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Kansas Family Farm Rehabilitation Act, Which Stays the Enforcement of Certain Judgments against Agricultural Property and Provides for Redemption of that Property in Certain Circumstances, Violates the Contract Clause of the United States Constitution – *Federal Land Bank v. Bott*, 240 Kan. 624, 732 P.2d 710 (1987)

by

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AGRICULTURAL LEGISLATION—Kansas Family Farm Rehabilitation Act, Which Stays the Enforcement of Certain Judgments Against Agricultural Property and Provides for Redemption of that Property in Certain Circumstances, Violates the Contract Clause of the United States Constitution—*Federal Land Bank v. Bott*, 240 Kan. 624, 732 P.2d 710 (1987).

TABLE OF CONTENTS

I.	Introduction	705
II.	Provisions of the Kansas Family Farm Rehabilitation Act . . .	706
III.	Application of the Contract Clause to the Kansas Family Farm Rehabilitation Act	707
IV.	Application of the Contract Clause to Iowa Agricultural Stabilization Legislation	712
	A. The Iowa Real Estate Foreclosure Moratorium	712
	B. The 1987 Amendments Regarding Homestead Redemption	714
V.	Conclusion	716

I. INTRODUCTION

On April 11, 1986, the District Court of Washington County, Kansas, granted judgment to the Federal Land Bank of Wichita in a foreclosure action against Delwin, Lois, Herman, and Amanda Bott.¹ On July 8, 1986, the Federal Land Bank of Wichita was also granted judgment in a foreclosure action against Clarence and Ethel Nelson.² Seeking stays of the execution of the judgments,³ both the Botts and the Nelsons filed motions for protection in the appropriate district court under the Kansas Family Farm Rehabilitation Act.⁴ Within two weeks of one another, both the District Court of Washington County and the District Court of Republic County held the Kansas Family Farm Rehabilitation Act unconstitutional and ordered execution of their respective judgments.⁵ The Botts and the Nelsons appealed these rulings to the Supreme Court of Kansas which *held*, affirmed.⁶ The Kansas Family Farm Rehabilitation Act substantially impairs the contractual relationship between mortgagor and mortgagee, thus violating the contract clause of the United States Constitution, and even though the Kansas

1. *Federal Land Bank v. Bott*, 240 Kan. 624, —, 732 P.2d 710, 712 (1987).

2. *Id.*

3. Neither the Botts nor the Nelsons appealed the judgments. *Id.*

4. *Id.*

5. *Id.*

6. *Id.* at 719.

Legislature was justified by a significant and legitimate public purpose in exercising its police power to assist the troubled agricultural industry, the impairments to the contracting parties' rights are not based upon reasonable conditions and are not of a character appropriate to the public purpose. *Federal Land Bank v. Bott*, 240 Kan. 624, 732 P.2d 710 (1987).

The opinion of the Kansas Supreme Court did two things. It struck down an important piece of Kansas agricultural legislation. It also provided the legislatures of other agricultural states with a contemporary guide to the rationale a court might follow in evaluating the constitutionality of agricultural stabilization legislation.

II. PROVISIONS OF THE KANSAS FAMILY FARM REHABILITATION ACT

The initial portion of the *Bott* opinion is devoted to a summary of the Kansas Family Farm Rehabilitation Act.⁷ The Kansas Legislature enacted the Family Farm Rehabilitation Act in 1986.⁸ The legislature found that the economy of Kansas was based to a large extent on agriculture and that the livelihoods of individual farmers, ranchers, and agribusinessmen in Kansas were jeopardized by low commodity prices, high interest rates, the declining value of agricultural land, and the increasing rate of farm foreclosures.⁹ The legislature found that these conditions created an economic emergency for the state of Kansas.¹⁰ The legislature enacted the Family Farm Rehabilitation Act with the stated purpose: "to assist in stabilizing the economic conditions of [the state of Kansas]."¹¹

The Act became effective on May 8, 1986, and was to be applied retroactively from October 1, 1985.¹² In summary, it authorized the stay of enforcement of certain judgments relating to agricultural property and provided for redemption of that property in certain circumstances.¹³

The Family Farm Rehabilitation Act provided a procedure for the stay of execution of an agricultural foreclosure or repossession judgment when the defendant was an "insolvent"¹⁴ "farmer"¹⁵ engaged in a "farming operation."¹⁶ If a farmer applied for protection from foreclosure or repossession¹⁷

7. *Id.* at 712-13.

8. *Id.* at 712.

9. KAN. STAT. ANN. § 2-3401 (Supp. 1986).

10. *Id.*

11. *Id.*

12. *Id.* at § 2-3403.

13. *Id.* at § 2-3406.

14. "Insolvent" was defined as "a person with no equity in property other than exempt property under other provisions of Kansas law." *Id.* at § 2-3402(e).

15. A "farmer" was defined as a person or family farm corporation which derived more than 80% of gross income from "farming operations." *Id.* at § 2-3402(c).

16. A "farming operation" included farming; tillage of the soil; dairy farming; ranching; production or raising of crops, poultry, or livestock; and production of poultry or livestock products in an unmanufactured state. *Id.* at § 2-3402(b).

and the court determined the Act was applicable, the court was required to stay execution of judgment for thirty days.¹⁸ If, within those thirty days, the farmer paid into court one year's interest on the fair market value of the agricultural property, or one year's interest plus depreciation of the fair market value of the property, the court was required to stay execution of the judgment for one year.¹⁹ The interest rate during the stay was prescribed by the Act.²⁰ In addition, the court was to provide "adequate protection"²¹ for the mortgagee during the stay.²² At the expiration of the first year's stay, the farmer could apply for additional one-year stays for up to two additional years if similar conditions were met.²³

The Act provided that the farmer waived his right to redeem by the usual method of redemption during the stay period,²⁴ but allowed the farmer to redeem any portion of the property as provided under the Act.²⁵ A farmer could do so by paying costs, taxes, and the greater of the fair market value of the property (as determined by the court) either at the time of the initial trial or hearing or at the time of redemption.²⁶

If the farmer did not meet the above requirements, the mortgagee could proceed with execution of its judgment.²⁷

III. APPLICATION OF THE CONTRACT CLAUSE TO THE KANSAS FAMILY FARM REHABILITATION ACT

After summarizing the Act, the court prepared to discuss its constitu-

17. The debtor needs to file his application for protection at least twenty days prior to the trial or hearing date. *Id.* at § 2-3405.

18. *Id.* at § 2-3406(a).

19. *Id.*

20. The interest rate was to be the current 52-week United States Treasury bill rate plus 2%. *Id.* at § 2-3406(c).

21. "Adequate protection" was defined as any requirement which maintained the creditor in substantially the same position as the creditor was in at the time the court ordered the stay of execution of the judgment. *Id.* at § 2-3402(f). Methods of protection suggested by the Act included insurance, prevention of waste, and preservation and inspection of land or property. *Id.*

22. *Id.* at § 2-3406(a).

23. *Id.* at § 2-3406(b).

24. *Id.* at § 2-3406(d).

25. *Id.* at § 2-3407.

26. *Id.*

27. Additional provisions of the Act included the following:

(1) A construction clause which stated that nothing in the Act was to be "construed to forgive or discharge any indebtedness of the judgment debtor or to affect any judgment lien on property of the [farmer] other than property subject to the mortgage or lien being foreclosed . . ." *Id.* at § 2-3411.

(2) A severability clause which stated that, if any part of the Act was held to be unconstitutional, the remainder of the Act should be conclusively presumed to be constitutional. *Id.* at § 2-3413.

(3) An expiration date of July 1, 1991. *Id.* at § 2-3412.

tionality.²⁸ First, the court stated that the Act was presumed to be constitutional.²⁹ Then, the court undertook a long discussion of the contract clause³⁰ of the United States Constitution.³¹ The court stated that the contract clause was adopted to prevent states from enacting debtor relief legislation.³² The court recognized that, despite its original narrow scope, the contract clause has historically been given a more expansive interpretation by the United States Supreme Court.³³

After tracing the development of the contract clause through the nineteenth century,³⁴ the court determined the appropriate contract clause test applicable to agricultural stabilization legislation.³⁵ In doing so, the court noted three relevant United States Supreme Court decisions.³⁶

*Home Building & Loan Association v. Blaisdell*³⁷ was both an important decision of the Depression Era and a decision relevant to any discussion of debtor relief legislation.³⁸ The court concluded from its consideration of *Blaisdell* "that while the contract clause appears facially absolute, it must be considered in conjunction with the reserved power of the state to protect

28. *Federal Land Bank v. Bott*, 240 Kan. 624, ___, 732 P.2d 710, 713-17 (1987).

29. *Id.* at 713-14. The Kansas Supreme Court had previously held:

This court adheres to the proposition that the constitutionality of a statute is presumed, that all doubts must be resolved in favor of its validity, and before the statute may be stricken down, it must clearly appear the statute violates the constitution. Moreover, it is the court's duty to uphold the statute under attack, if possible, rather than defeat it, and if there is any reasonable way to construe the statute as constitutionally valid, that should be done.

Barnes v. Kansas Dept. of Revenue, 238 Kan. 820, 824, 714 P.2d 975, 978-79 (1986) (quoting *State v. Huffman*, 228 Kan. 186, ___, 612 P.2d 630, 631 (1980)).

30. The contract clause provides, "No State shall . . . pass any . . . Law impairing the Obligation of Contracts . . ." U.S. CONST. art. I, § 10, cl. 1.

31. *Federal Land Bank v. Bott*, 240 Kan. 624, ___, 732 P.2d 710, 714 (1987).

32. *Id.* The court identified the Family Farm Rehabilitation Act as a debtor relief law. *Id.*

33. *Id.*

34. The court cited *Fletcher v. Peck*, 10 U.S. (6 Cranch) 87 (1810) (a decision, partially based on the contract clause, which left uncertain the authority of the contract clause to prohibit legislation impairing the obligation of a state to a private party); *Dartmouth College v. Woodward*, 17 U.S. (4 Wheat.) 518 (1819) (used the contract clause to invalidate a state attempt to change the provisions of a corporate charter); *Sturges v. Crowninshield*, 17 U.S. (4 Wheat.) 122 (1819) (applied the contract clause to invalidate a state insolvency law which discharged debtors' obligations once they had surrendered their property); *Ogden v. Saunders*, 25 U.S. (12 Wheat.) 213 (1827) (held prospective application of debtor relief legislation constitutional despite the contract clause). *Id.* at 714-15.

35. *Id.* at 715-17.

36. *Id.*

37. *Home Bldg. & Loan Ass'n v. Blaisdell*, 290 U.S. 398 (1934). In *Blaisdell* a Minnesota law had given state courts the authority to extend a mortgagor's redemption period after a foreclosure sale from eighteen months to three years. *Id.* at 416. During the extension period the mortgagor was allowed to remain in possession if he paid the reasonable rental value of the property toward the mortgage debt, interest, taxes, and insurance. *Id.*

38. *Federal Land Bank v. Bott*, 240 Kan. 624, ___, 732 P.2d 710, 715 (1987).

the vital interests of the community."³⁹ Five factors were found in *Blaisdell* which, when considered together, could justify the exercise of a state's police power despite the contract clause.⁴⁰ These factors were said to be:

- (1) [T]he existence of an emergency;
- (2) the legislation was addressed to a legitimate end for the protection of a basic interest of society as opposed to the advantage of particular individuals;
- (3) the relief afforded was of a character appropriate to the emergency;
- (4) the statute imposed reasonable conditions; and
- (5) the statute was limited to the "exigency which called it forth."⁴¹

The "reasonable conditions" imposed by the statute considered in *Blaisdell* were that "the integrity of the mortgage indebtedness [was] not impaired; interest continue[d] to run; the validity of the sale and the right of a mortgagee-purchaser to title or to obtain a deficiency judgment [were] maintained; and the conditions of redemption [stood] as they were under the prior law."⁴²

In *Allied Structural Steel Co. v. Spannaus*,⁴³ the United States Supreme Court applied the factors utilized in *Blaisdell* to invalidate a Minnesota statute.⁴⁴ The statute violated the contract clause because it: "(1) did not deal with a broad, generalized economic or social problem; (2) did not operate in an area already subject to state regulation; (3) severely, permanently, and immediately altered contractual relationships; and (4) protected a narrow class rather than a broad societal interest."⁴⁵

Finally, the court cited *Energy Reserves Group v. Kansas Power & Light*⁴⁶ as a more recent case dealing with the contract clause.⁴⁷ The court determined that the test provided by *Energy Reserves* was applicable because it took "into account the factors applied in *Blaisdell* and *Spannaus* as well as the overriding general principle that the reservation of the State's police power must be read into all contracts."⁴⁸ The test was stated as

39. *Id.* at 716.

40. *Id.*

41. *Id.* (citing *Home Bldg. & Loan Ass'n v. Blaisdell*, 290 U.S. 398, 444-47 (1934)).

42. *Id.* (citing *Home Bldg. & Loan Ass'n v. Blaisdell*, 290 U.S. 398, 445 (1934)).

43. *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234 (1978). In *Spannaus* a Minnesota statute required certain pension rights to vest when certain companies terminated their pension plans or closed their Minnesota plants. *Id.* at 238-39.

44. *Id.* at 243.

45. *Federal Land Bank v. Bott*, 240 Kan. 624, ____, 732 P.2d 710, 716 (1987) (citing *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 250 (1978)).

46. *Energy Reserves Group v. Kansas Power & Light*, 459 U.S. 400 (1983). In *Energy Reserves*, the Court upheld a Kansas law which placed a ceiling on price increases which a natural gas supplier could charge a public utility under a pre-existing contract. *Id.* at 403.

47. *Federal Land Bank v. Bott*, 240 Kan. 624, ____, 732 P.2d 710, 716 (1987).

48. *Id.* at 717.

follows:

"The threshold inquiry is 'whether the state law has, in fact, operated as a substantial impairment of a contractual relationship.'

"If the state regulation constitutes a substantial impairment, the State, in justification, must have a significant and legitimate public purpose behind the regulation, such as the remedying of a broad and general social or economic problem. . . .

"Once a legitimate public purpose has been identified, the next inquiry is whether the adjustment of 'the rights and responsibilities of contracting parties [is based] upon reasonable conditions and [is] of a character appropriate to the public purpose justifying [the legislation's] adoption.'"⁴⁹

The court then proceeded to apply this test to the Family Farm Rehabilitation Act.⁵⁰

The court determined that the Family Farm Rehabilitation Act substantially impaired the contractual relationship between the mortgagor and the mortgagee.⁵¹ It reached this determination because "the Act (1) impairs the mortgage indebtedness; (2) alters the contract rate of interest; (3) permits partial redemption of the mortgaged property; and (4) provides inadequate protection for the mortgagee."⁵²

The Family Farm Rehabilitation Act impaired the mortgage indebtedness by allowing the farmer to redeem the property and depriving the lender of any security for the difference between the redemption amount and the judgment amount.⁵³ As mentioned above, the court was required to determine the redemption price at the time of the hearing or trial or at the time of redemption.⁵⁴ The Kansas Supreme Court speculated that this price would generally be substantially less than the judgment amount.⁵⁵ Thus, title to mortgaged property could be obtained free and clear of the mortgage lien simply by redeeming the property at a price which might have no relationship to the amount of the judgment.⁵⁶

The contract rate of interest was altered by the statutory provision tying the rate during the stay period to the United States Treasury bill rate,⁵⁷ which would be much lower than the contract rate.⁵⁸ In addition, this inter-

49. *Id.* (quoting *Energy Reserves Group v. Kansas Power & Light*, 459 U.S. 400, 411-12 (1983), which in turn quotes *Allied Structural Steel Co. v. Spannaus*, 438 U.S. at 244).

50. *Id.*

51. *Id.* at 718.

52. *Id.*

53. *Id.* at 717.

54. *Id.*

55. *Id.*

56. *Id.* The court reached this conclusion despite the provision of the Act regarding its construction. *Id.* See *supra* note 27.

57. See *supra* note 20.

58. *Federal Land Bank v. Bott*, 240 Kan. 624, ____, 732 P.2d 710, 717 (1987).

est was payable only on the fair market value of the land which, again, might be substantially less than the amount of outstanding indebtedness.⁵⁹

Partial redemption of the mortgaged property was permitted by the statutory provision which allowed a farmer to redeem any portion of the property upon which the execution had been stayed.⁶⁰ The court speculated that a farmer could redeem the most valuable portion of the mortgaged land, leaving the mortgagee with security of little or no value.⁶¹

Finally, the mortgagee was inadequately protected, since the farmer could remain in possession of the land without paying rent or taxes or accounting for profits.⁶² Even though the Act required the court to specify methods of providing adequate protection for the mortgagee,⁶³ it did not obligate the court to order any of these protections.⁶⁴ The court found the potential for abuse too great and the protection of the mortgagee insufficiently specific.⁶⁵

The court's conclusion—that the Act substantially impaired the contractual relationship between mortgagor and mortgagee—seems unavoidable. In fact, it could hardly be conceived that the Kansas Legislature did not also recognize this fact. Still, the Act could have been saved had it satisfied the two remaining prongs of the *Energy Reserves* test.

With regard to the second prong of the *Energy Reserves* test, the court concluded that a significant and legitimate public purpose existed to justify the use of the legislature's police power to assist the troubled agricultural industry.⁶⁶ The legislature had clearly stated the purpose of the Act and the court agreed that the stability of agricultural conditions had been threatened.⁶⁷ The court spent little time in concluding that the stability of agriculture affected the "well-being of all" Kansas.⁶⁸

The third prong of the *Energy Reserves* test proved to be the undoing of the Family Farm Rehabilitation Act. The court determined that the impairments to the contracting parties' rights were not based upon reasonable conditions and were not of a character appropriate to the public purpose.⁶⁹ The court made this determination by comparing the conditions imposed by the Kansas statute with those which had been found reasonable in *Blaisdell*.⁷⁰ The integrity of the mortgage indebtedness had been impaired by the

59. *Id.*

60. *Id.* See *supra* note 25 and accompanying text.

61. *Id.* at 717-18.

62. *Id.* at 718.

63. See *supra* note 20 and accompanying text.

64. *Federal Land Bank v. Bott*, 240 Kan. 624, ____, 732 P.2d 710, 718 (1987).

65. *Id.*

66. *Id.*

67. *Id.*

68. *Id.*

69. *Id.* See *supra* note 42 and accompanying text.

70. *Federal Land Bank v. Bott*, 240 Kan. 624, ____, 732 P.2d 710, 718 (1987).

authorization of redemption at less than the judgment amount.⁷¹ The mortgage interest continued to run but it did so at a rate provided by the Act.⁷² The mortgagee had no right to obtain either title to the security or a deficiency judgment.⁷³ The conditions of redemption were changed by the provision authorizing redemption of a portion of the mortgaged property.⁷⁴ In addition, the mortgagor was under no obligation to pay taxes, nor to pay either a share of the profits or a reasonable rental, during the extended period of redemption.⁷⁵ The court noted the danger that, under the Family Farm Rehabilitation Act, "all institutions and persons making farm loans would cease doing so because the statute impairs the security for such loans."⁷⁶

The Act was declared unconstitutional.⁷⁷ The Federal Land Bank of Wichita was allowed to proceed with execution of its judgment.⁷⁸ The Kansas Family Farm Rehabilitation Act altered the contract rights of mortgagees too extensively and unreasonably to survive a contract clause challenge despite the legitimacy of its purpose.

IV. APPLICATION OF THE CONTRACT CLAUSE TO IOWA AGRICULTURAL STABILIZATION LEGISLATION

A. *The Iowa Real Estate Foreclosure Moratorium*

During periods of instability in the Iowa agricultural economy, mortgage debtors look for protection to the Iowa Real Estate Foreclosure Moratorium. This statute was enacted in 1939.⁷⁹ In summary, it authorizes a continuance of foreclosures on certain types of real estate when the governor declares a state of economic emergency.⁸⁰

71. *Id.*

72. *Id.*

73. *Id.*

74. *Id.*

75. *Id.*

76. *Id.*

77. *Id.* at 719. The deficiencies found in the Act were considered so pervasive that the court could not apply the severability clause. *Id.* See *supra* note 27.

As a final note, the court pointed out that Congress had enacted Chapter 12 of the Bankruptcy Code to benefit economically depressed farmers. *Id.* The court suggested that this new provision might furnish some relief for these farmers. *Id.*

78. *Id.*

79. The Iowa legislature enacted the Moratorium in 1933 and extended it in 1935 and 1937. Ch. 182, § 1, 1933 IOWA ACTS 211; Ch. 115, § 1, 1935 IOWA ACTS 163; Ch. 80, § 1, 1937 IOWA ACTS 96. The current statute was enacted in 1939 and revised in 1985. Ch. 245, § 1, 1939 IOWA ACTS 353; Ch. 250, §§ 1, 2, 1985 IOWA ACTS 520.

80. IOWA CODE § 654.15 (1987).

A state of emergency was declared on October 1, 1985. The Iowa General Assembly extended the declaration to continue in effect until March 20, 1988. 1987 Iowa Legis. Serv. S.F. 138 (West).

When the governor determines that a state of economic emergency exists, he is required to declare such an emergency in order to make the statute available to debtors.⁸¹ The governor is also required to state the types of real estate⁸² eligible for protection under the moratorium.⁸³

In an action to foreclose on eligible real estate used for farming, the defendant-owner may apply⁸⁴ for a continuance of the foreclosure if he enters an appearance and files an answer admitting some indebtedness and breach of the terms of the debt instrument.⁸⁵ The court⁸⁶ may continue the foreclosure proceeding for two years.⁸⁷ During the continuance the court is required to appoint a receiver⁸⁸ to take charge of and rent⁸⁹ the property.⁹⁰ The receiver is required to collect rents and profits and distribute them in a manner prescribed by the statute.⁹¹

The constitutionality of the Iowa Real Estate Foreclosure Moratorium, in its present form, has never been examined.⁹² However, if one analyzes the Moratorium statute under the *Energy Reserves* test, as the Kansas Supreme Court analyzed the Kansas Family Farm Rehabilitation Act, one is compelled to conclude that the statute does not violate the contract clause of the United States Constitution.

The Moratorium does not substantially impair the contractual relationship between mortgagor and mortgagee. During the continuance provided by the Moratorium, interest continues to run on the outstanding balance of the debt. (Under the Kansas Act interest ran on a principal amount which could have been substantially less than the balance of the debt.) Under the Iowa law the mortgagor cannot redeem a valuable portion of the mortgaged prop-

81. IOWA CODE § 654.15(2) (1987).

82. The statute suggests types of real estate which the governor may designate. *Id.* These include: real estate used for farming; types of real estate not used for farming, such as real estate used for small business; or all real estate. *Id.*

83. Only property of a type specified by the governor which is subject to a mortgage, deed of trust, or contract for purchase entered into before the date of the declaration is eligible. *Id.*

84. Applications must be made within one year of the governor's declaration of economic emergency. *Id.*

85. The admissions made cannot be withdrawn or denied after a continuance is granted. *Id.*

86. The court must find that the application was made in good faith and that the owner is unable to perform. *Id.*

87. *Id.* An owner may be granted only one continuance for each written instrument under each declaration of emergency. *Id.* at § 654.15(2)(b).

88. The owner may be appointed receiver. *Id.* at § 654.15(2)(c).

89. The owner is given preference in the occupancy of the property. *Id.*

90. *Id.*

91. *Id.*

92. The Iowa Supreme Court reviewed the original Moratorium Act in *Des Moines Joint Stock Land Bank v. Nordholm*, 217 Iowa 1319, 253 N.W. 701 (1934). Extensions of the original act were held unconstitutional in *First Trust Joint Stock Land Bank v. Arp*, 225 Iowa 1331, 283 N.W. 441 (1939) and in *John Hancock Mut. Life Ins. Co. v. Egglund*, 225 Iowa 1073, 283 N.W. 444 (1939).

erty and leave the mortgagee with virtually worthless security, as was possible under the Kansas Act. Under the Iowa law the court is required to appoint a receiver to protect the interests of the mortgagee. The mortgagee's protection is not left to the discretion of the court. The contractual relationship is impaired only to the extent that the mortgagee is delayed in seeking the execution of its judgment. This impairment does not appear substantial considering the protection guaranteed the mortgagee.

Assuming, however, that the contractual relationship was impaired to an extent which would cause the Moratorium statute to fail the threshold inquiry, there can be little question that the Iowa Legislature was moved by a significant and legitimate public purpose in enacting the statute and that the rights of the contracting parties have been adjusted by reasonable conditions of a character appropriate to that purpose. The court in *Bott* had no difficulty in finding a significant and legitimate purpose behind the Kansas Family Farm Rehabilitation Act. The Iowa Real Estate Foreclosure Moratorium, passed during the Great Depression, derived from the same public purpose. In addition, the reasonable conditions found in the *Blaisdell* statute are also present in the Iowa statute: the integrity of the mortgage indebtedness is not impaired; the mortgage interest continues to run, pursuant to the contract; the mortgagee has a right to obtain title to the security or a deficiency judgment once the continuance has expired; the normal conditions of redemption apply. Finally, the mortgagor, if he remains in possession, is required to pay a reasonable rent. Thus, the Iowa Real Estate Foreclosure Moratorium does not violate the contract clause of the United States Constitution.

B. *The 1987 Amendments Regarding Homestead Redemption*

In 1986 the Iowa Legislature enacted section 654.16 of the Iowa Code, which provided a procedure for the separate redemption of a homestead.⁹³ The statute provided that a mortgagor could designate a portion of the mortgaged land as a homestead and redeem that portion of the land separately from other agricultural land used for farming when the homestead was not sold separately from the other land.⁹⁴ The provision became effective on June 1, 1986.⁹⁵

In 1987 the Iowa Legislature amended Iowa Code section 654.16.⁹⁶ The amendments provided that, if a designated homestead is sold at a foreclosure sale to satisfy a judgment, the court must determine its fair market value.⁹⁷ After this determination, the mortgagor may redeem the designated

93. IOWA CODE § 654.16 (1987).

94. *Id.*

95. *Id.*

96. IOWA CODE § 654.16 (Interim Supp. 1987).

97. *Id.*

homestead by tendering its fair market value at any time within two years from the date of the foreclosure sale.⁹⁸ The amendments were made applicable to foreclosure sales held after the effective date, June 4, 1987, and to foreclosure sales of agricultural land held within one year before the effective date if the holder of the sheriff's certificate of sale was a mortgagee who had not sold or otherwise disposed of the land and whose mortgage was enforced by the foreclosure sale.⁹⁹

In *Federal Land Bank v. Arnold*,¹⁰⁰ the Iowa Supreme Court applied the *Energy Reserves* test used in *Bott* to the homestead redemption amendments and concluded that the retroactive application of these amendments violated the contract clause of the United States Constitution,¹⁰¹ despite the fact that the court found the Iowa amendments less oppressive and destructive than the provisions of the Kansas Family Farm Rehabilitation Act.¹⁰²

The court in *Arnold* quickly disposed of the first two prongs of the *Energy Reserves* test.¹⁰³ The court could find "no serious dispute" that the mortgage obligation was significantly impaired by the provision allowing the mortgagor to redeem the homestead at fair market value rather than at the mortgage balance.¹⁰⁴ In addition, neither party in the case had questioned the significant and legitimate purpose which motivated the Iowa Legislature.¹⁰⁵

As with the Family Farm Rehabilitation Act, the third prong of the *Energy Reserves* test proved to be the undoing of the homestead redemption amendments. The court noted that the retroactive application of the amendments denied the mortgagee an opportunity to adjust its bid to reflect fair market value at the time of the foreclosure sale.¹⁰⁶ In addition, because the amendments failed to specify the time for fixing the fair market value of the homestead, the court speculated that the mortgagee could not collect interest on the redemption amount.¹⁰⁷ Given these two considerations, the court concluded that the retroactive application of the amendments was not based on reasonable conditions.¹⁰⁸

98. *Id.* The two-year time period was made inapplicable to a member institution. *Id.* The redemption period for member institutions was set at one year. *Id.* The Iowa Supreme Court has held that this distinction violated the equal protection clause of the United States Constitution. *Federal Land Bank v. Arnold*, 426 N.W.2d 153 (Iowa 1988).

99. IOWA CODE § 654.16(2) (Interim Supp. 1987).

100. *Federal Land Bank v. Arnold*, 426 N.W.2d 153 (Iowa 1988).

101. *Id.* at 159-61.

102. *Id.* at 160.

103. *Id.*

104. *Id.*

105. *Id.*

106. *Id.*

107. *Id.* at 161.

108. *Id.* The court invalidated retroactive application of the amendments while stating that prospective application would withstand constitutional challenge. *Id.*

V. CONCLUSION

As the severity of the farm crisis diminishes, the pressure on the Iowa Legislature to provide emergency farm relief diminishes as well. Economic upheaval in the agricultural sector is not a thing of the past, however. It will occur again, and it will be more severe because the federal government is no longer politically inclined or financially able to prevent it. Consequently, the primary protector of the family farm will be state government.

In the area of agricultural legislation, there is an inherent tension between the protection of farmers and the availability of credit. Historically, the state of Iowa has preferred farm protection over credit availability.¹⁰⁹ Despite this preference, agricultural lenders continue to extend credit to Iowa farmers. There is every reason to assume that this phenomenon will continue.

Now is the time for the Iowa Legislature to evaluate the provisions of the Code of Iowa which were designed to stabilize the Iowa agricultural economy in times of crisis. Both borrowers and lenders would benefit by knowing the law which would be applicable to them in the next farm crisis. The legislature now has time to consider proposals from both sides without the urgency which accompanies economic emergency. The legislature also has recent experience available to help it determine which provisions to maintain, refine, or delete. In addition, *Federal Land Bank v. Bott*¹¹⁰ and *Federal Land Bank v. Arnold*¹¹¹ provide important lessons which should be considered in future agricultural stabilization legislation. *Bott* demonstrates that a state legislature can overreact to an economic crisis by favoring farming interests to so great an extent that the continued availability of credit is severely impaired. Clearly the Iowa Legislature should avoid extending so far its historical preference for farm protection. *Arnold* shows that retroactive application of substantial impairments to existing contract obligations is unreasonable. The Iowa Legislature should not attempt to apply such provisions retroactively even though an economic emergency makes retroactive application appear desirable.

Because the most severe stage of the current farm crisis has passed, now is the time for the legislature to make the tough decisions which must be made to ensure that the family farm survives the next emergency.

Scott E. Wolfe

109. Bauer, *Judicial Foreclosure and Statutory Redemption: The Soundness of Iowa's Traditional Preference for Protection over Credit*, 71 IOWA L. REV. 1 (1985).

110. *Federal Land Bank v. Bott*, 240 Kan. 624, 732 P.2d 710 (1987).

111. *Federal Land Bank v. Arnold*, 426 N.W.2d 153 (Iowa 1988).