank of Jackson in Receivership v. Federal Intermediate Credit Bank, 727 F. Supp. 1055, 1059-60 (S.D. Miss. 1989) (relying on *Boyster* and Birbeck v. Southern New England Production Credit Ass'n, 606 F. Supp. 1030, 1041 (D. Conn. 1985), for the proposition that "[f]ederal law has not preempted the regulation and supervision of the Farm Credit System."); *In re* Louden, 106 Bankr. 109, 113 (Bankr.

However, the court indicated that the regulations imposing certain standards of conduct on System employees, could "probably be used by appellants as evidence in a trial of their claim under state law."[305]

Boyster was followed in *Hartman v. Farmers Production Credit Association of Scottsburg.*[306] In *Hartman*, the borrowers had asserted various claims against the PCA including a claim based on an assertion of an implied right of action under the Farm Credit Act of 1971.[307] In rejecting the borrower's argument that the purpose of the Farm Credit Act would be frustrated if a private cause of action was not implied, the court concluded that the borrower's state law remedies, including a claim for breach of fiduciary duty, would adequately protect the borrower's rights.[308]

In *Umbaugh Pole Building Co., Inc. v. Scott*,[309] the borrowers sought to establish that a PCA owed them a fiduciary duty, apparently as a result of the course of dealing between the borrowers and the PCA arising from a series of loans during a two year period.[310] Although the trial court found that a fiduciary relationship existed, the Supreme Court of Ohio reversed that finding.[311]

In reaching its decision, the court in *Umbaugh* noted that, ordinarily, the relationship between a debtor and creditor is not a fiduciary relationship.[312] Nevertheless, the court pointed out that a fiduciary relationship may be created out of an informal relationship, but "only when both parties understand that a special trust or confidence has been reposed."[313] When the court examined the

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W.D. Ky. 1989)(stating that any fiduciary relationship between a FLB and a borrower is governed by state law (citing Creech v. Federal Land Bank of Wichita, 647 F. Supp. 1097, 1101 (D. Colo. 1986)).

305. *Id.* at 1125 n.5. *See also* Creech v. Federal Land Bank of Wichita, 647 F. Supp. 1097, 1101 (D. Colo. 1986) (noting that "The regulations governing operation of Farm Credit Associations impose high standards of honesty, integrity and professionalism on officers, employers and agents of the Farm Credit System" (citations omitted)).

306. 628 F. Supp. 218 (S.D. Ind. 1983).

307. *Id.* at 219.

308. *Id.* at 222. *Accord* Creech v. Federal Land Bank of Wichita, 647 F. Supp. 1097, 1101 (D. Colo. 1986); Spring Water Dairy, Inc. v. Federal Intermediate Bank of St. Paul, 625 F. Supp. 713, 720 (D. Minn. 1986); Apple v. Miami Production Credit Ass'n, 614 F. Supp. 119, 122 (S.D. Ohio 1985), *aff'd*, 804 F.2d 917 (6th Cir. 1986); Birbeck v. Southern New England Production Credit Ass'n, 606 F. Supp. 1030, 1034-44 (D. Conn. 1985); Bowling v. Block, 602 F. Supp. 667, 672, n.3 (S.D. Ohio 1985), *aff'd*, 785 F.2d 556 (6th Cir.), *cert. denied*, 479 U.S. 829 (1986).

309. 58 Ohio St. 2d 282, 390 N.E.2d 320 (1979).

310. Umbaugh Pole Building Co., Inc. v. Scott, 390 N.E.2d 320, 322 (1986).

311. *Id.* at 320.

312. *Id.* at 323.

313. *Id.* For a discussion of the generally applicable elements of an "informal" fiduciary relationship between a borrower and a lender, see *infra* note 336.

dealings between the borrowers and the PCA, it concluded as follows:

> There was no property or interest of the Scotts entrusted to the association. The only basis for the findings of the fiduciary relationship was the association's giving of advice and counseling to the Scotts relevant to their loans and business activities. But here the offering and giving of advice was insufficient to create a fiduciary relationship. While the advice was given in a congenial atmosphere and in a sincere effort to help the Scotts prosper, nevertheless, the advice was given by an institutional lender in a commercial context in which the parties dealt at arms length, each protecting his own interest.
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> * * * * *
>
> There was no promise for a continuing line of credit, and while a limited amount of advice and counseling was given, this did not vitiate the business relationship because neither party had, nor could have had, a reasonable expectation that the creditor would act solely or primarily on behalf of the debtor. Also, the rendering of advice by the creditor to the debtors does not transform the business relationship into a fiduciary relationship. The borrowers could not reasonably believe that the association was acting in a fiduciary capacity.[314]

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314. *Umbaugh*, 390 N.E.2d at 323 (citations omitted). In *Stone v. Davis*, 66 Ohio St.2d 74, 419 N.E.2d 1094, *cert. denied*, 454 U.S. 1081 (1981), the Ohio Supreme Court made a distinction between loan negotiations and "loan processing" in characterizing the relationship between the lender and borrowers. *Stone*, 419 N.E.2d at 1098. At issue was a mortgage lender's failure to advise and assist the borrowers in procuring mortgage insurance. *Id.* at 1095. In essence, the court found that the relationship between the parties changed after the loan agreement was completed and the loan transaction entered the processing or servicing stage. In the court's words:

> [t]he facts surrounding and the setting in which a bank gives advice to a loan customer on the subject of mortgage insurance warrant a conclusion that, in this aspect of the mortgage loan process, the bank acts as its customer's fiduciary and is under a duty to fairly disclose to the customer the mechanics of procuring such insurance.
>
> We observe that, while a bank and its customer may be said to, stand at arm's length in negotiating the terms and conditions of a mortgage loan, it is unrealistic to believe that this equality of position carries over into the area of loan processing, which customarily includes advising the customer as to the benefits of procuring mortgage insurance on the property which secures the bank's loan.

Id. at 1098.

See also Walters v. First National Bank of Newark, 69 Ohio St.2d 577, 433 N.E.2d 608, 610 (1982) ("The fiduciary nature . . . of the bank-customer relationship is predicated upon the bank's superior conversance with the area of loan processing. . . ."). The reasoning of the Ohio Supreme Court in *Stone v. Davis* is beneficial to borrowers in that most breaches

In *Jacobson v. Western Montana Production Credit Association*,[315] a PCA was held to a fiduciary standard in its dealings with a borrower.[316] However, in *Jacobson*, unlike the allegations based solely on a lender-borrower relationship as in *Umbaugh*,[317] the borrower alleged that the fiduciary relationship existed as a result of the PCA's involvement with a commodities broker in advising the borrower to participate in a futures trading venture.[318] Under those circumstances, the court in *Jacobson* found that the "obligation of the PCA was that of a fiduciary and the law would imply a duty to use reasonable care in giving of advice."[319]

In *Production Credit Association of Lancaster v. Croft*,[320] the borrowers attempted to establish that the PCA owed them a fiduciary duty, and that the PCA was negligent in making loans to the borrowers which the PCA knew the borrowers could not repay.[321] The trial court granted the PCA summary judgment and the borrowers appealed.[322] On appeal, the Crofts argued that the PCA owed them a fiduciary duty that was implied in law because the loan agreements gave the PCA control of the repayment requirements, and that there was a great disparity in knowledge and experience between the PCA and the Crofts.[323] The court held that the loan agreement did not create a fiduciary relationship because the provisions in the agreement that appeared to give the PCA control were necessary to protect PCA's interest in the collateral.[324] The court also held that the advice was offered by the PCA to the Crofts did not create a fiduciary relationship because the advice was not outside of what a lender would normally offer in protecting its interest.[325]

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of the lender's duties of honesty, disclosure, good faith, and fair dealing occur in the loan servicing stage.

315. 643 F. Supp. 391 (D. Mont. 1986).

316. Jacobson v. Western Montana Production Credit Ass'n, 643 F. Supp. 391, 392 (1979).

317. 390 N.E.2d. 320 (1979).

318. *Jacobson*, 643 F. Supp. at 395.

319. *Id.* at 395.

320. 423 N.W.2d 544 (Wis. Ct. App. 1988), *rev. denied*, 428 N.W.2d 554 (Wisc. 1988).

321. Production Credit Ass'n of Lancaster v. Croft, 423 N.W.2d 544, 548 (Wis. 1988).

322. *Id.*

323. *Id.* at 545-46.

324. *Id.* at 546-47.

325. *Id.* at 546-49. In reaching its decision, the court relied heavily on Bahls, *Termination of Credit for the Farm or Ranch: Theories of Lender Liability*, 48 MONT. L. REV. 213, 232 (1987) ("So long as the farmer makes his or her own business decisions and the advice given by the lender is nothing more than optional advice or is reasonably related to protection of the lender's interest in its collateral, lenders should not be treated as having a fiduciary responsibility to the borrower"). *See also* Production Credit Ass'n of West Central Wisconsin v. Vodak, 441 N.W.2d 338, 344, 346 (Wis. Ct. App. 1989) (stating that *Croft* did not hold that "a lending institution may not, under any circumstances, be liable to a customer for negligence in advising the customer on financial decisions" and also stating

A review of the foregoing cases reveals at least the following three points pertaining to a PCA's, FLBA's, or Farm Credit Bank's fiduciary obligations, if any:

1. there is no federal common law fiduciary duty of PCAs, FLBAs, or Farm Credit Banks, and any fiduciary obligation will arise solely under state law;
2. when a PCA, FLBA, or Farm Credit Bank is characterized simply as a lender in a lender-borrower relationship, "extraordinary circumstances" must be present before a fiduciary relationship will arise; and
3. if a PCA, FLBA, or Farm Credit Bank acts as a financial advisor or a broker, or in some other capacity where the law will ordinarily impose a fiduciary relationship, the institution will be treated no differently than any other entity so acting.[326]

Both Congress and the Farm Credit Administration have acknowledged that a fiduciary duty may be imposed upon Farm Credit System officers and directors to their respective institutions and shareholders under state law. For example, section 2264(a) of the Farm Credit Act provides that an institution's officers and directors may be removed from office by the Farm Credit Administration for a "breach of fiduciary duty as such director or officer."[327] Similarly, the Farm Credit Administration Board, in justifying certain regulations requiring financial disclosures by System officers and directors, has asserted that "such disclosure is needed to provide shareholders with sufficient information to hold directors and officers accountable for the performance of their fiduciary duties. . . ."[328]

It is unlikely that any Farm Credit System institution would contend that its officers and directors do not owe a fiduciary duty

that "*Croft* simply held that a fiduciary relationship did not arise under the facts of that case," not that there could never be a fiduciary relationship between a PCA and one of its borrowers), *rev. denied*, 443 N.W.2d 311 (Wisc. 1989); Nelson v. Production Credit Ass'n of the Midlands, 729 F. Supp. 677, 685 (D. Neb. 1989) (declining, with little explanation, to find a fiduciary relationship between a borrower and a PCA, but indicating that it was not persuaded to find a fiduciary relationship by the assertion that the PCA had a "special concern" towards its member-borrowers).

326. Farm Credit Banks, FLBAs, and PCAs are authorized to provide technical assistance and financial related services to borrowers. 12 U.S.C.A. §§ 2020, 2093(15), 2076 (West 1989)). *See also* Federal Land Bank of St. Paul v. Asbridge, 414 N.W.2d 596, 600-01 (N.D. 1987) (holding that the borrowers had not established a fiduciary relationship between them and the FLB on which to premise the claim that the FLB had a "fiduciary responsibility . . . to provide it member borrowers with all necessary information so that borrowers may make timely payments").

327. 12 U.S.C.A. § 2264(a) (West 1989).

328. 51 Fed. Reg. 42,084-085 (1986) (prefatory comment).

to the institution. Of course, because the System is a cooperative entirely owned by its member-borrowers, the borrowers are the "institution." Moreover, because PCAs and FLBAs are cooperatives, they are subject to a body of law that applies only to cooperative associations or cooperative corporations.[329]

Cooperatives owe unique duties to their members. As expressed in a widely recognized treatise on agricultural cooperatives, "the relationship between the members and the [cooperative] association is much more intimate and personal than between other corporations and their stockholders."[330]

This "more intimate and personal" relationship between a cooperative's members and the cooperative institution arises from the basic aim of a cooperative "to create 'a union of men, not a union of capital, as does the ordinary commercial corporation'."[331] Thus,

> ". . .it is particularly important to remember that the [cooperative] association is an organization of individuals rather than a mere abstract and impersonal entity. The personal character of the ownership in a cooperative is one of the main distinctions between the cooperative and the ordinary corporation."[332]

The unique relationship between a cooperative and its members has led some courts to impose, as a matter of law, fiduciary obligations on officers of marketing cooperatives in their dealings

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329. *See, e.g.*, Knox National Farm Loan Ass'n v. Phillips, 300 U.S. 194, 198 (1937) ("A national farm loan association [predecessor to FLBAs] is a cooperative enterprise."). It is extremely important not to confuse corporate law principles with cooperative law principles. Although many cooperatives are incorporated, their actions and conduct are subject to a body of law that is in many respects unique to cooperatives. Thus, a claim such as was made in Production Credit Ass'n of Fargo v. Ista, 451 N.W.2d 118, 120-21 (N.D. 1990), that, as a matter of corporate law, there is a fiduciary relationship between a PCA and its borrowers, is misplaced. In that case, the court correctly held that corporate law does not create fiduciary duties running from a PCA to its members. *Id.* at 121. However, the court was never presented with the question, nor did it address, whether cooperative law imposed fiduciary duties on the cooperatively organized PCA in favor of its individual members. For a discussion of the cooperative law duties of a cooperative toward its members, see *infra* notes 334-38 and the accompanying text.

330. FARMER COOPERATIVE SERVICE, USDA, LEGAL PHASES OF FARMERS COOPERATIVES 10-11 (1976) [hereinafter LEGAL PHASES].

331. E. NOURSE, THE LEGAL STATUS OF AGRICULTURAL CO-OPERATION 268 (1927).

332. I. PACKEL, THE LAW OF THE ORGANIZATION AND OPERATION OF COOPERATIVES 17 (4th ed. 1970). *See generally* Note, *Legal Aspects of Cooperative Organizational Structure*, 27 IND. L.J. 377, 378 (1952) (noting that a member of a cooperative occupies two roles: "He is both a proprietor and one of the vendors with whom the cooperative transacts business"); Staatz, *Recent Developments in the Theory of Agricultural Cooperation*, 2 J. AGRIC. COOPERATION 74, 79-80, 88-89 (1987) (discussing the theoretical aspects of the cooperative as a "coalition").

with cooperative members.[333]

To some extent, the imposition, as a matter of law, of fiduciary duties on marketing cooperatives may be motivated by the fact of the entrustment of the member's crop with the cooperative for marketing purposes. If that is the case, then a different basis will need to be found for imposing a fiduciary duty on non-marketing cooperatives such as financial or lending cooperatives as are the institutions of the Farm Credit System.

An argument can be made that there is, as a matter of law, a fiduciary obligation on the part of a cooperative towards its members. In large part, that obligation flows from the following seven criteria or hallmarks of a cooperative:

> 1. [t]he basic purpose of cooperatives is to render economic benefits to members;
> 2. [c]ooperatives are organized around the mutual interest of members;
> 3. [r]isks, costs, and benefits are shared 'equitable' among members;
> 4. [c]ooperatives are non-profit enterprises in the sense that they are organized for the economic benefit of members as users of the cooperatives' services and not to make profits for the cooperatives as legal entities for their members as investors;
> 5. [c]ooperatives are democratically controlled;
> 6. [m]embers of cooperatives have an obligation to patronize their cooperatives; and
> 7. [c]ooperatives do business primarily with members.[334]

For example, because cooperatives are nonprofit organizations in the sense that they operate at cost, it has been held that "the cooperative stands in the relationship of a trustee to the members."[335] Thus, the nature of cooperatives, coupled with

333. *E.g.*, Rhodes v. Little Falls Dairy Co., Inc., 230 App. Div. 571, 245 N.Y.S. 432, 434-35 (1930), *aff'd*, 256 N.Y. 559, 177 N.E. 140 (1931). *See also* Snyder v. Colwell Cooperative Grain Exchange, 231 Iowa 1210, 3 N.W.2d 507 (1942) (ruling that a cooperative has a duty to each member to fully disclose all material facts regarding the cooperative and that member's dealings with the cooperative). In a marketing cooperative, the members frequently deliver their products to the cooperative for marketing. A fiduciary relationship usually arises when one entrusts property with another with the understanding that the latter will use the money for the benefit of the former on in a manner consistent with the former's desires. *See* RESTATEMENT (SECOND) OF TRUSTS 2 (1959).

334. LEGAL PHASES, *supra* note 329, at 4.

335. White, *The Farmer and His Cooperative*, 7 KANSAS L. REV. 334, 335 (1959) (citing San Joaquin Valley Poultry Producers v. Comm'r, 136 F.2d 382 (9th Cir. 1943)). The "service at cost" principle dictates that there be no exploitation by the cooperative of its

increasing judicial recognition that lending institutions should be held to a higher standard than the law of the marketplace,[336]

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members. Ultimately, the members of a cooperative bear the risk for the success or failure of the cooperative. Accordingly, the cooperative must do what it can for its members, not what it must. Bakken, *Principals and their Role in the Statutes Relating to Cooperatives*, 1954 WIS. L. REV. 550, 559 (offering an informative discussion of basic cooperative principles and noting that "in cooperative business there shall be no elements of exploitation"). A pervasive theme in the academic writings on the law of fiduciaries is the role of fiduciary law as a shield against the potential abuse of power by the dominant party or parties in a relationship. *See* Frankel, *Fiduciary Law* 71 CALIF. L. REV. 795 (1983); Shepard, *Towards a Unified Concept of Fiduciary Relationships*, 97 L.Q. REV. 51 (1981).

336. *See, e.g.*, Barrett v. Bank of America, 183 Cal. App. 3d 1362, 1328, 229 Cal. Rptr. 16, 20 (1986) (holding that relationship between a bank and its borrower to be "at least quasi-fiduciary"); Lash v. Cheshire County Savings Bank, 474 A.2d 980, 982 (N.H. 1984) (upholding a jury finding of a commercial bank's breach of fiduciary duty). *See also* Djowharzadeh v. City Nat'l Bank & Trust Co., 646 P.2d 616, 619 (Okla. Ct. App. 1982) ("The precarious position of the borrower and the relatively superior position of the bank mandates there be a counterbalancing special duty imposed on the part of the bank."); Stewart v. Phoenix Nat'l Bank, 64 P.2d 101, 106 (Ariz. 1937) (noting that the changing role of banks from mere safeguarders of deposits to advice-givers justifies the imposition of higher standards of care on a bank that assumes the role of an advice-giver). ***But see*** Price v. Wells Fargo bank, 213 Cal. App. 3d 465, 261 Cal. Reptr. 735 (Cal. App. 1st Dist. 1989) (containing a highly critical discussion of injecting fiduciary concepts into the lender-borrower relationship), *rev. denied* (Cal. Dec. 7, 1989). ***See generally*** Harrell, *The Bank-Customer Relationship: Evolution of a Modern Form*, XI OKLA. CITY U.L. REV. 641 (1986) (discussing the changing nature of bank-borrower relationships and the standards of care applicable to those relationships); Oglivie, ***Banks, Advice-Giving And Fiduciary Obligation***, 17 OTTAWA L. REV. 263 (1985) (same); Hagedorn, ***Fiduciary Aspects of the Bank-Customer Relationship***, 34 MO. B.J. 406 (1978) (same).

In most jurisdictions, borrowers seeking to establish that an informally created fiduciary relationship exists between a lender and a borrower must satisfy at least two, and often three, requirements. First, it must be shown that the borrower had reposed trust and confidence in the lender. Second, as a result of that reposal of trust, the lender must have attained a position of influence and superiority over the borrower. *E.g.*, First Bank of Wakeeny v. Modern, 681 P.2d 11, 13 (Kan. 1984) (*per curiam*). In many jurisdictions a third requirement is implicitly or explicitly imposed. That requirement is that the trust and confidence reposed by the borrower "must actually be accepted by the second party [the bank]." Dewitt County Public Bldg. Comm. v. County of Dewitt, 469 N.E.2d 689, 770 (Ill. Ct. App. 4th Dist. 1984). *Accord* Umbaugh Pole Bldg Co. v. Scott, 58 Ohio St.2d 282, 390 N.E.2d 320, 323 (1979) ("A fiduciary relationship may be created out of an informal relationship, but this is done only when both parties understand that a special trust or confidence has been reposed") (citations omitted).

An argument has been advanced that the relationship between an agricultural lender and a farmer-borrower is sufficiently unique to warrant imposing a higher duty of care on the lender. When the lending relationship involves farm operating loans, this relationship is typically characterized by six attributes that distinguish it from many other lender-borrower relationships:

> First, the relationship is often a longstanding one. Once a farmer has a lender for operating capital, that relationship tends to continue.
>
> Second, the relationship is an exclusive one. The farmer depends exclusively on one lender for his operating money. That exclusivity benefits the lender by avoiding split repayment and split collateral problems.
>
> Third, the lender is intimately familiar with the operational and financial affairs of the farmer's enterprise. This familiarity is derived from the annual planning for loan disbursements and from the financial advice also given by the lender.
>
> Fourth, the lender, through its advice to the farmer and its realization that it has a financial interest in the farmer's success, may assume some control over the farmer's operation. This control is frequently manifested in the joint planning by the farmer and the lender for loan amounts and disbursements.
>
> Fifth, even if the lender does not exercise actual control, the lender has extraordinary latent control over the farmer. The source of this latent control is

strongly suggest that the cooperative institutions of the Farm Credit System might be held to a high standard of care in their dealings with their members in a properly presented case.

Of current concern to many System borrowers is the standard of care that a cooperative owes to its members when the cooperative seeks to expel a member from the cooperative. When a member is in default on a loan from a PCA, Farm Credit Bank, or FLBA, the member's stock in the PCA or FLBA is subject to liquidation.[337] Liquidation of the stock effectively expels the member from the cooperative.

Courts have consistently held that a cooperative seeking to expel a member must act fairly and in good faith. In essence, courts have resolved cooperative expulsion issues on the basic principle that "[a] private organization, especially if it has some public stature or purpose, may not expel or discipline a member and adversely affect substantial property, contract, or other economic rights unless such action results from proceedings conducted in an atmosphere of good faith and fair play."[338] These judicially imposed standards of good faith and fair play for cooper-

> usually twofold. First, the lender has substantial latent control by virtue of its security interest in most, if not all, of the farmer's machinery, equipment, land, annual production, and other personal property. Second, latent control may often exist because the loan is evidenced by a demand note. Because a demand note is due at any time that the lender desires it to be due, the lender can force a farmer to refinance or liquidate at will.
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> Sixth, as a result of their longstanding and relatively close working relationship with their lenders, most farmers develop expectations regarding their lenders. Specifically, where the relationship between a farmer and lender has been a good for one for several years, farmers reasonably expect that their lender will continue to deal with them honestly, fairly, and in good faith.

Kelley, *supra* note 4, at 19-20.

However, although this argument may afford a basis for showing that in the typical farm lender — farmer borrower relationship the borrower had reposed his confidence in the lender, and, as a result, the lender assumed a position of superiority and influence over the borrower, satisfying those elements of the three-part test for an informally created fiduciary relationship are usually not the borrower's biggest obstacle. Rather, the biggest obstacle has been showing that the lender tacitly or otherwise agreed to be held to the higher standard. Indeed, in one case where a borrower had attempted to show through the bank's advertisements that the bank had solicited the trust and confidence of the public, the bank disavowed any such intention. *In re* Werth, 37 Bankr. 979, 989 (Bankr. D. Colo. 1984) (the court characterized the bank's disavowal as "somewhat bizzare and extraordinary," but it also found that there was no fiduciary relationship established), *aff'd*, 54 Bankr. 619 (D.C. Co. 1985). *See also* Atlantic National Bank of Florida v. Vest, 480 So.2d 1328, 1333 (Fla. Ct. App. 2d Dist. 1985) (noting that where a breach of fiduciary duty between a bank and its customer has been found, it is generally possible to identify a benefit flowing to the bank as a result of the breach), *rev. denied*, 491 So.2d 281 (Fla. 1986), 508 So.2d 16 (Fla. 1987).

337. 12 U.S.C.A. §§ 2094(k), 2097 (West 1989).

338. Copeland, *Expulsion of Members by Agricultural Cooperatives*, J. AGRIC. COOPERATION 76, 82 (1986). *See also Developments in the Law — Judicial Control of Actions of Private Associations*, 76 HARV. L. REV. 983, 1006-36 (1963) (discussing the substantive and procedural limitations on actions by private associations against their members).

atives expelling member-borrowers from Farm Credit System institutions may afford the basis for enforcing or challenging the institution's consideration of the borrower for loan restructuring under section 2202(a) of the Farm Credit Act.[339]

VII. FARM CREDIT SYSTEM BORROWER RIGHTS

As a result of the Farm Credit Amendments Act of 1985 and the Agricultural Credit Act of 1987, borrowers from System institutions have statutory rights in the following areas:

1. protection of stock;
2. disclosure of interest rates and related information;
3. access to certain documents and information;
4. written notice on loan applications and review of loan application denials;
5. protection from foreclosure when loan obligations are current;
6. written notice of loan restructuring policies and review of loan restructuring denials;
7. prohibition against waiver of mediation rights;
8. rights of first refusal on land acquired by an institution from a borrower as a result of foreclosure or certain voluntary conveyances;
9. review of System lender decisions establishing the interest rate applied to a loan;
10. application of funds in uninsured accounts to borrower's outstanding loans;
11. use of FmHA guaranteed loans or other state or federal loan programs in restructuring.[340]

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339. 12 U.S.C.A. § 2202(a) (West 1989). *See also* Federal Land Bank of St. Paul v. Overboe, 404 N.W.2d 445, 448-50 (N.D. 1987) (applying equitable principles to protect FLB borrowers in judicial foreclosure proceedings); Benson Cooperative Creamery Ass'n v. First District Ass'n, 151 N.W.2d 422, 427 (Minn. 1967) (holding that a cooperative member who is wrongfully expelled from a cooperative may recover for any damages resulting from that wrongful expulsion). For a more detailed discussion of this issue, see Hoekstra, *The Cooperative Fiduciary Duty Owed by the Farm Credit System Cooperatives to their Member/Borrowers* (1989) (first place winner in the 1989 American Agricultural Law Association Writing Competition) (available from the National Center for Agricultural Law Research and Information, Leflar Law Center, University of Arkansas, Fayetteville, AR 72701) (scheduled for publication in the *J. of Agric. L. and Tax'n*, Spring 1991).

340. Proposed regulations implementing the rights created by the Agricultural Credit Act of 1987 were published on May 12, 1988, at 53 Fed. Reg. 16,934-947 (1988). The final regulations appear at 53 Fed. Reg. 35,427-458 (1988). The final regulations are codified at 12 C.F.R. Pt. 614, subpts. L & N (1990). Descriptive summaries of the borrowers' rights provisions of the Agricultural Credit Act of 1987 can be found in N. HAMILTON, BORROWERS' RIGHTS AND THE AGRICULTURAL CREDIT ACT OF 1987: A GUIDE FOR FARMERS HOME ADMINISTRATION AND FARM CREDIT SYSTEM BORROWERS AND THE ATTORNEYS (1988) (available from the Agricultural Law Center, Drake University School of

A. PROTECTION OF BORROWER STOCK

"Eligible borrower stock" in a system institution must be retired at par value.[341] "Eligible borrower stock" is defined as stock that:

(a) is outstanding on January 6, 1988;
(b) is required to be purchased, and is purchased, as a condition of obtaining a loan made after January 6, 1988, but prior to the earlier of —
    (i) in the case of each bank and association, the date of approval, by the stockholders of such bank or association, of the capitalization requirements of the institution in accordance with section 4.9B; or
    (ii) the date that is nine months after January 6, 1988;
(c) was, after January 1, 1983, but before January 6, 1988, frozen by an institution that was placed in liquidation; or
(d) was retired at less than par value by an institution that was placed in liquidation after January 1, 1983, but before January 6, 1988.[342]

B. DISCLOSURE OF INTEREST RATES AND RELATED INFORMATION

The stock purchase requirement for System loans increases the equivalent annual rate by one-half to two percentage points depending on the level of the stock requirement, the interest rate, whether "automatic or end-of-period cancellation" is used, and other factors.[343] Prior to the 1985 Act, that increased cost was not always disclosed to borrowers. Enacted in 1985 and amended by the 1987 Act, Section 2199(a) of the Farm Credit Act requires that System lenders provide borrowers with the following information:

Law, Des Moines, Iowa 50311), and Farmers' Legal Action Group, Inc., *Special Report on the Agricultural Credit Act of 1987*, FARMERS' LEGAL ACTION REP. (1988) (available from the Farmers' Legal Action Group, Inc., 1301 Minnesota Building, 46 East Fourth Street, St. Paul, Minnesota 55101). *See also* Massey & Schneider, *supra* note 6, at 589-613 (describing the borrowers' rights regulations and discussing some of the problems encountered by borrowers under the regulations).

341. 12 U.S.C.A. § 2162(a) (West 1989).

342. 12 U.S.C.A. § 2162(d)(2) (West 1989).

343. LaDue, *Influence of the Farm Credit System Stock Requirement on Actual Interest Rates*, 43 AGRIC. FIN. REV. 50, 51-52 (1983). *See also* Jones & Barry, *Impacts of Production Credit Association Capitalization Policies on Borrowers' Costs*, 46 AGRIC. FIN. REV. 15 (1988) (discussing the affect of PCA capitalization on borrower interest rates).

> . . . meaningful and timely disclosure not later than the time of the loan closing of:
> (1) the current rate of interest on the loan;
> (2) in the case of an adjustable or variable rate loan, the amount and frequency by which the interest rate can be increased during the term of the loan or, if there are no such limitations, a statement to that effect, and the factors (including, but not limited to, the cost of funds, operating expenses, and provision for loan losses) that will be taken into account by the lending institution on the effective rate of interest;
> (3) the effect, as shown by a representative example or examples, of the required purchase of stock or participation certificates in the institution on the effective rate of interest;
> (4) any change in the interest rate applicable to the borrowers loan;
> (5) except with respect to stock guaranteed under section 2162 of this title [protection of borrower stock], a statement indicating that stock that is purchased is at risk; and
> (6) a statement indicating the various types of loan options available to borrowers, with an explanation of the terms and borrowers' rights that apply to each type of loan.[344]

System lenders that offer more than one rate of interest to borrowers, often referred to as interest rate "tiers," must, at the request of a borrower holding a loan, provide the following information:

> (1) provide a review of the loan to determine if the proper interest rate has been established;
> (2) explain to the borrower in writing the basis for the interest rate charged; and
> (3) explain to the borrower in writing how the credit status of the borrower may be improved to receive a lower interest rate on the loan.[345]

344. 12 U.S.C.A. § 2199(a) (West 1989).

345. 12 U.S.C.A. § 2199(b) (West 1989). *See also* 12 C.F.R. §§ 614.4365-614.4368 & 614.4440-614.4444(1990) (regulations governing disclosure of loan information).

C. ACCESS TO CERTAIN DOCUMENTS AND INFORMATION

The 1985 Act added section 2200 to the Farm Credit Act to provide as follows:

> In accordance with regulations of the Farm Credit Administration, System institutions shall provide their borrowers, at the time of execution of loans, copies of all documents signed or delivered by the borrower and at any time, on request, a copy of the institution's articles of incorporation or charter and bylaws.[346]

That provision and other borrowers' rights provisions and regulations prompted the only farmer on the Farm Credit Administration Board to comment, "I think it's a shame when the FCA has to issue regulations to ensure the rights of stockholders and loan applicants."[347] That statement is most telling when it is noted that an act of Congress was required to give borrowers access to loan documents that they had signed. Therefore, many observers of Farm Credit System behavior were not surprised when Congress chose to act again in 1987 to expand section 2200 to give borrowers the right to receive "copies of each appraisal of the borrower's assets made or used by the qualified lender."[348]

D. WRITTEN NOTICE ON LOAN APPLICATIONS AND REVIEW OF LOAN APPLICATION DENIALS

Section 2201 of the Act provides as follows:

> Each qualified lender to which a person has applied for a loan shall provide the person with prompt written notice of —
> (1) the action on the application;
> (2) if the loan applied for is reduced or denied, the reasons for such action; and
> (3) the applicant's right to review under section 2202 of this title.[349]

If an application for a loan is denied, the applicant may request a review of that denial before the institution's credit

346. 12 U.S.C.A. § 2200 (West Supp. 1986). *See also* 12 C.F.R. § 618.8325 (1990) (disclosure of loan documents).
347. Webster, *Lenders of Interest* (interview with James R. Billington) AGRIFINANCE 12 (Dec. 1966).
348. 12 U.S.C.A. § 2200 (West 1989). *See also* 12 C.F.R. § 618.8325(b) (1990) (requiring the furnishing, on request, of copies of appraisals).
349. 12 U.S.C.A. § 2201(a) (West 1989). *See also* 12 C.F.R. § 614.4441 (1990) (notice of action on loan applications).

review committee.[350] The institution must be the lender with the "ultimate decision making authority on the loan."[351] The request must be made in writing within 30 days "after receiving a notice denying or reducing the amount of the loan application."[352]

The institution's credit review committee is usually composed of three individuals. It must include a farmer board member.[353] The delegation of duties is limited:

> The duties of the members of the review committees may not be delegated to any other person, except that the credit review committee duties of the board member may be performed from time to time by an alternate designated by the board who shall also be a board member.[354]

A loan officer who was involved in the initial decision on a loan may not serve on the credit review committee reviewing that loan.[355] However, that loan officer may "participate" in the review to answer questions but may not "serve" on the committee by being present or voting in the final deliberations.[356] The borrower has a right to appear before the credit review committee and may be accompanied by an attorney or other representative.[357]

Unsuccessful applicants for a loan or loan restructuring who appeal to the credit review committee may include in their request for review a request for an independent appraisal of any interest in property securing the loan other than the stock held by the borrower in the institution.[358] The procedure for obtaining the independent appraisal is as follows:

> Within 30 days after a request for an appraisal under paragraph (1), the credit review committee shall present

350. 12 U.S.C.A. § 2202 (West 1989).
351. 12 C.F.R. § 614.4442 (1990).
352. 12 U.S.C.A. § 2202(b)(1) (West 1989).
353. 12 U.S.C.A. § 2202(a)(1) (West 1989).
354. 12 C.F.R. § 614.4442 (1990).
355. 12 U.S.C.A. § 2202(a)(2) (West 1989).
356. *See* 53 Fed. Reg. 35,427, 35,436 (1988).
357. 12 U.S.C.A. § 2202(c) (West 1989). *See also* 12 C.F.R. § 614.4443(a) (1990) (personal appearance in the review process).
358. 12 U.S.C.A. § 2202(d)(1) (West 1989); Agricultural Credit Technical Corrections Act of 1988, Pub. L. No. 100-399, 103, 102 Stat. 989, 990. *See also* 12 C.F.R. § 614.4443(c) (1990) (independent appraisals). The right to an independent appraisal in the review of a loan restructuring denial was at issue in Zajac v. Federal Land Bank of St. Paul, No. 88-5353ND (8th Cir. July 31, 1990) (*en banc*) (1990 U.S. App. LEXIS 12932) (holding that there is no implied cause of action under the 1987 Act). For a discussion of the *Zajac* decision, see *supra* notes 242-67 and the accompanying text.

> the borrower with a list of three appraisers approved by the appropriate qualified lender from which the borrower shall select an appraiser to conduct the appraisal the cost of which shall be borne by the borrower and shall consider the results of such appraisal in any final determination with respect to the loan.[359]

A copy of the appraisal must be provided to the borrower.[360] "Promptly" after a review by a credit review committee, the committee must notify the applicant in writing of its decision and the reasons for that decision.[361]

E. PROTECTION FROM FORECLOSURE WHEN LOAN OBLIGATIONS ARE CURRENT

The Agricultural Credit Act of 1987 added a new provision that prohibits System institutions from foreclosing on any loan "because of the failure of the borrower thereof to post additional collateral, if the borrower has made all accrued payments of principal, interest, and penalties with respect to the loan."[362]

In addition, as a result of the 1987 Act, sections 2202d(b) and (c) now provide as follows:

> (b) Prohibition against required principal reduction
>
> A qualified lender may not require any borrower to reduce the outstanding principal balance of any loan made to the borrower by any amount that exceeds the regularly scheduled principal installment payment (when due and payable), unless —
>
> (1) the borrower sells or otherwise disposes of part or all of the collateral; or
>
> (2) the parties agree otherwise in a written agreement entered into by the parties.
>
> (c) Nonenforcement
>
> After a borrower has made all accrued payments of principal, interest, and penalties with respect to a loan made by a qualified lender, the lender shall not enforce acceleration of the borrower's repayment

359. 12 U.S.C.A. § 2202(d)(2) (West 1989). *See also* 12 C.F.R. § 614.4443(c) (1990) (independent appraisals in the review process).

360. 12 U.S.C.A. § 2202(d)(3) (West 1989). *See also* 12 C.F.R. § 614.4443(c) (1990) (independent appraisals in the review process).

361. 12 U.S.C.A. § 2202(e) (West 1989). *See also* 12 C.F.R. § 614.4443(d) (1990) (review process decisions).

362. 12 U.S.C.A. § 2202d(a) (West 1989). *See also* 12 C.F.R. § 614.4443(a) (1990) (protection of borrowers who meet all loan obligations).

schedule due to the borrower having not timely made one or more principal or interest payments.[363]

The 1987 Act also affords borrowers certain rights with respect to the placing of a loan in nonaccrual status. Specifically, section 2202d(d) provides as follows:

(d) Placing loans in nonaccrual status

(1) Notification

If a qualified lender places any loan in nonaccrual status, the lender shall document such change of status and promptly notify the borrower thereof in writing of such action and the reasons therefore.

(2) Review of Denial

If the borrower was not delinquent in any principal or interest payment under the loan at the time of such action and the borrower's request to have the loan placed back into accrual status is denied, the borrower may obtain a review of such denial before the appropriate credit review committee under section 2202 of this title.

(3) Application

This subsection shall only apply if a loan being placed in nonaccrual status results in an adverse action being taken against the borrower.[364]

F. WRITTEN NOTICE OF LOAN RESTRUCTURING POLICIES AND REVIEW OF LOAN RESTRUCTURING DENIALS

The Agricultural Credit Act of 1987 imposed new "mandatory" restructuring requirements on System lenders. The requirements are mandatory in the sense that an institution desiring to foreclose on a distressed loan must, except in limited circumstances,[365] notify the borrower of the right to apply for

363. 2202d(b), (c) (West 1989). *See also* 12 C.F.R. § 614.4514(c) (1990) (nonenforcement of acceleration).

364. 12 U.S.C.A. § 2202d(d) (West 1989). *See also* 12 C.F.R. § 614.4514(d) (1990) (nonaccrual status resulting in adverse action against the borrower; the regulation emphasizes that the placing of the loan in nonaccrual status must have resulted in adverse action being taken against the borrower).

365. When the lender has reasonable grounds to believe that "loan collateral will be destroyed, dissipated, consumed, concealed, or permanently removed from the state in which the collateral is located," the lender may take "appropriate" action to protect the

restructuring not later than 45 days before commencing foreclosure proceedings, and, after consideration of such an application, the institution must restructure the loan if the "cost" of the proposed restructuring plan is equal to or less than the "cost" of foreclosure.[366]

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collateral, including foreclosure. 12 U.S.C.A. § 2202a(j) (West 1989). Assumably, the notice of the right to apply for loan restructuring would be given after the collateral has been protected. See notes 475-79 *infra* and the accompanying text in Appendix A for an additional discussion of this issue.

It is axiomatic that only "borrowers" have the right to seek restructuring. *See* 12 C.F.R. §§ 614.4516, 614.4518 (1990) (implicitly defining a "borrower" as a "primary obligor." A mortgagor of a borrower is not a "borrower" for purposes of loan restructuring. Federal Land Bank of St. Louis v. McGinnis, 711 F. Supp. 952, 957-58 (E.D. Ark. 1989).

366. 12 U.S.C.A. § 2202a (West 1989). *See also* 12 C.F.R. §§ 614.4512 & 614.4514-4522 (1990) (consisting of Part K, subpart N).

A borrower who files a bankruptcy petition is eligible for a loan restructuring under the 1987 Act. *See In re* James Desmond Woods, Jr., No. 88-BK-01659-M11 (W.D. La. March 16, 1989)(interim order in adversary proceeding) (1987 Act remedies and remedies under Bankruptcy Code are not mutually exclusive). Thus, it has been held that an FLB's compliance with the 1987 Act is "a condition precedent to the commencement of a proceeding in bankruptcy that constitutes a foreclosure proceeding as defined by the Act." In the Matter of Dilsaver, 86 Bankr. 1010, 1015 (Bankr. D. Neb. 1988), *aff'd sub nom., In re* Hilton Land & Cattle Co., 101 Bankr. 604, 606 (D. Neb. 1989) (holding that an FLB "must comply with the [1987] Act by providing the appropriate restructuring process requested by the debtors prior to commencing a foreclosure proceeding to sequester rents and profits"); Hill v. Farm Credit Bank of St. Louis, 726 F. Supp. 1201, 1205 (E.D. Mo. 1989) ("[U]pon review of the legislative history of the 1987 Act, the Court is persuaded that Congress did not intend to exclude debtors in bankruptcy from the protections of the Act"); *In re* Kramer, 107 Bankr. 668, 669-70 (Bankr. D. Neb. 1989)(1989 Bankr. LEXIS 2076) (following *Dilsaver* as affirmed *sub nom. In re* Hilton Land and Cattle Co.).

However, by the weight of authority, the 1987 Act does not alter or displace any provision of the Bankruptcy Code. *See In re* Kraus, No. BK 86-2677, slip op. at 2 (Bankr. D. Neb. May 20, 1988) (memorandum order denying, *inter alia*, debtor's motion to dismiss) (holding that "the enactment of the Agricultural Credit Act [of 1987] should not be construed to alter the rights, interests and relationships of the parties under a [Chapter 11] plan confirmed before the effective date of the statute"); *In re* Pennington, No. 87-01485-BKC-DTW (Bankr. N.D. Miss. March 22, 1988) (1987 Act does not affect the valuation of secured property in bankruptcy pursuant to 11 U.S.C.A. § 506(a)); *In re* Bellman Farms, Inc., 86 Bankr. 1016 (S.D. Iowa 1988) (1987 Act does not affect the valuation of secured property in bankruptcy pursuant to 11 U.S.C.A. § 506(a)); *In re* Kvamme, 91 Bankr. 77, 78 (Bankr. D.N.D. 1988) (1987 Act does not "overrule, repeal, or render inoperative any portion of the Bankruptcy Code including [11 U.S.C.] section 1111(b)"); *In re* Felton, 95 Bankr. 629 (Bankr. N.D. Iowa 1988); *contra In re* Burton, No. 87-01099-K52, slip op. at 1 (Bankr. E.D. Wash. Aug. 12, 1988) (order fixing value of secured claim) (ordering that "the allowed secured claim of FCB [Farm Credit Bank of Spokane] under 11 U.S.C.A. § 1225(a)(5)(B)-(ii) shall be equal to the fair value of the real property collateral reduced by the cost of foreclosure as defined in the 1987 Act").

The issue of whether a debtor in a Chapter 12 bankruptcy proceeding may surrender or compel the retirement of his or her stock in an FLBA or PCA has resulted in inconsistent holdings by the courts addressing the issue. All of the reported decisions have permitted either full or partial surrender of stock, although the first of those decisions to be reported was reversed and the most recently decided case is on appeal to the Sixth Circuit. *In re* Massengill, 73 Bankr. 1008 (Bankr. E.D. N.C. 1987), *rev'd in part*, 100 Bankr. 276 (E.D. N.C. 1988); *In re* Indreland, 77 Bankr. 268 (Bankr. D. Mont. 1987); *In re* Chaney, 87 Bankr. 131 (Bankr. D. Mont. 1988); Matter of Arthur, 86 Bankr. 98 (Bankr. W.D. Mich. 1988); *In re* Ivy, 86 Bankr. 623 (Bankr. W.D. Mo. 1988); *In re* Neff, 89 Bankr. 672 (Bankr. S.D. Ohio 1988), *modified in part on reconsideration*, 96 Bankr. 800 (Bankr. S.D. Ohio 1989); *In re* Miller, 98 Bankr. 311 (Bankr. N.D. Ohio 1989), *order amended*, 106 Bankr. 136 (Bankr. N.D. Ohio 1989); *In re* Shannon, 100 Bankr. 913 (S.D. Ohio 1989), *appeal filed*, No. 89-3585 (6th Cir. June 19, 1989). *See also In re* Greseth, 78 Bankr. 936 (D. Minn. 1987) (affirming the

As a threshold matter, "restructuring" is broadly defined as follows:

> The terms "restructure" and "restructuring" include rescheduling, reamortization, renewal, deferral of principal or interest, monetary concessions, and the taking of any other action to modify the terms of, or forbear on, a loan in any way that will make it probable that the operations of the borrower will become financially viable.[367]

A borrower seeking to have a loan restructured must apply in writing on forms provided by the institution and, where appropriate, must support the proposed restructuring plan with "sufficient financial information and repayment projections."[368]

The general criteria for evaluating a restructuring proposal are as follows:

> When a qualified lender receives an application for restructuring from a borrower, the qualified lender shall determine whether or not to restructure the loan, taking into consideration —
> (a) whether the cost to the lender of restructuring the loan is equal to or less than the cost of foreclosure;
> (b) whether the borrower is applying all income over and above necessary and reasonable living and operating expenses to the payment of primary obligations;
> (c) whether the borrower has the financial capacity and the management skills to protect the collateral from diversion, dissipation, or deterioration;
> (d) whether the borrower is capable of working out existing financial difficulties, reestablishing a viable

bankruptcy court's approval of a partial surrender of stock). *But cf. In re* Stedman, 72 Bankr. 49 (Bankr. D. N.D. 1987) (declining to deduct the value of the debtors' FLBA stock from the debtors' indebtedness to the FLB in determining the debtors' eligibility for Chapter 12). In addition, in affirming an unreported bankruptcy court decision, a district court has approved a Chapter 12 plan allowing the debtors to surrender their stock. *In re* Cansler, 99 Bankr. 758 (W.D. Ky. 1989).

367. 12 U.S.C.A. § 2202a(7) (West 1989). *See also* 12 C.F.R. § 614.4512(h) (1990) (defining "restructure" and "restructuring"). See 12 U.S.C.A. § 2202b (West 1989) and *supra* note 366 for the effect of restructuring on the borrower's stock in the institution.

368. 12 U.S.C.A. § 2202(a)(1) (West 1988). *See also* 12 C.F.R. § 614.4512(a) (1990) (defining "application for restructuring"); Federal Land Bank of Omaha v. Christensen, No. 22641 (Buena Vista Co. Dist. Ct., Iowa, July 6, 1988) (order granting FLB's motion for summary judgment on the grounds that an application for restructuring unaccompanied by a plan was fatally defective); Federal Land Bank of St. Louis v. McGinnis, 711 F. Supp. 952, 957 (E.D. Ark. 1989) ("FLB has authority to establish a deadline for submitting an application.").

operation, and repaying the loan on a rescheduled basis; and

(e) in the case of a distressed loan that is not delinquent, whether restructuring consistent with sound lending practices may be taken to reasonably ensure that the loan will not become a loan that it is necessary to place in nonaccrual status.[369]

Of those five criteria, the initial two warrant explanation and discussion.

A comparison of the "cost of foreclosure" with the "cost of restructuring" is at the core of the evaluation process. Indeed, because section 2202a(e)(1) provides that: [i]f a qualified lender determined that the potential cost to a qualified lender of restructuring the loan in accordance with a proposed restructuring plan is less than or equal to the potential cost of foreclosure, the qualified lender shall restructure the loan in accordance with the plan,[370] the comparison may be determinative.

"Cost of foreclosure" is specifically defined as follows:

The term "cost of foreclosure" includes—

(a) the difference between the outstanding balance due on a loan made by a qualified lender and the liquidation value of the loan, taking into consideration the borrower's repayment capacity and the liquidation value of the collateral used to secure the loan;

(b) the estimated cost of maintaining a loan as a nonperforming asset;

(c) the estimated cost of administrative and legal actions necessary to foreclose a loan and dispose of property acquired as the result of the foreclosure, including attorneys' fees and court costs;

(d) the estimated cost of changes in the value of collateral used to secure a loan during the period beginning on the date of the initiation of an action to foreclose or liquidate the loan and ending on the date of the disposition of the collateral; and

(e) all other costs incurred as the result of the foreclosure or liquidation of a loan.[371]

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369. 12 U.S.C.A. § 2202a(d)(1) (West 1989).

370. 12 U.S.C.A. § 2202a(e)(1) (West 1989).

371. 12 U.S.C.A. § 2202a(a)(2) (West 1989). *See also* 12 C.F.R. § 614.4512(c) (1990) (defining "cost of foreclosure").

"Cost of restructuring," or the computation of it, takes into account "all relevant factors" including the following:

(a) the present value of interest income and principal forgone by the lender in carrying out the restructuring plan;
(b) reasonable and necessary administrative expenses involved in working with the borrower to finalize and implement the restructuring plan;
(c) whether the borrower has presented a preliminary restructuring plan and cash-flow analysis taking into account income from all sources to be applied to the debt and all assets to be pledged, showing a reasonable probability that orderly debt retirement will occur as a result of the proposed restructuring; and
(d) whether the borrower has furnished or is willing to furnish complete and current financial statements in a form acceptable to the institution.[372]

Because the "cost of restructuring" considers "the present value of interest income and principal forgone by the lender in carrying out the restructuring plan," the conceptual approach to restructuring under the 1987 Act has generated confusion and questions as to whether Congress intended that the System apply traditional approaches to restructuring.

Traditionally, most lenders and borrowers have used the recovery value of the assets securing the note together with any other unencumbered, nonexempt assets as the benchmark for assessing the propriety of restructuring. If the borrower could "cash flow" a restructured note that had a present value equal to or greater than the value of the recoverable assets, then the lender could justify restructuring on the grounds that the restructured note would pay the same sum than the lender would realize through foreclosure or in a Chapter 12 bankruptcy proceeding.[373]

372. 12 U.S.C.A. § 2202a(e)(2) (West 1989). *See also* 12 C.F.R. § 614.4517(a) (1990) (consideration of application).

373. 11 U.S.C.A. §§ 1201-31 (West Supp. 1990) (codifying Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, 251-57, 100 Stat. 3088, 3104-16 (1986)). For general discussions of Chapter 12, see Aiken, *Chapter 12 Family Farmer Bankruptcy*, 66 NEB. L. REV. 632 (1987); Armstrong, *The Family Farmer Bankruptcy Act of 1986: An Analysis for Farm Lenders*, 104 BANKING L.J. 189 (1987); Hahn, *Chapter 12 — The Long Road Back*, 66 NEB. L. REV. 726 (1987); Matson, *Understanding the New Family Farmer Bankruptcy Act*, 21 U. RICH. L. REV. 521 (1987); Wilson, *Chapter 12: Family Farm Reorganization*, 8 J. AGRIC. TAX'N & L. 299 (1987); Note, *Bankruptcy Chapter 12: How Many Family Farms Can It Salvage?*, 55 UMKC L. REV. 639 (1987); Note, *An Analysis of the Family Farmer Bankruptcy Act of 1986*, 15 HOFSTRA L. REV. 353 (1987).

Although each of the Farm Credit districts are operating under the same statute and essentially the same restructuring policies,[374] at least three different approaches to computing the appropriateness of restructuring appear to be in use. One approach, apparently employed only by the Seventh Farm Credit District based in St. Paul, Minnesota, is discussed in detail below.[375] Described charitably, the Seventh Farm Credit District's approach is nonsensical. As can be seen by examining the worksheets and their accompanying instructions set forth below, the Seventh Farm Credit District determines the cost of restructuring essentially by subtracting the present value of the proposed restructured note from the present value of the outstanding principal and interest on the original note computed at an interest rate, currently 12.5 percent, that is higher than the discount rate, currently 9 percent.[376] In effect, the computational formula used by the Seventh Farm Credit District allows the sum of money owed on the original rate that will never be paid, under any circumstances, to be the reference point for comparing all other cost. Under traditional, common sense approaches to restructuring, the reference point is the recovery value of the collateral together with any other recoverable assets, not a sum of money that the borrower is unable to repay.

No other district appears to be following the Seventh Farm Credit District's approach. Most appear to be using a liquidation analysis.[377] A liquidation analysis first determines the recovery value of any collateral and/or other recoverable assets.[378] Next, it determines the present value of the proposed restructured note.[379] Finally, it compares the recovery value of the assets with

374. Each system lender was required by the 1987 Act to develop a restructuring policy. 12 U.S.C.A. § 2202a(g) (West 1989). By and large, each of the policies parroted the language of the 1987 Act's loan restructuring provisions. (Copies of the policies are available from Mr. Kelley.) *See* Massey & Schneider, *supra* note 6, at 593 (the authors of this article reviewed the same policies reviewed by Mr. Massey and Ms. Schneider and came to the same conclusion).

375. *See infra* notes 389-94 and the accompanying text.

376. *Id.*

377. Although the meaning of a "liquidation analysis" varies with the context in which it is used, for bankruptcy purposes, liquidation analysis has been defined as follows: "... the debtor's equity (value of debtor's assets less the amount of any liens) in his non-exempt assets, when divided by all unsecured claims, must not exceed the percentage repayment to unsecured creditors proposed under the plan." Matson, *Understanding the New Family Farmer Bankruptcy Act*, 21 U. RICH. L. REV. 521, 531 (1987). A further definition is that a plan cannot be approved unless unsecured creditors receive as much under the plan as they would have in a chapter 7 bankruptcy. *Id.*

378. *Id.*

379. *Id.*

the present value of the proposed restructured note.[380] To the extent that other districts incorporate into their analysis the present value of interest income and principal forgiven by the lender in carrying out the restructure plan, those districts compute that figure under both the cost of foreclosure and the cost of restructuring so that the sum is "cancelled out."[381] In that way, the restructuring decision is not based on the sum of money that the borrower is unable to repay and that will never be recovered by the institution. However, at least one court has ruled that the 1987 Act "does not mandate the restructuring of the debt at the liquidation value of the collateral."[382]

At least one of the districts, the Fifth Farm Credit District based in Jackson, Mississippi, appears to be using what might be described as an "institutional cash flow analysis" approach to restructuring.[383] The analysis has many of the same features of a liquidation analysis, but it also incorporates the institution's "cost of funds" in the computations.[384]

Currently, borrowers seeking to apply for restructuring are encountering at least two practical difficulties. First, the computational process contemplated by the restructuring provisions of the 1987 Act are not discernible from anything less than a laborious, time-consuming reading of the statute. The restructuring policies issued to date pursuant to section 2202a(g) and provided to bor-

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380. *Id.*

381. *See* Wilson, *supra* note 373, at 302.

382. *In re Bellman Farms, Inc.*, 86 Bankr. 1016, 1022 (Bankr. D.S.D. 1988).

383. *See* FIFTH FARM CREDIT SYSTEM 1987, INTERNAL RESTRUCTURING MANUAL (1988) (available from Mr. Kelley).

384. Although the authors of this article have examined restructuring "worksheets" given to borrowers by System institutions in a number of districts, the authors only have copies of the internal restructuring manuals for the St. Paul and Jackson districts. Because North Dakota is in the Seventh Farm Credit District based in St. Paul, that district's restructuring formula is the focus of this article. Readers who represent borrowers in other districts may find common issues in the discussion that follows, but they should be aware that St. Paul may be the only district employing the formula discussed.

Readers are also advised that the restructuring formulas employed by System lenders may be modified from time to time. There is reason to believe that the restructuring requirements of the 1987 Act caused some confusion and disagreement among System lenders as to the specific methods by which the cost of restructuring and the cost of foreclosure were to be computed. As a consequence, the development of restructuring formulas has been influenced by differing interpretations of the law and differing institutional traditions, philosophies, and biases as well as an element of "trial and error."

It has been the experience of one of the authors, Mr. Kelley, an experience reportedly shared by others, that occasionally a loan will be restructured with little or no regard to the stated formula. Such experiences should not be unexpected given the number of differences between institutions, loan officers, and borrowers. Nevertheless, despite the difficulties of doing so, borrowers would be well advised to attempt to obtain their respective lender's formula prior to submitting an application for loan restructuring. Those difficulties are discussed at *infra* note 390 and the accompanying text. *See also* Massey & Schneider, *supra* note 6, at 592.

rowers as a part of the restructuring application "packet" generally parrot the language of the statute.[385]

In other words, as a matter of course, borrowers are not being provided with a clear, simple explanation of the computational steps involved in computing and comparing the cost of foreclosure and the cost of restructuring.

The second difficulty is that borrowers, as a matter of course, are not being provided with the institution's anticipated costs of foreclosure. In addition, some of the cost projections used by some institutions are either not justified or are not justifiable.[386]

The Seventh Farm Credit District, has issued a manual to its employees explaining the computational steps and the cost figures to be used in restructuring.[387] The manual includes worksheets that are to be completed by the loan officer and presented to the borrower at the credit review committee should review be necessary and requested. The current practice of the Seventh Farm Credit District is not to provide those worksheets to the borrower prior to the credit review committee meeting.[388] Even then, some institutions will not provide the borrower with a photocopy of the worksheets.[389]

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385. The adoption of restructuring policies is required by 12 U.S.C.A. § 2202a(g) (West 1989).

386. SEVENTH FARM CREDIT SYSTEM 1987, RESTRUCTURING MANUAL (1988). Significant portions of the manual can be found at *Oversight On The Implementation Of The Agricultural Credit Act Of 1987: Hearings Before the Subcommittee on Agricultural Credit of the Senate Committee on Agriculture, Nutrition, And Forestry*, 100th Cong., 2nd Sess. 415-76 (1988) (statement of James T. Massey, Executive Director of the Farmers' Legal Action Group, Inc.).

387. A more detailed statement of the views of one of the authors on these difficulties can be found at *Review Of Implementation Of The Agricultural Credit Act of 1987, Public Law 100-233: Hearing Before the Subcommittee on Conservation, Credit, And Rural Development of the House Committee on Agriculture*, 100th Cong., 2nd Sess. 286-94 (1988) (statement of Christopher R. Kelley, Visiting Assistant Professor of Law, William Mitchell College of Law).

Although the System lenders are not subject to the Freedom of Information Act (FOIA), 5 U.S.C.A. § 552 (West 1977 & Supp. 1990), the Farm Credit Administration is subject to the Act. *See* 12 C.F.R. §§ 602.250-602.265 (1990). Pursuant to 12 U.S.C.A. § 2202a(g)(3) (West 1989), some System lenders submitted substantial portions of their loan restructuring manuals or worksheets to the FCA. Those materials are available from the FCA through an FOIA request. *See also* Massey & Schneider, *supra* note 6, at 593 (referencing loan restructuring documents obtained through FOIA). *See generally* COMMITTEE ON GOVERNMENT OPERATIONS, 101ST CONG., 1ST SESS., A CITIZEN'S GUIDE ON USING THE FREEDOM OF INFORMATION ACT AND THE PRIVACY ACT OF 1974 TO REQUEST GOVERNMENT RECORDS (Comm. Print 1989) (a guide to the use of FOIA).

388. This statement is based on one of the author's, Mr. Kelley's, experience with borrower litigation. He found the practice to result in a significant waste of time at the credit committee review hearing because time had to be spent reviewing the figures used and checking the accuracy of the calculations made.

389. This practice is particularly pointless in light of the fact that the committee will usually permit the copying of the figures and calculations by hand. It underscores why Congress heard enough complaints from borrowers to prompt it to enact a statute requiring System lenders to give borrowers copies of the loan documents that they had signed. 12

The text of two of the basic worksheets used by the Seventh Farm Credit District together with the text of the instructions provided by the District together with the text of the instructions provided by the District to its loan officers follows. The worksheets included here are used for analyzing a restructuring proposal contemplating level payments. A restructuring proposal contemplating a cash-out, partial deed-back, or debt set aside requires the use of different restructuring worksheets. However, most of the basic concepts and calculations remain the same regardless of the terms of the restructuring proposal.

Because the worksheets and instructions require the use of present value calculations, present value and annuity tables based on a nine percent discount rate follow the worksheets and instructions. The Seventh Farm Credit District has chosen nine percent as its discount factor, and the tables must be consulted to complete the worksheets. Following the tables is a brief discussion of several aspects of the worksheets and the instructions that require clarification or comment.

U.S.C.A. § 2200 (West 1989). *See also supra* note 347 and the accompanying text (quoting a member of the FCA Board as stating that "I think it's a shame when the FCA has to issue regulations to insure the rights of stockholders and loan applicants").

FORECLOSURE COSTS

WORKSHEET

MEMBER VIEW $__________

PRINCIPAL $__________

INTEREST $__________

		COSTS
1. INVESTMENT		$ ________
2. ADD: COSTS		
A) TAXES	$ ________	
B) DISPOSITION COSTS	$ ________	
C) LEGAL	$ ________	
D) INSURANCE AND REPAIR	$ ________	
$ ________		
3. TOTAL INVESTMENT		
$ ________		
4. LESS: RECOVERABLE ASSETS		
A) STOCK	$ ________	
B) AV OF PROPERTY X (.8780) NPV	$ ________	
C) OTHER RECOVERABLE ASSET (PV)	$ ________	$ ________
5. FORECLOSURE		
$ ________		

COST OF FORECLOSURE PROCEDURE

1. INVESTMENT — This line shows our total investment to date, including all expenses advanced and accrued interest.
2. ADD: COSTS —
   a) TAXES — This represents all past due taxes (excluding those advanced and shown above in Line 1) and two years of estimated future taxes.
   b) DISPOSITION COSTS — This represents our anticipated sales costs. Based on projections and experience in acquired property sales, this is a flat 3% of appraised value. Calculation: AV X 3%.[390]
   c) LEGAL — Again, these are anticipated legal expenses which are not already included in Line 1. We expect 1-2% of AV for legal expenses; however, your legal expense levels must be based on individual service center experience.
   d) INSURANCE AND REPAIR — Enter estimated insurance and repair expenses during the foreclosure process.
3. TOTAL INVESTMENT — This represents our investment after adding the foreclosure costs FCS faces in a foreclosure action. Please note that the added costs are not calculated on a net present value basis. The timing of expenses is so varied, including many front-end expenses, such that a present value calculation would require an inordinate amount of time and would show only a slight impact on the costs presented.
4. LESS: RECOVERABLE ASSETS
   a) STOCK — Enter the current amount of stock held by the borrower. Remember that on a foreclosure in process stock may have been applied as a reduction in the investment amount (Line 1). If that is the case, Line 4a should be zero.

390. The three percent figure may have been increased to five percent in mid-1988. Because it is the current policy of the Seventh Farm Credit District not to divulge the specific contents of current loan restructuring policy manuals, this figure cannot be confirmed. Telephone interview with William Collins, General Counsel for the Seventh Farm Credit District, Dec. 22, 1989. Moreover, as noted at *supra* note 384, loan restructuring policies for all of the System lenders are subject to change in various respects. Accordingly, the reader is advised to attempt to obtain the current manual or other written policy statement prior to relying on the information provided in this article regarding the contents of the Seventh Farm Credit District's loan restructuring manual. Failing that, the reader should use the portions of the manual discussed or reproduced in this article only as a general guide.

b) AV OF PROPERTY — This line represents the present value of the property we would recover in foreclosure. We recommend calculating an amount by multiplying the appraised value of the property by a .8780 discount factor (based on a 9% discount rate over one and a half years). However, if the loan officer has *strong* evidence that the property value will change (up or down), you may use the present value of the appreciated or depreciated property. Also, the length of foreclosure may vary if properly supported.

c) OTHER RECOVERABLE ASSETS — This line includes the present value of any other assets we could recover in the foreclosure process, including the value of any deficiency judgments. The asset should reflect present values.

5. COST OF FORECLOSURE — This line represents the cost of foreclosure for comparison with restructuring costs. It is calculated by subtracting the Total Recoverable Assets from Total Investment. Line 3 — (lines 4a + 4b)

COMMENTS — If foreclosure costs exceed restructure costs, explain here the appropriate credit factors which support foreclosure over restructure. This section must address factors supporting foreclosure such as:

a) borrower applying all available income to the payment of primary obligations

b) borrower's financial capacity and management skills to protect collateral

c) borrower's capacity to work out of existing financial difficulties

RESTRUCTURE COSTS — LEVEL PAYMENTS[391]

WORKSHEET

1. RESTRUCTURE TERMS
   - A) PRINCIPAL $ ________
   - B) CASH $ ________
   - C) STOCK ________
   - D) OTHER CONSIDERATIONS ________
   - E) TOTAL CONSIDERATIONS $ ________
   - F) INTEREST RATE/TERMS ________________

COSTS

2. PRESENT VALUE ORIGINAL LOAN $ ________
3. ADD: PRESENT INTEREST FORGIVEN
   - A) PRESENT INTEREST $ ________
   - B) LESS: CASH PAYMENT ________
   - C) LESS: STOCK ________
   - D) LESS: OTHER CONSIDERATIONS ________ ________
4. LESS: PRESENT VALUE RESTRUCTURED LOAN $ ________
5. OTHER RESTRUCTURE COSTS
   - A) $ ________
   - B) ________

$________________________________

6. COMPROMISE/RESTRUCTURE COSTS

$________________________________

391. The Seventh Farm Credit District has changed the restructure costs worksheet that formerly accompanied the instructions that follow. The worksheet set forth is the newer one. Thus, Item 2 in the instructions that follow, "Present Interest Forgiven," is now found at Item 3 on the new worksheet. Item 4 is the instructions, "Present Value of Interest Concessions," is omitted from the newer worksheet. Item 3(a) in the instructions, "Present Value of Foregone Principal and Interest — Original Amount," is now shown at Item 2 on the newer worksheet. Item 3(b) of the instructions, "Less: Restructured Amount," is shown at Item 4 of the newer worksheet.

* * * * * * * * * *

RESTRUCTURE COSTS — LEVEL PAYMENTS
PROCEDURES/DEFINITIONS

1. RESTRUCTURE TERMS —
   a) PRINCIPAL — This line shows the principal balance of the loan after the restructure is completed and accounted for.
   b) CASH — Enter any cash payment received.
   c) STOCK — Enter the value of all stock reductions which are applied to the loan in the restructure.
   d) OTHER CONSIDERATIONS — This category includes any other monetary considerations received for the restructure, including up-front cash, set aside loans or net recovery value of collateral deeded to FCS. In complex restructures, loan officers have the option to add lines (d, e, f . . .) if necessary to clarify the restructure terms. Do not include the value of additional collateral as other considerations.
   e) TOTAL CONSIDERATION — This line is the sum of Lines 1a, 1b, 1c and 1d.
   f) INTEREST RATE/TERMS — This line briefly defines the interest rates charged on the restructured loan, including any concessionary rates (and their duration). It also should identify the term of the restructured loan. This format is for level payments.
2. PRESENT INTEREST FORGIVEN — The Agricultural Credit Act of 1987 provides Farm Credit institutions with the ability to consider foregone principal and interest as part of its Restructure Costs. This section identifies the cost associated with present interest forgiven.
   a) PRESENT INTEREST — Enter the present interest balance.
   b) LESS: CASH PAYMENT — Enter any cash payment (if any) intended to be a payment of interest. Show the net of Lines 2a and 2b under the "Cost" column.
   c) LESS: STOCK — Enter the value of any stock applied to the loan as part of the restructure.
   d) LESS: OTHER CONSIDERATIONS — Enter the value of other considerations identified on Line 1d. Enter the result of Lines 2a minus 2b minus 2c minus 2d in the right hand column.

3. PRESENT VALUE OF FOREGONE PRINCIPAL AND INTEREST — This section evaluates the present value of foregone principal and interest by comparing the present value of the original loan with the present value of the restructured loan. We use the present value of the original loan with the present value of the restructured loan. We use the present value of an annuity concept (annual payments over a defined period of time) to determine the present value of a flow of equal payments. The difference is foregone for the life of the loan.
   a) ORIGINAL AMOUNT — Enter the result of the original payment amount times the appropriate present value factor (PVF) to show the present value of the original loan.
   b) LESS: RESTRUCTURED AMOUNT — This line begins with a restructured payment amount which is calculated from the restructured principal amount and the general interest rate that would apply to the loan without any interest rate concessions. Enter the result of the restructured payment times the appropriate present value factor to show the present value of the restructured loan. Subtract this amount from the result in Line 3a and enter this difference in the right hand column.
4. PRESENT VALUE OF INTEREST CONCESSIONS — There are costs associated with interest concessions which can be calculated on a present value basis. These calculations are less exact, but provide a sound approximation of the cost of an interest rate concession. Use this only when offering a concessionary interest rate for part of the loan term.
   a) RESTRUCTURED PAYMENT AMOUNT — Enter the same payment amount as shown on Line 3b.
   b) LESS: CONCESSION PAYMENT AMOUNT — Enter the payment amount based on the concessionary interest rate and the term of the concessionary rate.
   c) FOREGONE ANNUAL PAYMENT AMOUNT — Enter the difference between Line 4a and 4b on this line.
   d) TIMES: PRESENT VALUE FACTOR — Multiply the result on Line 4c by appropriate present value factor based on the interest rate concession and the length of the concession. Show the results of this calculation under the "Cost" column. (We are using a present value of an annuity table — further directions will be provided in the final draft.)

5. OTHER RESTRUCTURE COSTS — Recognizing there may be additional out of pocket costs for the Farm Credit lender in restructuring a loan, this section allows for consideration of those costs. Most will likely be up-front costs and, therefore, no present value calculations are necessary. Show the total other restructure costs under the "Cost" column.
6. COMPROMISE/RESTRUCTURE COSTS — Add the costs for each section and show the total at Line 6 under the "Cost" column.

ORDINARY ANNUITY TABLE

(Present Value Factors)

DISCOUNT FACTORS: 9% annual rate

DIRECTIONS: To use this ordinary annuity table to determine appropriate present value factors, begin by identifying the number of years the periodic payments will be made. Moving down the year column to the appropriate year identifies the present value factors available for monthly, quarterly, semi-annual and annual payment options. Move across from the year column at the selected number of years to the payment option that fits the loan being present valued. The present value factor is the number under the appropriate payment option and across from the appropriate year. For example, the present value factor for a 20 year loan with annual payments is 9.129.

	PAYMENT OPTIONS			
YEAR	MONTHLY	QUARTERLY	SEMI-ANNUAL	ANNUAL
1	11.435	3.785	1.873	.917
2	21.889	7.247	3.588	1.759
3	31.447	10.415	5.158	2.531
4	40.185	13.313	6.596	3.240
5	48.173	15.964	7.913	3.890
6	55.477	18.389	9.119	4.486
7	62.154	20.608	10.223	5.033
8	68.258	22.638	11.234	5.535
9	73.839	24.495	12.160	5.995
10	78.942	26.194	13.008	6.418
11	83.606	27.748	13.784	6.805
12	87.606	29.170	14.495	7.161
13	91.770	30.470	15.147	7.487
14	95.335	31.660	15.743	7.786
15	98.593	32.749	16.289	8.061
16	101.573	33.745	16.789	8.313
17	104.297	34.656	17.247	8.544
18	106.787	35.490	17.666	8.756
19	109.064	36.353	18.050	8.950
20	111.145	36.950	18.402	9.129
21	113.048	37.588	18.724	9.292
22	114.788	38.172	19.018	9.442
23	116.378	38.706	19.288	9.580
24	117.832	39.195	19.536	9.707
25	119.162	39.642	19.762	9.823
26	120.377	40.051	19.969	9.929
27	121.488	40.425	20.159	10.027
28	122.504	40.767	20.333	10.116
29	123.433	41.080	20.492	10.198

PRESENT VALUE TABLES

DISCOUNT FACTOR: 9% annual rate

DIRECTIONS: Use this table to determine the present value of a single payment at a future point in time. Determine the present value factor by moving down the Year column to the year in which you will receive the single payment. Then move across to the Present Value Factor column and identify the appropriate present value factor. For example, the present value factor for a single payment in year 20 is .178. These factors assume annual compounding of the discount factor.

YEAR	PRESENT VALUE FACTOR
1	.917
2	.842
3	.772
4	.708
5	.650
6	.596
7	.547
8	.502
9	.460
10	.422
11	.388
12	.356
13	.326
14	.299
15	.275
16	.252
17	.231
18	.212
19	.194
20	.178
21	.164
22	.150
23	.138
24	.126
25	.116
26	.106
27	.098
28	.090
29	.075
30	.069

The preceding worksheets and instructions are largely self-explanatory. However, they are imprecise at points and possibly inaccurate with respect to certain foreclosure costs. Therefore, several comments are in order.[392]

FORECLOSURE COSTS:

Item 2(b) *Disposition Costs*: The use of 3% of the appraised value of the collateral for the disposition cost of that collateral appears to be extraordinarily conservative. The instructions offer no justification for that figure. Bearing in mind that arbitrary and capricious behavior by the institution may be the basis for a defense to a foreclosure action,[393] the institution should be put to the task of justifying all of its foreclosure cost figures.

Item 2(c) *Legal Costs*: Note that the instructions require that those costs be based on actual service center experience. As with disposition costs, legal costs must be justified. If the institutions assume incorrectly that the foreclosure will be uncontested and not followed by a bankruptcy reorganization proceeding, the institution should be requested to adjust its legal costs accordingly.

Item 2(d) *Insurance and Repair*: Generally, the insurance cost for bare land will be 0. For buildings, it will be $9.00 per $1,000 of insurable value. Repair needs and costs should be brought to the attention of the institution. Some institutions are using 1-12% of appraised value for their cost.

Item 4(b) *Net Present Value of the Collateral*: The .8780 net present value factor reflects a 9% discount rate for 1-1/2 years. If a longer time before recovery is anticipated, such as where a contested foreclosure or reorganization proceeding is contemplated, a lower net present value factor should be used.

Item 4(c) *Other Recoverable Assets*: This figure should reflect net recovery value discounted from the date of anticipated recovery. In other words, there will be costs associated with the recovery of those assets, and the institution should take those costs into account.

COST OF RESTRUCTURING:

Item 2 *Present Interest Forgiven*: Make sure that this future has not been improperly included in the item 2 calculation above it. If the item 2 calculation runs from the date of the initial default, it necessarily will have included the accrued interest reflected in the item 3(a) figure. Thus, the institution will have

392. These comments are based on Mr. Kelley's experiences in representing borrowers seeking restructuring and on his conversations with other attorneys and borrowers.

393. See *infra* notes 444-73 and the accompanying text.

"double-dipped" and improperly increased the cost of restructuring amount.

Item 3 *Present Value of Foregone Principal and Interest*: Make sure that the original loan payment used in the item 2 calculation is not based on a default interest rate. Using a default interest rate is inappropriately punitive and will result in a higher cost of restructuring. The institution should assume that the foregone payments on the original note will be based on the interest rate applicable to the loan prior to default. Also, be sure that the calculation is based only on foregone payments. In other words, the present value factor used should correlate with the number of payments that will not be made, not the full term of the note from its inception. Otherwise, the borrower is not given credit for payments made prior to default.

Item 5 *Other Restructure Costs*: This figure will usually be $500.00.

In applying for restructuring, borrowers should be aware of the "least cost alternative" provisions of section 2202a(f).[394] That section provides as follows:

> If two or more restructuring alternatives are available to a qualified lender under this section with respect to a distressed loan, the lender shall restructure the loan in conformity with the alternative that results in the least cost to the lender.[395]

If a borrower's restructuring proposal does not contemplate paying to his primary creditors all of his income in excess of his reasonable living and operating expenses, section 2202a(f) appears to give the institution the option of proposing an alternative that captures that income.[396]

System institutions are required to provide written notice to a borrower that the borrower's loan "may be suitable for restructuring" when the institution determines that the loan is or has

394. 12 U.S.C.A. § 2202a(f) (West 1989).

395. *Id.*

396. *See* 12 U.S.C.A. § 2202a(d)(1)(B) (West 1989) (a consideration in determining whether a borrower is eligible for restructuring is "whether the borrower is applying all income over and above necessary and reasonable living and operating expenses to the payment of primary obligations"); 12 U.S.C.A. § 2202a(d)(2) (West 1989) ("This section shall not prevent a qualified lender from proposing a restructuring plan for an individual borrower in the absence of an application for restructuring from the borrower."). *See* Hill v. Farm Credit Banks of St. Louis, 726 F. Supp. 1201, 1206 (E.D. Mo. 1989) ("The 1987 Act specifically provides that a lender may propose a restructuring plan in the absence of an application from the borrower." (citing 12 U.S.C. § 2202a(d)(2)). *See also* 12 C.F.R. § 614.4516(c) (1990) ("A qualified lender may, in the absence of an application for restructuring from a borrower, propose a restructuring plan for an individual borrower.").

become a "distressed loan."[397] The notification must include a copy of the appropriate restructuring policy and "all materials necessary to enable the borrower to submit an application for restructuring the loan."[398] A distressed loan is defined as follows:

> The term "distressed loan" means a loan that the borrower does not have the financial capacity to pay according to its terms and that exhibits one or more of the following characteristics:
> (a) The borrower is demonstrating adverse financial and repayment trends.
> (b) The loan is delinquent or past due under the terms of the loan contract.
> (c) One or both of the factors listed in subparagraphs (a) and (b), together with inadequate collateralization, present a high probability of loss to the lender.[399]

Notice must also be given not later than 45 days before the commencement of foreclosure proceedings against the borrower.[400] In addition, section 2202(b)(3) provides as follows:

> No qualified lender may foreclose or continue any foreclosure proceeding with respect to any distressed loan before the lender has completed any pending consideration of the loan for restructuring under this section.[401]

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397. 12 U.S.C.A. § 2202a(b)(1) (West 1989). *See also* 12 C.F.R. § 614.4516(a) (1990) (restructuring procedures: notice); Erickson v. Federal Land Bank of Omaha, 101 Bankr. 124, 125-26 (D. Neb. 1989) (borrowers unsuccessfully argued that the FLB had failed to make a specific determination that their loan was distressed before advising them of the right to seek restructuring), *aff'd*, 894 F.2d 1342 (8th Cir. 1989); *In re* Wagner, 107 Bankr. 662, 663 (Bankr. D. Neb. 1989) ("The statute requires and the debtors have the right to know that the Farm Credit Bank has made a determination that the loan 'is or has become distressed' before any restructuring obligations fall upon debtors and before any foreclosure rights accrue to Farm Credit Bank."); *In re* Rudloff, 107 Bankr. 663, 665 (Bankr. D. Neb. 1989) (interpreting the Act to require the lender to determine that the loan is distressed prior to providing notice of restructuring rights).

398. 12 U.S.C.A. § 2202a(b)(1)(B) (West 1989). *See also* 12 C.F.R. § 614.4516(a)(2) (1990) (same requirement).

399. 12 U.S.C.A. § 2202a(3) (West 1989). *See also* 12 C.F.R. § 614.4512(d) (1990) (defining "distressed loan").

400. 12 U.S.C.A. § 2202a(b)(2) (West 1989). *See also* 12 C.F.R. § 614.4516(a)(2), 614.4519(a) (1990) (same requirement).

401. 12 U.S.C.A. § 2202a(b)(3) (West 1989). *See also* 12 C.F.R. § 614.4519(b) (1990) (same requirement). The issue of whether a "foreclosure proceeding" is continuing or has been completed is to be resolved under state law. *See* Harper v. Federal Land Bank of Spokane, 692 F. Supp. 1244, 1250 (D. Ore. 1988), *rev'd* 878 F.2d 1172 (9th Cir. 1989), *cert. denied*, 110 S. Ct. 867 (1990); Federal Land Bank of St. Louis v. Cupples, 889 F.2d 764, 767-68 (8th Cir. 1989); Griffin v. Federal Land Bank of Wichita, 708 F. Supp. 313 (D. Kan. 1989), *aff'd*, 902 F.2d 22 (10th Cir. 1990); Federal Land Bank of Omaha v. Engelken, No. C85-2062 (N.D. Iowa Aug. 25, 1988).

The term "foreclosure proceeding" is specifically defined in section 2202a(4) as follows:

> The term "foreclosure proceeding" means:
> (a) a foreclosure or similar legal proceeding to enforce a lien on property, whether real or personal, that secures a nonaccrual or distressed loan; or
> (b) the seizing of and realizing on nonreal property collateral, other than collateral subject to a statutory lien arising under subchapters I or II of this chapter to effect collection of a nonaccrual or distressed loan.[402]

Apparently, an action to collect on an unsecured note would not be a foreclosure proceeding within the meaning of section 2202a(4).

Section 2202a(c) requires institutions to give borrowers a "reasonable opportunity" for a meeting between the borrower and a loan officer or other representative.[403]

Specifically, that section provides as follows:

> On determination by a qualified lender that a loan made by the lender is or has become a distressed loan, the lender shall provide a reasonable opportunity for the borrower thereof to personally meet with a representative of the lender —
> (1) to review the status of the loan, the financial condition of the borrower, and the suitability of the loan for restructuring; and
> (2) with respect to a loan that is in nonaccrual status, to develop a plan for restructuring the loan if the loan is suitable for restructuring.[404]

If the restructuring proposal is denied, the borrower may request a review of the denial by a credit review committee. The request must be made in writing within seven days after receiving the notice of denial.[405]

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402. 12 U.S.C.A. § 2202a(4) (West 1989). *See also* 12 C.F.R. § 614.4512(e) (1990) (defining "foreclosure proceeding").
403. 12 U.S.C.A. § 2202a(c) (West 1989). *See also* 12 C.F.R. § 614.4516(b) (1990) (opportunity for meeting).
404. 12 U.S.C.A. § 2202a(4) (West 1989). *See also* 12 C.F.R. § 614.4516(b)(1) (1990) (same requirement).
405. 12 U.S.C.A. § 2202(b)(2) (West 1989). *See also* 12 C.F.R. § 614.4518(c) (1990) (same requirement).

At the credit review committee, the borrower may appear in person accompanied by counsel or any other representative.[406] Prior to the enactment of the Agricultural Credit Technical Corrections Act of 1988,[407] the borrower seeking review of a denial of restructuring did not have the right to an independent appraisal except when "additional collateral for a loan is demanded by the qualified lender when determining whether to restructure the loan."[408] However, under the 1988 Act, the borrower now has a right to request an independent appraisal.[409] The borrower must be notified in writing of the decision of the credit review committee and the reasons for that decision.[410]

The credit review committee's review ends the institution's review process. If the credit review committee affirms the initial denial of the restructuring, the institution may and usually will commence the appropriate legal proceedings to foreclose on the collateral and obtain judgment on the note.[411]

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406. 12 U.S.C.A. § 2202(c) (West 1989). *See also* 12 C.F.R. § 614.4443(a) (1990) (personal appearance).

407. Pub. L. No. 100-399, 102 Stat. 989 (1988).

408. 12 U.S.C.A. § 2202(d)(4) (West Supp. 1989).

409. Agricultural Technical Corrections Act of 1988, Pub. L. No. 100-399, 103, 102 Stat. 989, 990 (codified at 12 U.S.C.A. § 2202(d) (West 1989). *See also* 12 C.F.R. § 614.4443(c) (1990) (same requirement). However, neither the statute nor the regulations provide that the credit review committee must give any particular weight to the independent appraisal. The only requirement is that the committee must "consider" the results of the appraisal. In the absence of an implied cause of action permitting judicial review of that "consideration," System institutions have little, if any, fear of recourse if the appraisal is ignored. *See also* Payne v. Federal Land Bank of Columbia, 711 F. Supp. 851, 855 (W.D.N.C. 1989) ("It is common knowledge in land and lending circles that appraisers can be selected with a view toward valuation of a given property that is congenial to the employing party. . . . This is why many evaluation provisions in real estate contracts are drafted to permit each side to choose an appraiser, the two of whom in turn choose a third; the resulting three appraisals then being averaged").

410. 12 U.S.C.A. § 2202(e) (West 1989). *See also* 12 C.F.R. § 614.4443(d) (1990) (same requirement).

411. If the institution has been certified by the Assistance Board pursuant to 12 U.S.C.A. § 2278a-4 (West 1989), there is one more stage in the review process. Specifically, 12 U.S.C.A. § 2202c(a) (West 1989) provides as follows:

> Within 9 months after a qualified lender is certified under section 2278a-4 of this title, such lender shall review each loan that has not been previously restructured and that is in nonaccrual status on the date the lender is certified, and determine whether to restructure the loan.

Id. The review contemplated by section 2202c(a) is to be done by a special asset group established by each district. 12 U.S.C.A. §§ 2202, 2202c(b)(1) (West 1989). If the district special asset group determines that a loan should be restructured, "the group shall prescribe a restructuring plan for the loan that the qualified lender shall implement." 12 U.S.C.A. § 2202c(b)(2) (West 1989). If the group determines that a loan should not be restructured, it must submit a report to the National Special Asset Council described below explaining that decision. 12 U.S.C.A. § 2202c(d) (West 1989).

The statute is silent as to the borrower's right to participate in the review by the district special asset group. The regulations governing that review are also silent as to that issue. 12 C.F.R. § 614.4520 (1990).

Pursuant to 12 U.S.C.A. § 2202c(c)(1) (West 1989), the Assistance Board is to establish a National Special Asset Council to do the following:

G. RIGHT OF FIRST REFUSAL

The 1987 Act requires System institutions, except for the bank for cooperatives, holding agricultural real estate acquired through foreclosure or voluntarily conveyed by a borrower who, in the institution's determination, did not have the financial resources to avoid foreclosure to give the former owner the right of first refusal to repurchase or lease the property.[412] With respect to the right of first refusal to purchase the property, sections 2219a(b) (1) - (5) provide as follows:

> (1) Election to sell and notification
> Within 15 days after an institution of the System first elects to sell acquired real estate, or any portion of such real estate, the institution shall notify the previous owner by certified mail of the owner's right —
> (A) to purchase the property at the appraised fair market value of the property, as established by an accredited appraiser; or
> (B) to offer to purchase the property at a price less than the appraised value.
>
> (2) Eligibility to purchase
> To be eligible to purchase the property under paragraph (1), the previous owner must, within 30 days after receiving the notice required by such paragraph, submit an offer to purchase the property.[413]
>
> (3) Mandatory sale

> (A) monitor compliance with the restructuring requirements of this section by qualified lenders certified to issue preferred stock under section 2278b-7 of this title, and by special asset groups established under subsection (b) of this section; and
> (B) review a sample of determinations made by each special asset group that a loan will not be restructured.

Id. In addition, 12 U.S.C.A. § 2202c(c)(2) (West 1989) provides that the National Special Asset Council "shall review a sufficient number of determinations made by each special asset group to foreclose on any loan to assure the Council that such group is complying with this section." *Id.* For each determination reviewed, "the Council shall make an independent judgment on the merits of the decision to foreclose rather than restructure the loan." *Id.* In addition:

> If the National Asset Council determines that any special asset group is not in substantial compliance with this section, the Council shall notify the group of the determination, and may take such other action as the Council considers necessary to ensure that such group complies with this section.

12 U.S.C.A. § 2202c(c)(3) (West 1989). As with reference to the district special asset group, the statute and the regulations are silent regarding the borrower's right to participate in any review by the National Special Asset Council. 12 C.F.R. § 614.4520 (1990).

412. 12 U.S.C.A. § 2219a (West 1989). *See also* 12 C.F.R. § 614.4522(2) (1990) (defining "previous owner").

413. As originally enacted, the 1987 Act prescribed a fifteen day time period. The fifteen day period was changed to thirty days by the Agricultural Technical Corrections Act

An institution of the System receiving an offer from the previous owner to purchase the property at the appraised value shall, within 15 days after the receipt of such offer, accept such offer and sell the property to the previous owner.[414]

(4) Permissive sale

An institution of the System receiving an offer from the previous owner to purchase the property at a price less than the appraised value may accept such offer and sell the property to the previous owner. Notice shall be provided to the previous owner of the acceptance or rejection of such offer within 15 days after the receipt of such offer.

(5) Rejection of offer of previous owner

(A) Duties of institution

An institution of the System that rejects an offer from the previous owner to purchase the property at a price less than the appraised value may not sell the property to any other person —

(i) at a price equal to, or less than, that offered by the previous owner, or

(ii) on different terms and conditions than those that were extended to the previous owner, without first affording the previous owner an opportunity to purchase the property at such price or under such terms and conditions.

(B) Notice

Notice of the opportunity in subparagraph (A) shall be provided to the previous owner by certified mail, and the previous owner shall have 15 days in which to submit an offer to purchase the property at such price or under such terms and conditions.[415]

The provisions governing the right of first refusal to lease acquired

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of 1988, Pub. L. No. 100-399, 104, 102 Stat. 989, 990 (codified at 12 U.S.C.A. § 2219a(b)(2) (West 1989). *See also* 12 C.F.R. § 614.4522(c)(3) (1990) (thirty days).

414. As originally enacted, the 1987 Act prescribed a thirty day time period. The thirty day period was changed to fifteen days by the Agricultural Technical Corrections Act of 1988, Pub. L. No. 100-399, 104, 102 Stat. 989, 990 (codified at 12 U.S.C.A. § 2219a(b)(3) (West 1989). *See also* 12 C.F.R. § 614.4522(c)(2) (1990) (fifteen days).

415. 12 U.S.C.A. § 2219a(b)(1)-(5) (West 1989).

property are similar.[416]

The right of first refusal as set forth in sections 2219(a)(b) (1) - (5) presents several potential difficulties for borrowers. First, neither the statute nor the regulations specifically define the event constituting the institution's "first elect[ion] to sell."[417] In states where corporations are prohibited from owning agricultural real estate, it might be argued that the "election to sell" occurs as soon as the land is acquired since the institution is not permitted to retain it. On the other hand, it might be argued that no election to sell occurs until an eligible purchaser actually has agreed to buy the parcel.

A more troublesome difficulty for borrowers is the absence of any express mechanism for challenging the appraisal of the property. In addition, neither the statute nor the regulations define the statute's term "accredited appraiser."[418] It can be expected that some Farm Credit Banks will use "in house" appraisers who may base their appraisals on sales of other inventory land that has been sold with inflationary inducements such as money-back guarantees and low interest rate financing that would not be offered to former owners under the right of first refusal.[419]

The former owner who cannot match the appraised price faces uncertainty as to whether he will receive another opportunity to elect to buy the land. The statute does permit the former owner to offer a sum less than the appraised value. However, if that offer is rejected, the institution must again offer the right of first refusal only if it subsequently desires to sell the land at "a price equal to, or less than, that offered by the previous owner" or "on different terms and conditions than those that were extended to the previous owner."[420] In areas where land values are increasing, it is unlikely that the institution will desire to sell the land at a price equal to, or less than, that offered by the previous owner. In addition, it is very likely that the terms and conditions will be dif-

416. 12 U.S.C.A. § 2219a(c)(1)-(6) (West 1989).

417. 12 C.F.R. § 614.4522 (1990).

418. *Id.* *See* 55 FED. REG. 24,861 (1990) (prefatory comments stating that the FCA intends to republish proposed regulations on appraisal standards "in the near future").

419. *See* 12 U.S.C.A. § 2219a(f) (West 1989) (". . . a system institution shall not be required to provide financing to the previous owner in connection with the sale of acquired real estate"). *See also* Payne v. Federal Land Bank of Columbia, 711 F. Supp. 851, 855 (1989) ("It is common knowledge in land and lending circles that appraisers can be selected with a view toward valuation of a given property that is congenial to the employing party"); *In re* Jarrett Ranches, Inc., 107 Bankr. 969, 973 (Bankr. D.S.D. 1989) (invalidating the FCB's appraisal of former borrowers' land in parcels rather than as a whole and setting an appraised value).

420. 12 U.S.C.A. § 2219a(b)(5) (West 1989). *See also* 12 C.F.R. § 614.4522(c)(3) (1990) (same requirement).

ferent. This occurs because the only "terms and conditions" that likely will have been initially offered to the former owner are the sale of the land at a lump sum cash price. On the other hand, a third-party prospective purchaser is likely to be offered many other "terms and conditions" such as a money-back guarantee, apportionment of real estate taxes, etc.[421] The uncertainty regarding a second chance to elect to buy the land arises because even if the "terms and conditions" differ, it is possible that the institution may neglect to inform the former owner not only of those differences but also, and more fundamentally, of the transaction itself, because the institution may choose to ignore or narrowly read the statute.

To date, some System institutions have attempted to avoid giving former owners the benefits of sections 2219a(b) (1) - (5) by choosing to sell the acquired property by auction without first giving the former owner the opportunity to buy it at its appraised value.[422] Institutions may sell acquired land by auction. In that regard, sections 2219a(d) (1) - (3) provide as follows:

(d) Public Offerings

(1) Notification of previous owner

If an institution of the System elects to sell or lease acquired property or a portion thereof through a public auction, competitive bidding process, or other similar public offering, the institution shall notify the previous owner, by certified mail, of the availability of the property. Such notice shall contain the minimum amount, if any, required to qualify a bid as acceptable to the institution and any terms and conditions to which such sale or lease will be subject.

(2) Priority

If two or more qualified bids in the same amount are received by the institution under paragraph (1), such bids are the highest received, and one of the qualified bids is offered by the previous owner, the institution shall accept the offer by the previous owner.

(3) Nondiscrimination

No institution of the System may discriminate

421. Financing is not considered a "term or condition" of sale. 12 U.S.C.A. § 2219a(e) (West Supp. 1989). *See also* 12 C.F.R. § 614.4522(c)(4) (1990) (same).

422. *See infra* notes 424-25 and the accompanying text.

> against a previous owner in any public auction, competitive bidding process, or other similar public offering of property acquired by the institution from such person.[423]

However, at least two federal district courts have held that sales by auction must be preceded by giving the former owner the opportunity to buy the acquired land at its appraised value.[424] A third federal district court has held to the contrary.[425]

Finally, with respect to the right of first refusal, 2219a(h) provides that "[t]he rights provided in this section shall not diminish any such right of first refusal under the law of the State in which the property is located."[426] This provision appears to provide that state first refusal statutes will supplement the federal right.

H. PROHIBITION AGAINST WAIVER OF MEDIATION RIGHTS

The 1987 Act encourages the states to establish mediation programs. Further, the Farm Credit System is required to participate in mediation.[427] In addition, Congress had the foresight to realize that the right to mediation could be used as a chip in negotiations for a loan. In order to avoid that, the 1987 Act contains the following language:

> No System institution may make a loan secured by a mortgage or lien on agricultural property to a borrower on the condition that the borrower waive any right under the agricultural loan mediation program of any State.[428]

The Farm Credit Administration is required to promulgate rules

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423. 12 U.S.C.A. § 2219a(d)(1)-(3) (West 1989).

424. Leckband v. Naylor, 715 F. Supp. 1451, 1455 (D. Minn. 1988), *appeal dismissed*, Nos. 88-5301 MN & 89-5141 MN (8th Cir. May 5, 1989); Martinson v. Federal Land Bank of St. Paul, 725 F. Supp. 469 (D.N.D. 1988), *appeal dismissed*, No. 88-5252 ND (8th Cir. May 5, 1989). *See also In re* Jarrett Ranches, Inc., 107 Bankr. 969, 975-76 (Bankr. D.S.D. 1989) (invalidating the particular bidding process used by a FCB under the right of first refusal).

425. Payne v. Federal Land Bank of Columbia, 711 F. Supp. 851, 859-60 (W.D.N.C. 1989) (holding that auction sales need not be preceded by opportunity to buy land at appraisal value).

426. 12 U.S.C.A. § 2219a(h) (West 1989). *See generally* Houser, *A Comparative Study of the Former Owner's Right of First Refusal Upon a Lender's Resale of Foreclosed Agricultural Land: A New Form of State Mortgagor Relief Legislation*, 13 J. CORP. L. 895 (1988) (discussing statutory rights of first refusal).

427. Agricultural Credit Act of 1987, Pub. L. No. 100-233, 503, 101 Stat. 1663 (1988). Unlike other provisions of the 1987 Act relating to the Farm Credit System, this provision was codified in Title 7 of the United States Code, not Title 12, at 7 U.S.C.A. § 5103(b)(1) (West 1988). *See generally* Note, *Mediation in Debtor-Creditor Relationships*, 20 U. MICH. J. L. REF. 110 (1987) (discussing debtor-creditor mediation); Note, *The American Response to Farm Crises: Procedural Debtor Relief*, 1988 U. ILL. L. REV. 1037 (discussing various farm debtor relief measures).

428. 12 U.S.C.A. § 2202e (West 1989).

regarding System lender's participation in mediation.[429]

I. DIFFERENTIAL INTEREST RATES

Farm Credit System institutions in the past have used different interest rates on loans. This is commonly known as the "three-tier" method. The interest rate was based on a number of factors, including borrower qualifications. The 1987 Act allows the System institutions to continue this practice.[430] However, the borrower can now ask a System institution:

1) to provide a review of the loan to determine if the proper interest rate has been used;
2) give the borrower a written explanation of the basis for charging the interest rate used; and
3) give the borrower a written explanation of what the borrower must do to improve his credit status to receive a lower interest rate.[431]

J. UNINSURED ACCOUNTS

Some System institutions have used uninsured accounts in the past as part of their loan servicing procedures.[432] Borrowers would deposit funds in these accounts over a period of time in order to insure that they would meet their scheduled payments. The 1987 Act provided that if the institution becomes insolvent, all of the funds in uninsured accounts are to be applied to a borrower's debt.[433]

K. USE OF FMHA GUARANTEED LOANS, ETC.

The 1987 Act also expresses Congress' desire for the Farm Credit System to look outside the System in restructuring:

> It is the sense of Congress that the banks and associations (except for the banks for cooperatives) operating under the Farm Credit Act of 1971, should administer distressed loans to farmers with the objective of using the

429. The rules regarding System lenders' participation in mediation are found at 12 C.F.R. § 614.4521 (1990).

430. Agricultural Credit Act of 1987, Pub. L. No. 100-233, 109, 101 Stat. 1584 (1988) (codified at 12 U.S.C.A. § 2199(b) (West 1989).

431. 12 U.S.C.A. § 2199(b) (West 1989). *See also* 12 C.F.R. § 614.4368 (1990) (same requirement).

432. 12 C.F.R. § 614.4510 (1988) (currently found at 12 C.F.R. § 614.4513(b) (1990)).

433. 12 U.S.C.A. § 2219b (West 1989). *See also* 12 C.F.R. § 614.4513(a) (1990) (same requirement).

> loan guarantee programs of the Farmers Home Administration and other loan restructuring measures, including participation in interest rate buy down programs that are Federally or State funded or other Federal or State sponsored financial assistance programs that offer relief to financially distressed farmers, as alternatives to foreclosure, considering the availability and appropriateness of such programs on a case-by-case basis.[434]

While this section has not been codified, it may prove helpful to the borrower who wishes to use the FmHA guaranteed loan program or other program in order to qualify for restructuring.

VIII. JUDICIAL REVIEW OF RESTRUCTURING DENIALS

At least one court has declined to review decisions adverse to the borrower under the former forbearance policies developed by System institutions. In Federal Land Bank of Wichita v. Read,[435] the borrower's request for forbearance under the FLB's forbearance policy adopted pursuant to pre-1985 Act forbearance regulation[436] had been denied.[437] The policy conditioned forbearance on the borrower meeting three conditions: the borrower must be cooperative; the borrower must make an honest effort to meet the conditions of the loan contract; and the borrower must be capable of working out the debt burden.[438] The FLB found that the borrower did not satisfy the third condition.[439] In declining to review the forbearance decision, the court expressed the belief that the "matter is best left to those in whom the land bank places that responsibility. . . . We find no statutory authority for court review of such a determination."[440]

For similar reasons, a federal district court recently declined

434. Agricultural Credit Act of 1987, Pub. L. No. 100-233, 102, 101 Stat. 1579 (1988). For a description of the FmHA guaranteed loan program, see Scott & Roth, *Guaranteed Farmer Program Loans: Questions and Answers*, FARMERS' LEGAL ACTION GROUP REP. 1 (Winter 1989).

435. 703 P.2d 777 (Kan. 1985).

436. *See* 12 C.F.R. § 614.4510 (1985).

437. Federal Land Bank of Wichita v. Read, 703 P.2d 777 (Kan. 1985).

438. *Id.* at 780. *See* 12 C.F.R. § 614.4510(1) (1985).

439. Federal Land Bank of Wichita v. Read, 703 P.2d at 779.

440. *Id.* at 780. *See also* Woodsmall v. Lyng, 816 F.2d 1241, 1245 (8th Cir. 1987) (denial of Farmers Home Administration (FmHA) loan on the grounds that the applicant was not creditworthy was not reviewable because the federal courts "are not equipped to undertake such a task, for in these matters we have neither the training nor the experience of an FmHA loan officer"); Tuepker v. Farmers Home Admin., 708 F.2d 1329, 1332 (8th Cir. 1983) (declining to review a Farmers Home Administration loan denial in the absence of a claim "alleging a substantial departure from important procedural rights, a misconstruction of governing legislation, or some like error 'going to the heart of the administrative determination' ").

to review the "quality and good faith" of an FLB's decision not to restructure a borrower's loan under the 1987 Act.[441] The court expressed the view that "though courts will enforce consideration of loan restructuring under the Act, they probably will not scrutinize the details of loan decisions when FLB has considered applications for restructure and reviewed denial."[442]

However, despite the absence of express statutory authority for judicial review under the Farm Credit Act and the regulations and policies adopted pursuant to it, there are several potential theoretical bases for seeking judicial review. Listed in order of their current state of judicial development, the respective basis for each of those theories are as follows:

1. invocation of the maxim "he who seeks equity, must do equity" as an equitable affirmative defense to the institution's foreclosure proceeding;
2. failure to follow statutory directives asserted as an implied cause of action under the Farm Credit Act, as amended by the Agricultural Credit Act of 1987;[443] and
3. failure to adhere to state cooperative law requiring procedural and substantive fairness in the expulsion of members from cooperative institutions.

The latter two theories are discussed elsewhere in this article.[444] The following is a discussion of the first theory, the equitable defense.

In most, if not all jurisdictions, a proceeding to foreclose a mortgage is a proceeding in equity.[445] One of the fundamental

441. Troutman v. Federal Land Bank of Spokane, No. CV88-726-PA, Slip. op. at 4 (D. Ore. Sept. 15, 1988) (order denying preliminary injunction).

442. *Id.* at 3 (citing Miller v. Federal Land Bank of Spokane, 587 F.2d 415 (9th Cir. 1978), *cert. denied*, 441 U.S. 962 (1979)). *See also* Williams v. Federal Land Bank of Jackson, 729 F. Supp. 1387, 1390 (D.D.C. 1990) (". . . once a federal land bank has properly determined whether or not a particular borrower's offer of debt refinancing should be accepted, this Court will not second-guess that determination." (citing Perez v. Jefferson Standard Life Ins. Co., 781 F.2d 475, 479-80 (5th Cir. 1986); Federal Land Bank of Wichita v. Read, 237 Kan. 751, 703 P.2d 777, 780 (1985)).

443. This basis is unavailable in the Ninth, Tenth, and Eighth Circuits. *See* Harper v. Federal Land Bank of Spokane, 878 F.2d 1172, 1177 (9th Cir. 1989), *cert denied*, 110 S. Ct. 867 (1990); Griffin v. Federal Land Bank of Wichita, 902 F.2d 22, 24 (10th Cir. 1990); Zajac v. Federal Land Bank of St. Paul, No. 88-5353ND (8th Cir. July 31, 1990) (*en banc*) (1990 U.S. App. LEXIS 12932). Given the trend represented by these decisions, review through an implied cause of action is not likely to be available in any jurisdiction.

444. *See supra* notes 184-267 & 333-38, respectively, and the accompanying text.

445. *See, e.g.*, Federal Land Bank of St. Paul v. Bosch, 432 N.W.2d 855, 858 (N.D. 1988) ("An action to foreclose a mortgage is an equitable proceeding"); Continental Federal Savings and Loan Ass'n v. Fetter, 564 P.2d 1013, 1019 (Okla. 1977) ("Foreclosure of a real estate mortgage is an equitable action, and it is within the province of the court exercising

precepts of equitable relief is that it "cannot be demanded as a matter of right whenever specified facts are shown . . .," rather it "is granted in the discretion of the court."[446] Judicial discretion is ". . . to be exercised by applying established principle of equity to the situation presented by all of the facts in the case, and adapting the remedy to accomplish the most equitable result possible."[447]

The discretionary nature of equitable relief is "rooted in the historical concept of [a] court of equity as a vehicle for affirmatively enforcing the requirements of conscience and good faith."[448] As emphasized by the United States Supreme Court:

> A court of equity acts only when and as conscience commands, and if the conduct of the plaintiff be offensive to the dictates of natural justice, then, whatever may be the rights he possesses and whatever use he may make of them in a court of law, he will be held remediless in a court of equity.[449]

The discretion inherent in the granting or denial of equitable relief is guided by maxims or general principles.[450] One of those maxims is "he who seeks equity must do equity." As explained by Pomeroy, "this maxim expressed the governing principles that every action of a court of equity in determining rights and awarding remedies must be in accordance with conscience and good faith."[451] More specifically,

> The meaning is, that whatever be the nature of the controversy between two definite parties, and whatever be the nature of the remedy demanded, the court will not confer its equitable relief upon the party seeking its interposition and aid, unless he has acknowledged and conceded or will admit and provide for all the equitable rights, claims, and demands justly belonging to the adversary party, and growing out of or necessarily involved in

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its equitable power to see that the party seeking equity shall have dealt fairly before relief is given." (quoting Murphy v. Fox, 278 P.2d 820, 826 (Okla. 1955)).

446. H. McCLINTOCK, PRINCIPLES OF EQUITY 49 (2nd ed. 1948).

447. *Id.*

448. Precision Instrument Mfg. Co. v. Automotive Maintenance Mach. Co., 324 U.S. 806, 814 (1945) (holding that dismissal of a patent infringement suit was justified by the "unclean hands" doctrine).

449. Deweese v. Reinhard, 165 U.S. 386, 390 (1897) (stating that land dispute relief was available at an action of law).

450. *See Precision Instrument*, 324 U.S. at 814 (1945) ("The guiding doctrine . . . that he who comes into equity must come with clean hands . . . is far more than a mere banality. It is a self-imposed ordinance that closes the doors of a court of equity to one tainted with inequitableness or bad faith relative to the matter in which he seeks relief . . .").

451. J. POMEROY, EQUITY JURISPRUDENCE 51 (5th ed. 1941).

the subject-matter of the controversy.[452]

The principle requires the plaintiff to do "equity."[453] In essence, a condition precedent to the equity court's granting of relief to the plaintiff is the awarding to the defendant any rights possessed by the defendant, including those that have their genesis in the principles of fair dealing.

The failure of the FLB to consider a borrower for forbearance was held to be a defense to a foreclosure action in the case of Federal Land Bank of St. Paul v. Overboe.[454] In *Overboe*, the borrower obtained a loan from the Federal Land Bank of St. Paul which was secured by a mortgage.[455] The borrower became late in his payments, and in June, 1983, he requested that his annual payment date be changed from July 1 to December 31 of each year to coincide with the cash flow of his farm.[456] The federal land bank advised the borrower that a change in payment dates would require a reamortization of his loan, and that, based on the borrower's financial information on file, it was unable to grant a reamortization.[457] The borrower subsequently provided new financial information but the federal land bank declined to change its position and initiated a foreclosure action.[458]

The borrower contested the foreclosure action on the grounds that the federal land bank had failed to follow its policies, regulations, and procedures adopted under the Farm Credit Act of 1971 relating to forbearance when it denied his request for reamortization.[459] The federal land bank responded by asserting that its failure to follow its policies and the regulations governing it could not be raised as a defense to foreclosure, and, in the alternative, that it had not violated its policies and the applicable regulations.[460]

The forbearance regulation at issue in *Overboe* was adopted prior to the enactment of the Farm Credit Amendments Act of 1985.[461] The regulation provided that the federal land bank was

452. *Id.*
453. *Id.*
454. 404 N.W.2d 445 (N.D. 1987).
455. Federal Land Bank v. Overboe, 404 N.W.2d 445, 446 (N.D. 1987).
456. *Id.*
457. *Id.*
458. *Id.*
459. *Id.* at 447.
460. *Id.*
461. 12 C.F.R. § 614.4510(d)(1) (1986). The *Overboe* equitable defense was applied to a claim arising under the 1985 Act in Federal Land Bank of St. Paul v. Bosch, 432 N.W.2d 855, 858-59 (N.D. 1988). *See also* Federal Land Bank of St. Paul v. Asbridge, 414 N.W.2d 596, 597 (N.D. 1987) (applying *Overboe*); Farm Credit Bank of St. Paul v. Huether, 454 N.W.2d 710, 715 (N.D. 1990) (applying *Overboe*).

to develop loan servicing policies that included a provision for "a means of forbearance for cases when the borrower is cooperative, making an honest effort to meet the conditions of the loan contract, and is capable of working out of the debt burden."[462] Pursuant to that regulation, the federal land bank had adopted a policy authorizing the extension of "appropriate assistance" to borrowers who met certain criteria.[463]

The federal land bank argued that its failure to follow the policy that it adopted pursuant to the forbearance regulation could not be asserted as a defense because of the holding of several courts that borrowers do not have a private cause of action for damages under the Farm Credit Act of 1971 or the regulations promulgated pursuant to that Act.[464]

Although the *Overboe* court acknowledged that the Farm Credit Act of 1971 and the forbearance regulation did not create a private cause of action, it rejected the federal land bank's argument that the absence of a private cause of action precluded a borrower's assertion of noncompliance with the Act or the regulation as a defense in a foreclosure action.[465] The *Overboe* court's analysis of the issue was grounded on the recognition that "an action to foreclose a mortgage is an equitable proceeding."[466] With this recognition forming the basis of the court's analysis, the court then examined other instances, specifically, cases involving noncompliance with Department of Housing and Urban Development regulations, where federal regulations which have been held not to imply a private cause of action may nevertheless provide a basis for an equitable defense to a foreclosure action.[467]

The *Overboe* court examined the notions of fair dealing applicable to the Farm Credit System, and noted that the Congressional goal under the Farm Credit Act was "fostering agricultural development."[468] With that Congressional objective in mind, the Supreme Court of North Dakota held as follows:

> Allowing FLB to foreclose its mortgages without regard to the administrative forbearance regulation would be inimical to the achievement of this goal. We therefore

462. *Overboe*, 404 N.W.2d at 447 (citing 12 C.F.R. § 614.4510(d)(1)).
463. *Id.* at 447 (citing "District Policy 2501" of the Federal Land Bank of St. Paul).
464. *Id.* at 447-48. *See, e.g.*, Farmers Production Credit Ass'n of Ashland v. Johnson, 24 Ohio St.3d 69, 493 N.E.2d 946 (1986), *cert. denied*, 479 U.S. 1032 (1987).
465. *Overboe*, 404 N.W.2d at 449.
466. *Id.* at 448 (citations omitted).
467. *Id.* at 449.
468. *Id.* (citing Federal Land Bank of St. Paul v. Lillehaugen, 404 N.W.2d 452 (N.D. 1987)).

> conclude that the failure of FLB to comply with administrative forbearance regulation and policies adopted pursuant to the regulation gives rise to a valid equitable defense to a foreclosure action under state law.[469]

Having held that a federal land bank's failure to abide by its forbearance policies and the regulations governing it was a permissible affirmative defense to a foreclosure action, the *Overboe* court also concluded that the administrative forbearance defense permits judicial consideration of both the procedural and substantive aspects of the System institution's action.[470] In this regard, the court stated that the initial inquiry is whether the institution "has established a general policy of forbearance and whether it applied that policy in arriving at its decision to seek foreclosure."[471]

The *Overboe* court explained that if the trial court finds that the borrower's qualifications were considered by the institution in accordance with its procedures, the court's review of the merits of that consideration is to be confined to whether the institution abused its discretion.[472] In other words, to prevail, the borrower must show that the institution acted in an "arbitrary, capricious, unreasonable or unconscionable manner."[473] Finally, the *Overboe* court indicated that appellate review of a trial court's determination of the substantive issue will be guided by the standard of whether the abuse of discretion standard of review "appears to have been misapprehended or grossly misapplied."[474]

Litigation by member-borrowers against System institutions will undoubtedly continue. The current interest in lender liability in the farm community suggests that some of that litigation will take the form of "generic" lender liability claims.[475] However, a number of issues concerning the borrowers' rights provisions of the Agricultural Credit Act of 1987 remain unresolved.

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469. *Id.*
470. *Id.* at 449-50.
471. *Id.* at 449.
472. *Id.* at 450.
473. *Id.*
474. *Id.* (citing Universal Camera Corp. v. National Labor Relations Board, 340 U.S. 474, 491 (1951)). In jurisdictions providing for nonjudicial foreclosure, borrowers seeking to invoke the equitable defense employed in *Overboe* will have to seek injunctive relief in order to obtain judicial intervention. For a recent discussion and collection of authorities regarding the enjoining of the nonjudicial foreclosure process, see Note, *Nonjudicial Foreclosure in Arkansas with the Statutory Foreclosure Act of 1987*, 41 ARK. L. REV. 373, 389-403 (1988).
475. *See* Welsh, *Are Banks to Blame?*, FARM J., June-July 1988, at 11.

IX. CONCLUSION

Two specific and fundamental issues relating to the new borrowers' rights provisions are in need of immediate attention. A third, more general, issue is not likely to arise until the secondary agricultural mortgage market is implemented.

The first issue arises from the failure of most, if not all, of the farm credit districts to adopt loan restructuring policies that require the institutions within the district to explain in simple, understandable terms the computational steps involved in the determination of the cost of foreclosure and the cost of restructuring. That information, which has been made available to loan officers, is not routinely provided to borrowers holding distressed loans.[476] Without that information, the borrower is faced with the extraordinarily difficult task of gleaning the computational steps and arriving at an understanding of the restructuring formula from language in current policies that merely restates the language of the statute. Because the statutory language is not so specific as to make the computational steps self-evident, the practical effect is that the borrower "shoots in the dark" when submitting a restructuring application. Moreover, without knowledge of the computational steps involved, the borrower is not in a position to identify and urge the correction of computational errors made at either the initial stage of the review of his application or at the credit review committee level. As a matter of fundamental fairness, both parties to the restructuring process should have the instructions before them.

The second issue arises from the failure of most institutions to disclose or justify their "costs of foreclosure." That information is readily accessible to the institutions, but it is completely inaccessible to members unless the institution chooses to make it available.[477] Although member-borrowers are required to make a full disclosure of their current and projected financial and operational conditions when they apply for restructuring, institutions have routinely chosen not to disclose their costs. Thus, a member-borrower without that information cannot submit a restructuring proposal that will properly address each cost and other factors that will be considered by the institution in evaluating that application.

If one accepts that premise that restructuring is intended to

476. *See supra* notes 386-91 and the accompanying text.

477. For a discussion of the availability of information regarding the costs of foreclosure, *see supra* notes 386-91 and the accompanying text.

produce "win-win" results, the failure of System institutions to make the process accessible to its members by providing them with adequate instructions and to disclose and justify their anticipated costs of foreclosure is inexcusable. Moreover, if System institutions are under either an equitable or legal duty to be fair, that failure may be actionable. As discussed elsewhere in this article, ample authority exists to impose enforceable duties of good faith and fairness on System institutions in the restructuring process.[478]

The final, and less immediate, issue arises from sections 2279 aa-9(a) and (b) of the Farm Credit Act, as amended in 1987.[479] Those provisions, concerning loans from System institutions that may be pooled in the secondary market for farm mortgages, a market that is being created pursuant to sections 2279aa—2279aa-14,[480] provide as follows:

> (a) Restructuring
>
> Notwithstanding any other provision of law, sections 2202, 2202a, 2202b, 2202c, and 2219b of this title shall not apply to any loan included in a pool of qualified loans backing securities or obligations for which the Corporation provides guarantee. The loan servicing standards established by the Corporation shall be patterned after similar standards adopted by other federally sponsored secondary market facilities.
>
> (b) Borrowers rights
>
> At the time of application for a loan, originators that are Farm Credit System institutions shall give written notice to each applicant of the terms and conditions of the loan, setting forth separately terms and conditions for pooled loans and loans that are not pooled. This notice shall include a statement, if applicable, that the loan may be pooled and that, if pooled, sections 2202, 2202a, 2202b, 2202c, and 2219b of this title shall not apply. This notice also shall inform the applicant that he or she has the right not to have the loan pooled. Within 3 days from the time of commitment, an applicant has the right to refuse to allow the loan to be pooled, thereby retaining rights under sections 2202, 2202a, 2202b, 2202c, and 2219b of

478. *See generally* Federal Land Bank of St. Paul v. Overboe, 404 N.W.2d 445 (N.D. 1987) (applying equitable principles); Copeland, *Expulsion of Members by Agricultural Cooperatives*, 1 J. AGRIC. COOPERATION 76 (1986) (discussing the law governing the expulsion of members from agricultural cooperatives).

479. 12 U.S.C.A. § 2279aa-9 (a), (b) (West 1989).

480. 12 U.S.C.A. §§ 2279aa—2279aa-14 (West 1989).

this title, if applicable.[481]

It remains to be seen whether System institutions will attempt to pool significant numbers of loans and thus avoid the administrative expenses created by the restructuring provisions and whether borrowers will be "encouraged" to waive their rights in order to allow the pooling of loans.[482] The primary goal of farm credit system loan restructuring is to gain lender acceptance of a restructuring proposal that the borrower can actually perform. However, such a proposal may be denied, and judicial review may be sought. To prepare for this, documentation of any procedural irregularities or other arbitrary and capricious lender behavior is essential. But borrowers and their counsel must be aware that judicial intervention in the restructuring program is likely to be limited or even nonexistent. Thus, a realistic restructuring of a farm credit loan that is acceptable to the Farm Credit lender must be the paramount aim of the borrowers and counsel.

481. 12 U.S.C.A. § 2279aa-9(a), (b) (West 1989).

482. An overriding issue for the future, one beyond the scope of this article, is the availability of credit and the Farm Credit System's role in providing that credit. For recent discussions of those issues, see Boehlje and Pederson, *Farm Finance: The New Issues*, CHOICES, Third Quarter, 1988, at 16; Thompson, *The Farm Credit System: Rebuilding After the Big Debt Crisis*, AGRIFINANCE, Sept. 1990, at 30; Maio, *Think About It! Duncan Worries About Farm Credit System's Future*, ABA Bankers Weekly, Sept. 18, 1990 at 8; Duncan, *Rural Credit Markets: More Changes Ahead*, CHOICES, Third Quarter 1988, at 20; *Lessons From a System That Didn't Go Under*, WASH. POST NAT. WEEKLY ED., June 26-July 2, 1989, at 18, col.1.

APPENDIX A

THOUGHTS, COMMENTS AND A ROUGH CHECKLIST ON FARM CREDIT SYSTEM LOAN RESTRUCTURING FROM THE BORROWER'S PERSPECTIVE

I. GOALS:

A. Primary: Lender acceptance of a restructuring proposal that the borrower can perform. Unrealistic borrower cash flows may gain lender acceptance, but inability to perform may preclude subsequent loan restructuring.

B. Secondary: Because judicial review of a restructuring denial ultimately may be sought, documentation of any procedural irregularities or other arbitrary and capricious behavior on the part of the lender should be a continuing consideration throughout the process.[483] However, borrowers and their counsel should be mindful that judicial intervention in the restructuring process is likely to be very limited and, in some circumstances and jurisdictions, nonexistent.[484]

II. ELIGIBILITY FOR RESTRUCTURING

A. Definition of distressed loan:

The term of "distressed loan" means a loan that the borrower does not have the financial capacity to pay according to its terms and that exhibits one or more of the following characteristics:

A. The borrower is demonstrating adverse financial and repayment trends.

B. The loan is delinquent or past due under the terms of the loan contract.

483. *See* Federal Land Bank of St. Paul v. Overboe, 404 N.W.2d 445 (N.D. 1987).

484. *See, e.g.*, Harper v. Federal Land Bank of Spokane, 878 F.2d 1172, 1177 (9th Cir. 1989), *cert. denied*, 110 S. Ct. 867 (1990) (no implied cause of action to enforce borrowers' rights under the 1987 Act); Griffin v. Federal Land Bank of Wichita, 902 F.2d 22, 24 (10th Cir. 1990) (same); Zajac v. Federal Land Bank of St. Paul, No. 88-5353ND (8th Cir. July 31, 1990) (1990 U.S. App. LEXIS 12932) (same); Williams v. Federal Land Bank of Jackson, 729 F. Supp. 1387, 1390 (D.D.C. 1990). "[O]nce a federal land bank has properly determined whether or not a particular borrower's offer of debt refinancing should be accepted, this Court will not second-guess that determination. . . . *Williams*, 729 F. Supp. at 1390 (citations omitted); Troutman v. Federal Land Bank of Spokane, No. CV88-726-PA, slip op. at 4 (D. Or. Sept. 15, 1988) (order denying preliminary injunction) (declining to review the "quality and good faith" of FLB in denying restructuring); Kramer v. Federal Land Bank of St. Paul, No. Civ. 3-88-297 (D. Minn. Sept. 16, 1988) (order denying preliminary injunction) (finding, *inter alia*, that foreclosure does not present irreparable harm in view of state redemption and first refusal rights). *See also* Woodsmall v. Lyng, 816 F.2d 1241, 1245 (8th Cir. 1987) (denial of FMHA loan on the grounds that the applicant was not creditworthy was not reviewable because the federal courts "are bit equipped to undertake such a task, for in these matters we have neither the training nor the experience of a Farmers Home Administration loan officer"); Tuepker v. Farmers Home Admin., 708 F.2d 1329, 1332 (9th Cir. 1983) (declining to review an FmHA loan denial in the absence of a claim "alleging a substantial departure from important procedural rights, a misconstruction of governing legislation, or some like error going to the heart of the administrative determination").

C. One or both of the factors listed in subparagraph (A) and (B), together with inadequate collateralization, present a high probability of loss to the lender.[485]

The regulations provide that the lender has discretion in determining if the borrower has the financial capacity to repay the loan.[486]

B. What does a borrower do when he believes that his loan is a "distressed loan" eligible for consideration for restructuring, but the lender disagrees?

1. Creating a monetary default to "get the attention" of the lender is rarely, if ever, advisable. The lender may deem the default "voluntary" and continue to maintain that the loan is not distressed. Moreover, a "voluntary default" may result in the borrower being ineligible for the right of first refusal. "Previous owner," for purposes of the right of first refusal, is limited to prior record owners who "did not have the financial resources, as determined by the institution, to avoid foreclosure. . . ."[487]

2. A better alternative would be to prepare a cash flow that both illustrates that the borrower faces the prospect of being unable to pay the original loan according to the terms and also demonstrates that the borrower could repay a restructured note that would meet the criteria for mandatory loan restructuring. The lender may be more willing to consider a distressed loan if the borrower also presents to the lender an acceptable restructuring proposal with the request for a determination that the loan is distressed.

C. What does a borrower do if he has created a "voluntary default" and now desires to backtrack to avoid a foreclosure without the opportunity to be considered for restructuring? The best alternative may be to cure the default. Lenders may not enforce acceleration for monetary default "after a borrower has made all accrued payments of principal, interest, and penalties. . . ."[488]

485. 12 U.S.C.A. § 2202a(a)(3) (West 1989).
486. 12 C.F.R. § 614.4522(a)(2) (1990).
487. 12 C.F.R. § 614.4522(a)(2) (1990).
488. 12 U.S.C.A. § 2202d(c)(West 1989); 12 C.F.R. § 614.4514(c) (1990). In most instances, when a loan is accelerated, the loan accrues interest based on the accelerated principal. An unresolved issue is whether the borrower desiring to "de-accelerate" the loan must pay the interest on the accelerated principal or only the interest that had accrued irrespective of the accelerated principal. The Act's legislative history is ambiguous. The House bill, H.R. 3030, provided that the interest was to be computed "without regard to

D. Is a borrower who has converted collateral eligible for restructuring?

1. Conversion of System lender's collateral is a federal criminal offense.[489]

2. Conversion may prevent the borrower from avoiding acceleration by paying all accrued principal, interest, and penalties.[490]

3. Conversion or the dissipation, destruction, or deterioration of the collateral may also excuse the lender from having to provide the 45 day notice of the availability of restructuring prior to commencing foreclosure proceedings.[491] However, even though the 45 day notice is excused, the loan theoretically is still eligible for restructuring if it is a distressed loan.[492] As a practical matter, a conversion will probably provide a sufficient basis to deny restructuring, and the prior replevin or foreclosure of the collateral will have substantially impaired the borrower's ability to "cash flow" a restructured loan. The availability of restructuring may have practical significance only if the borrower can somehow excuse the loss or deterioration of the collateral and can file for bankruptcy relief prior to the replevying or foreclosure seizure. Of course, in such a case, the failure to excuse the conversion may result in the debt not being discharged.[493]

E. If the lender began foreclosure proceedings but did not complete those proceedings (according to state law) prior to January 6, 1988, the effective date of the Agricultural Credit Act of 1987, the loan is still eligible for restructuring.[494]

F. So long as a reorganization plan has not been confirmed, a borrower in bankruptcy appears to be eligible for consideration for restructuring.[495]

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acceleration." The Senate amendment did not contain a comparable provisions, and the Conference report adopted the House provision, but deleted the language "without regard to acceleration." HOUSE CONF. REP. NO. 100-490, 100th Cong., 1st Sess. 175, *reprinted in* 1987 U.S. CODE CONG. & ADMIN. NEWS 2956, 2970.

489. 18 U.S.C.A. § 658 (West 1976).

490. 12 C.F.R. § 614.4514 (1990).

491. 12 U.S.C.A. § 2202a(j) (West 1989); 12 C.F.R. § 614.4519 (1990).

492. 12 U.S.C.A. § 2202a(b)(1) (West 1989).

493. 11 U.S.C.A. § 523(a)(4) (West 1979).

494. *See* 53 Fed. Reg. 35,427, 35,428 (1988). *See also* Griffin v. Federal Land Bank of Wichita, 708 F. Supp. 313, 317 (D. Kan. 1989), *aff'd*, 902 F.2d 22 (10th Cir. 1990); Federal Land Bank of Omaha v. Engleken, No. C85-2062 (N.D. Iowa Aug. 25, 1988); Federal Land Bank of St. Louis v. Cupples Bros., 889 F.2d 764 (8th Cir. 1989).

495. *E.g.*, In the Matter of Dilsaver, 86 Bankr. 1010 (Bankr. D. Neb. 1988); Stainback v.

III. APPLYING FOR RESTRUCTURING:

A. Notification by a lender to the borrower of eligibility for loan restructuring consideration:

1. When lender determines loan is distressed;[496] or

2. 45 days prior to the commencement of foreclosure proceedings.[497]

B. Suit on the note or debt instrument is probably not a foreclosure proceeding.[498]

C. Notification must include a copy of the district restructuring policy and all material necessary to enable the borrower to submit an application.[499]

D. What should the borrower do upon receipt of the notification?

1. Immediately assemble financial records and obtain expert assistance in developing and exploring cash flow potentials and possibilities. If necessary, explore farm reorganization alternatives. Good cash flow projections take time to prepare. The borrower's financial data, including cash flow alternatives, will be the most significant information under consideration in most cases.

2. Consider requesting additional information from the lender, including the following:

(a) the computational formula that the lender will use to determine and compare cost of foreclosure with the cost of restructuring;

(b) the known costs of foreclosure, i.e., attorney's fees, disposition costs, etc.; and

(c) the appraised value of the collateral.

3. If the request is not answered, send another request bearing in mind the secondary goal listed under the first heading, "Goals," above. Stress that restructuring is designed to produce a "win-win" result, requiring good faith and full disclosure by both lender and bor-

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Federal Land Bank of Jackson, No. GC 88-25-NB-O (N.D. Miss. Feb. 5, 1988) (order granting preliminary injunction); *In re* Kraus, No. BK 86-2677 (Bankr. D. Neb. May 20, 1988); *In re* James Desmond Woods, Jr., No. 88-BK-01659-M11 (W.D. La. March 16, 1989) (interim order in adversary proceeding).

496. 12 U.S.C.A. § 2202a(b)(1) (West 1989); 12 C.F.R. 614.4516 (1990).

497. 12 U.S.C.A. § 2202a(b)(2) (West 1989); 12 C.F.R. § 614.4518) (1990).

498. 12 U.S.C.A. § 2202a(4) (West 1989); 12 C.F.R. § 614.4512(e)(1), (2) (1990).

499. 12 U.S.C.A. § 2202a(b)(1) (West 1989); 12 C.F.R. § 614.4516(a) (1990).

rower.[500] Restructuring is not a poker game — it involves a major business decision by both parties, each having legally enforceable duties to the other. In that regard, not all of the lender's duties arise from the Farm Credit Act, state cooperative law may impose overlapping and additional duties of good faith and full disclosure.[501]

4. Remember that all expenses and income considered in the cost of foreclosure and cost of restructuring are present-valued. Knowledge of the lender's discount rate is essential. Borrowers must be aware that in most districts the proposed restructured note will be discounted to reflect its present value.

5. Borrowers should also consider applying for a lower interest rate during the 45 day period.[502] The required written response by the lender may identify problem areas with the loan that can be addressed in the restructuring proposal.

6. Consider meeting with the loan officer before submitting the restructuring proposal.[503] Document all requests for information, responses, and other discussions at such a meeting.

7. Consider using any available mediation proceedings to obtain information from the lender. A provision of the 1987 Act, 504 requires that FCS lenders:

> (a) "present and explore debt restructuring proposals advanced in the course of such mediation" and
>
> (b) "cooperate in good faith with requests for information or analysis of information made in the course of mediation. . . ."[504]

8. Remember to provide all the information requested by the lender in submitting the borrower's applications for restructuring. This may include balance sheets, income tax returns, projected cash flow, production records, etc.

9. The application must be accompanied by a propo-

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500. *See* 53 Fed. Reg. 35,427, 35,433 (1988) ("A reading of the statute and regulation, [sic] indicates that both parties must put forth a good faith effort and work together").

501. *See, e.g.*, Snyder v. Colwell Cooperative Grain Exchange, 231 Iowa 1210, 1213, 3 N.W.2d 507, 509 (1942) (officers of a corporative have a duty of full and fair disclosure to members).

502. *See* 12 U.S.C.A. § 2199(b) (West 1989); 12 C.F.R. § 614.4368 (1990).

503. 12 U.S.C.A. § 2202a(c) (West 1989); 12 C.F.R. § 614.4516(b) (1990).

504. 7 U.S.C.A. § 5103 (West 1988).

sal for the restructuring of the loan.[505]

10. Consider "packaging" the application and plan in "brochure" from or as an extended letter beginning with a discussion of the background of the borrower, the nature of the borrower's farming operation, and the reasons for the default. Then, discuss in detail the proposed plan and justify it with specific references to the projected cash flow. Also an analysis of the cost of foreclosure and the cost of restructuring, including the necessary computations. Do not assume that there will be considerable negotiations. Put the best plan the borrower can propose on the table. The lender has a right to the "[l]east cost alternative,"[506] and the borrower may not be well served by a proposal that does not reflect that the borrower "is applying all income over and above necessary and reasonable living and operating expenses to the payment of primary obligations."[507] Remember that the burden of justifying restructuring is ultimately borne by the borrower.

IV. CREDIT REVIEW COMMITTEE PROCEEDINGS:

A. The borrower must receive prompt written notice of denial and the reasons for the denial.[508]

B. Insist on lender disclosure of all "critical assumptions and relevant information" (whatever that means) prior to the credit review committee meeting.[509]

C. Remember that the review process is just that, a review; most credit review committees will not consider new proposals at the committee meeting.[510]

D. The loan officer who made the initial denial of the restructuring proposal may participate in the review meeting by providing information and answering questions, but he may not vote or participate in the committee's deliberations.[511]

E. Borrowers may obtain "independent" appraisals of

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505. 12 C.F.R. § 614.4521(a), (b) (1990).

506. Federal Land Bank of Omaha v. Christensen, No. 22641 (Buena Vista Co. Dist. Ct., Iowa, July 6, 1988) (order granting plaintiff's motion for summary judgment on the grounds that an application for restructuring unaccompanied by a plan was fatally defective).

507. 12 U.S.C.A. § 2202a(f) (West 1989); 12 C.F.R. § 614.4517(b) (1990).

508. 12 U.S.C.A. § 2202a(d)(1)(B) (West 1989); 12 C.F.R. § 614.4517(a)(2) (1990).

509. 12 U.S.C.A. § 2201(b) (West 1989); 12 C.F.R. § 614.4518 (1990).

510. 53 Fed. Reg. 35,427, 35,444 (1988) (prefatory comments to the regulations).

511. 53 Fed. Reg. 35,427, 35,426 (1988) (prefatory comments to the regulations).

collateral.[512]

F. The board member serving on the committee must be a member of the board of the lender having ultimate authority over the loan.[513] Where the review is a consolidated one involving both an FLB loan and a PCA loan, a board member from each entity must be present, unless the district Farm Credit Bank has the ultimate authority over both loans.[514]

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512. 53 Fed. Reg. 35,427, 35,436 (1988) (prefatory comments to the regulations). *See also* 12 U.S.C.A. § 2202(a)(2) (West 1989) ("In no case shall a loan officer involved in the initial decision on a loan serve on the credit review committee when the committee reviews such loan."); 12 C.F.R. § 614.4442 (1990) (same).

513. 12 U.S.C.A. § 2202(d) (West 1989); 12 C.F.R. § 614.4443(c) (1990).

514. 12 C.F.R. § 614.4442 (1990).

Structure of the Farm Credit System

Farm Credit Administration

- Independent agency in the executive branch of government. 12 U.S.C. § 2241.

Farm Credit Administration Board

- Three members appointed by the President with advice and consent of Senate. 12 U.S.C.A. § 2242.

Farm Credit System Institutions

Federal Farm Credit Banks Funding Corporation

- Sells and manages securities. 12 U.S.C.A. § 2160.
- Nine voting members on board:
  - Four directors of district banks elected by shareholders of Funding Corporation.
  - Three CEOs of district banks elected by shareholders of Funding Corporation.
  - Two appointed by seven elected members; cannot be borrower, shareholder, or employee of any FCS institution
- One nonvoting member on board
  - Director of Assistance Board while it is in existence, to be replaced by director of Insurance Corporation

Farm Credit System Insurance Corporation

- Insure payment of principal and interest on notes, bonds, and debentures issued by banks of System. 12 U.S.C.A. § 2277a-1.
- Board is same as FCA Board. 12 U.S.C.A. § 2277a-2.
- Becomes effective January 1, 1989 12 U.S.C.A. § 2277a-3
- Insurance funded by premiums from banks. 12 U.S.C.A. § 2277a-4.

Federal Agricultural Mortgage Corporation

- Sets standards and eligibility of participants in secondary mortgage market. 12 U.S.C.A. § 2279aa-1(b).
- Interim board consists of nine members appointed by President:
  - Three representatives of banks;
  - Three representatives of FCS institutions;
  - Two farmers (one of which is an FCS borrower);
  - One member of general public
  - No more than five can be of same political party.

  12 U.S.C.A. § 2279aa-2(a)
- Permanent board comes into existence when common stock of corporation reaches level of $20,000,000; 15 members:
  - Five elected by insurance companies and banks
  - Five elected by members of FCS institutions
  - Five appointed by President (at least two with farming experience)

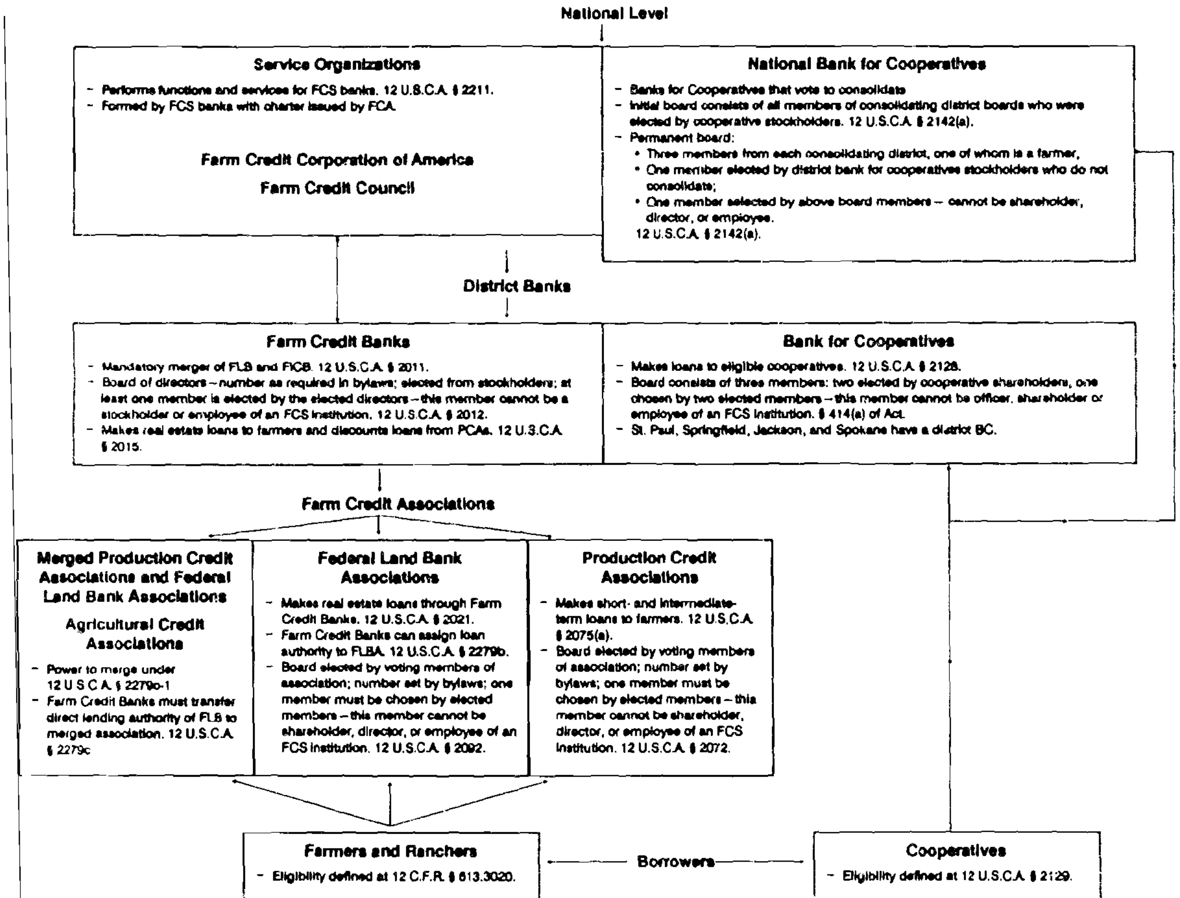
  12 U.S.C.A. § 2279aa-2(b).

Farm Credit System Financial Assistance Corporation

- Provide capital to FCS institutions in financial difficulty by purchasing preferred stock of certified institutions. 12 U.S.C.A. § 2278b-1.
- Board of Directors is the same as the Funding Corporation. 12 U.S.C.A. § 2278b-2.
- Raises capital by issuing bonds guaranteed by federal treasury. 12 U.S.C.A. § 2278b-6.

Farm Credit System Assistance Board

- Provide assistance to and protect stock of borrowers of FCS institutions. 12 U.S.C.A. § 2278a-1.
- Board of three: Secretary of Treasury, Secretary of Agriculture, and "agricultural producer" appointed by President with advice and consent of Senate. 12 U.S.C.A. § 2278a-2.
- Certifies institutions to enable it to issue preferred stock, 12 U.S.C.A. § 2278a-4, which is purchased by the Financial Assistance Corporation. 12 U.S.C.A. § 2278b-7



National Level
Service Organizations
- Performs functions and services for FCS banks. 12 U.S.C.A. § 2211.
- Formed by FCS banks with charter issued by FCA.
Farm Credit Corporation of America
Farm Credit Council
National Bank for Cooperatives
- Banks for Cooperatives that vote to consolidate
- Initial board consists of all members of consolidating district boards who were elected by cooperative stockholders. 12 U.S.C.A. § 2142(a).
- Permanent board:
• Three members from each consolidating district, one of whom is a farmer,
• One member elected by district bank for cooperatives stockholders who do not consolidate;
• One member selected by above board members – cannot be shareholder, director, or employee.
12 U.S.C.A. § 2142(a).
District Banks
Farm Credit Banks
- Mandatory merger of FLB and FICB. 12 U.S.C.A. § 2011.
- Board of directors – number as required in bylaws; elected from stockholders; at least one member is elected by the elected directors – this member cannot be a stockholder or employee of an FCS institution. 12 U.S.C.A. § 2012.
- Makes real estate loans to farmers and discounts loans from PCAs. 12 U.S.C.A. § 2015.
Bank for Cooperatives
- Makes loans to eligible cooperatives. 12 U.S.C.A. § 2128.
- Board consists of three members: two elected by cooperative shareholders, one chosen by two elected members – this member cannot be officer, shareholder or employee of an FCS Institution. § 414(a) of Act.
- St. Paul, Springfield, Jackson, and Spokane have a district BC.
Farm Credit Associations
Merged Production Credit Associations and Federal Land Bank Associations
Agricultural Credit Associations
- Power to merge under 12 U.S.C.A. § 2279c-1
- Farm Credit Banks must transfer direct lending authority of FLB to merged association. 12 U.S.C.A. § 2279c
Federal Land Bank Associations
- Makes real estate loans through Farm Credit Banks. 12 U.S.C.A. § 2021.
- Farm Credit Banks can assign loan authority to FLBA. 12 U.S.C.A. § 2279b.
- Board elected by voting members of association; number set by bylaws; one member must be chosen by elected members – this member cannot be shareholder, director, or employee of an FCS institution. 12 U.S.C.A. § 2092.
Production Credit Associations
- Makes short- and intermediate-term loans to farmers. 12 U.S.C.A. § 2075(a).
- Board elected by voting members of association; number set by bylaws; one member must be chosen by elected members – this member cannot be shareholder, director, or employee of an FCS Institution. 12 U.S.C.A. § 2072.
Farmers and Ranchers
- Eligibility defined at 12 C.F.R. § 613.3020.
Borrowers
Cooperatives
- Eligibility defined at 12 U.S.C.A. § 2129.

Farm Credit System Districts