Risk Sharing Down on the Farm: A Comparison of Farmer Bankruptcy and Insolvency Statutes

by

L. Leon Geyer

Originally published in DRAKE LAW REVIEW
34 DRAKE L. REV. 429 (1984)

RISK SHARING DOWN ON THE FARM: A COMPARISON OF FARMER BANKRUPTCY AND INSOLVENCY STATUTES

or

SELLING THE FARM

*L. Leon Geyer**

TABLE OF CONTENTS

> *[A] farmer appointed a business manager for his farm, allowing him to put all his time into working the farm.*
>
> *The farmer had a mortgage on the farm. Discovering this the manager decided to sell the farm, removing the farmer's mortgage.*
>
> *Pleased with his handiwork, the manager told the farmer: "You have no more debt."*

* Professor, Virginia Polytechnic Institute and State University. B.A., 1969, Purdue University; J.D., 1972, University of Notre Dame; Ph.D., 1985, University of Minnesota. Geyer@vt.edu

> *"How?" asked the farmer.*
> *"Well, I have sold your farm."*
> *Bewildered, the farmer asked: "But where am I going to live, where will I work, what do I have?"*[1]

I. INTRODUCTION

Government's response to farming crises in the 20th century has often been one of price subsidies, tax credits, and cheap money.[2] Such policies have been criticized as providing a cushion against long-term trends of declining crop prices.[3] Farmers, relying on government programs, may be encouraged not to plan for the "seven years of lean" that follow the "seven years of fat."[4] Government policies have supported agriculture in some geographical areas[5] that may not be sustainable[6] if risk and market discipline are placed back into the farming equation. Historically, few questioned the notion that farming was too risky and too important to be left to the vagaries of free markets.[7] Governments intervened with price,[8] market, credit, and other programs to reduce farmer risk. Subsidies, cheap money, and tax credits, however, have not been the only government involvement in modern agriculture.

Many industrial nations provide for preferential and differential treatment for insolvent farmers. Designed to protect farmers from the adverse impact of production and price risks, differential treatment may protect farmers with poor management practices and marketing skills. Preferential

1. David Baker, *Who Gave the Mandate for Selling Off the Farm?*, AGE, Mar. 15, 1995, at 14.

2. *Where Breakdown and Bankruptcy Play*, ECONOMIST, Nov. 2, 1991, at 21-23.

3. *Id.*

4. *Genesis* 41:25-31.

5. Impacts on farmers of proposed plans to reduce federal subsidies to American agriculture are likely to vary according to region. Scott Kilman, *Farmers React to Plans to Cut Subsidies*, WALL ST. J., May 30, 1995, at A2.

6. Marginal land may be driven from production with a corresponding impact on rural communities. Such communities, built 15 miles apart and separated by a day's horse or oxen cart trip, may now need to be abandoned or be consolidated into vibrant communities 50 miles apart—an hour's truck drive.

7. Peter Passell, *Economic Scene: When It Comes to Farm Subsidies*, N.Y. TIMES, July 20, 1995, at D2.

8. Janet Perry & Mitch Morehart, *Characteristics of Commodity Program Recipients*, *in* AGRICULTURAL INCOME AND FINANCE: SITUATION AND OUTLOOK REPORT 18, 19-20 (Dec. 1994). Direct government program payments designed to stabilize prices, income, production, and the agricultural sector generally represent a greater percentage of gross cash farm income in the Great Plains than in other regions of the United States. *Id.* at 20. For example, in the Western two-thirds of Kansas, government subsidies provide 80% of net farm income. *Dodge City Focus of Farm Subsidy Shoot-out*, FINANCIAL POST, May 31, 1995, at 50. The greatest share of farms in the most vulnerable financial conditions are generally in the same geographical area. ECONOMIC RESEARCH SERV., U.S. DEP'T OF AGRIC., *Balance Sheet Outlook*, *in* AGRICULTURAL INCOME AND FINANCE: SITUATION AND OUTLOOK REPORT 8 (Dec. 1994).

treatment for insolvent farmers may benefit lenders and suppliers of inputs to the farming sector. Marginal farm land may remain in production. Intuitively, such efforts hold the baseline of property values higher and fail to encourage the most economical redistribution and use of capital assets. This article will outline several of the alternative prevention, subsidization, and regulatory schemes adopted by Canada, Australia, and the United States to help farmers deal with financial risk resulting from the vagaries of agricultural production and prices. The article compares major efforts in the United States, Canada, and Australia to deal with price and production risks through insolvency and bankruptcy statutes.

II. THE AMERICAN EXPERIENCE

A. *The American Farm Financial Crisis of the 1980s*

Following a long period of rising prices for agricultural land, relatively low interest rates, and steady to higher prices for primary agricultural crops, a large number of farmers who had leveraged themselves with a substantial debt during the 1970s were caught in the mid-1980s by a regional downturn in land values, rising interest rates, and falling agricultural prices.[9] Falling prices and incomes created a crisis as lenders threatened farmers with foreclosure or as farmers perceived that they would be foreclosed on.[10] As a result, Congress was asked to improve upon the operation of the Bankruptcy Code then in force as it applied to farmers.[11]

By the 1980s, American farmers already received preferential treatment under the Bankruptcy Code.[12] American "farmers," "family farmers,"[13] and charitable institutions[14] were exempt from involuntary bankruptcy. The farmers' favored position was related to farm risk associated with the ravages of natural disasters.[15] The farmer was allowed to time his or her bankruptcy and protect the operating entity from unsecured creditors in times of pestilence, price collapse, or mismanagement.[16] Protection from involuntary bankruptcy did not, however, stop lenders from foreclosing on farm land under state law. Attempts at informal workouts with creditors, bankruptcy liquidation under Chapter 7, reorganization under Chapter 11, deeds in lieu of foreclosure, and the debt ceiling of Chapter 13[17] were perceived by many

9. Steven Shapiro, Note, *An Analysis of the Family Farmer Bankruptcy Act of 1986*, 15 HOFSTRA L. REV. 353, 360-62 (1987).

10. *Id.* at 360-61.

11. *Id.* at 366.

12. *Id.* at 360.

13. 11 U.S.C. § 303(a) (1994).

14. RANDY ROGERS, COLLIER FARM BANKRUPTCY GUIDE ¶ 2.04 (Lawrence P. King ed., 1994).

15. S. REP. NO. 989, at 32 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5818.

16. *See id.*

17. The debt ceiling under Chapter 13 has been raised from $350,000 to $750,000 for secured debts and from $100,000 to $250,000 for unsecured debts. 11 U.S.C. § 109(e) (1994).

farmers as inadequate to prevent foreclosure on farms. Populist sentiment encouraged the passage of legislation to save the embattled family farmer.[18]

B. *Chapter 12–Insolvency Intervention*

From 1935 to 1949, farmers received special bankruptcy treatment under the Frazier-Lemke Act.[19] Frazier-Lemke provided for voluntary composition, extension of time payment to creditors, moratorium on creditor action, and farm property redemption at the property's current appraised value.[20] In response to the American farm crisis of the 1980s,[21] Congress amended the American bankruptcy laws by passing the Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986 (Chapter 12)[22] which provided for the adjustment of debts of a family farmer, based in part on the Frazier-Lemke legislation. Effective from November 27, 1986,[23] to October 1, 1998,[24] Chapter 12 allows for the reclassification of debt or bifurcation of undersecured debt into secured and unsecured debt, debt write-off, and composition of secured debt.[25]

Chapter 12 allows the secured debt to be bifurcated into a secured amount equal to the current fair market value of the collateral and the undersecured portion of the debt to be treated as unsecured debt for purpose of bankruptcy.[26] The amortization period and interest rates of secured debt can also be modified under a Chapter 12 plan.[27] Chapter 12 effectively freezes and rewrites the value of secured creditor's liens.[28] Even if the future value of the collateral substantially increases, the amount of the indebtedness remains

18. James J. White, *Taking from Farm Lenders and Farm Debtors: Chapter 12 of the Bankruptcy Code*, 13 J. CORP. L., 1, 2-3 (1987).

19. Frazier-Lemke Act of 1934, Pub. L. No. 73-486, 48 Stat. 1289.

20. *Id.*

21. *See Farm Bankruptcy: Hearings Before the Subcomm. on Administration Practice and Procedure and Courts of the Senate Comm. on the Judiciary*, 99th Cong. 1-2 (1985) [hereinafter *Farm Hearings*]; *America's Farm Crisis: Who's to Blame, Government or Farmer?: Hearing Before a Subcomm. of the House Comm. on Gov't Operations*, 99th Cong. 1-3 (1985); *Crisis in the Rural Economy and Its Effect on Small Businesses: Hearings Before the Subcomm. on Export Opportunities and Special Small Business Problems of the Comm. on Small Business*, 99th Cong. 2 (1985) [hereinafter *Farm Hearings 2*]; *The Economic Evolution of Rural America: Hearings Before the Subcomm. on Agric. and Transp. of the Joint Econ. Comm.*, 99th Cong. 2 (1985).

22. Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, § 255, 100 Stat. 3088, 3105 (codified as amended at 11 U.S.C. §§ 1201-1231 (1994)).

23. *Id.* § 302.

24. Act of Aug. 6, 1993, Pub. L. No. 103-651, § 1, 107 Stat. 311.

25. 11 U.S.C. §§ 1122(b), 1222(b)(1) (1994).

26. For example, if the secured debt is $500,000, but the fair market value of collateral at time of filing is $350,000, the secured debt is written down to $350,000 with the $150,000 undersecured portion treated as an unsecured debt. In many cases, the undersecured debt resulted from accumulated interest unpaid due to low production, low farm commodity prices, and/or rapid increase in interest rates coupled with falling land values.

27. 11 U.S.C. § 1222 (1994).

28. *Id.*

the same. Although secured creditors complain about this provision of Chapter 12, when a Chapter 12 case is filed it gives the secured creditor the value the creditor would receive if debtor was liquidated.[29] In short, Chapter 12 forces the secured creditor to share in the value reduction of the debtor's property under reorganization just as they would in a liquidation.[30] The logic of Chapter 12 is to encourage the secured party to accept, outside of bankruptcy, a composition which rewrites the security interest to the current market value of the collateral and current market interest rate. The creditor can request an equitable share of future asset appreciation value.[31]

C. *Not All Troubled Loans Need Apply*

Chapter 12 does not apply to every troubled farm loan.[32] "[T]he cash flow effect that is simultaneously favorable to the debtor and adverse to the secured creditor occurs only when the collateral value has significantly declined or when the creditor is undersecured at the inception of the secured transaction."[33] The property in question will be land or nondepreciable assets.[34] During the operation of Chapter 12, the farm must operate without additional money from the undersecured lender.[35] The debtor must be able to generate post-confirmation income sufficient to cover: (1) debt service on secured loans, (2) production operating costs, (3) living expenses, and (4) "disposable income."[36] A disposable income is paid over three to five years to undersecured creditors and unsecured creditors.[37] The disposable income is all that is left after the first three are subtracted from gross income during the reorganization provisions of Chapter 12.[38] During the three to five year payout, the disposable income must pay each secured and undersecured creditor at least as many dollars as the two parties would have received under a Chapter 7 liquidation of the farm debtor.[39]

---

29. Jane E. Bahls & Steven C. Bahls, *How Credit Managers Cope with Chapter 12 Bankruptcy*, BUS. CREDIT, Mar. 1988, at 24, 25. In liquidation, the creditor would receive the collateral and, in theory, be able to auction the property for current fair market value and have an unsatisfiable deficiency.

30. Even though Chapter 12 leaves the creditor with the same payout as foreclosure or Chapter 7 liquidation, and reinvestment of principal at market rate interest, Chapter 12 is considered "extreme[ly] pro-debtor." David M. Powlen & David T. Thuma, *More Pages on Chapter 12*, A.B.A. BANKING J., Oct. 1987, at 158; David M. Powlen, *Ag Lenders Beware*, A.B.A. BANKING J., Feb. 1987, at 47.

31. James A. Chatz et al., *Farm Bankruptcy and Chapter 12*, COM. L. BULL., Jan.-Feb. 1988, at 25, 32.

32. Arnold B. Cohen, *Undersecured Creditors and New Chapter 12*, COM. LENDING REV., 1, 7 (1988).

33. *Id.*

34. *Id.*

35. *Id.*

36. 11 U.S.C. § 1225(b)(2) (1994).

37. *Id.* § 1222(c).

38. *Id.*

39. *Id.* § 1225.

Chapter 12 provides financially distressed farmers with a tool to reduce a secured lender's lien on farm property or equipment to the collateral's current market value. Chapter 12 allows the reclassification and "write down" of the farmer's secured debt to the current fair market value of the collateral.[40] Cramdown standards embody one of the most fundamental tensions of the bankruptcy law: the desire to provide an opportunity for rehabilitation for the debtor while simultaneously preserving as much as possible of the creditors' rights as defined under state law.[41]

Critics of U.S. farm mortgage lenders maintain that the extension of excess credit during the 1970s with generous terms fueled land prices higher than market fundamentals justified.[42] Defenders of farm mortgage lenders argue that lenders extended credit to "willing borrowers under a rational economic scenario that included both current and capital gains from farmland."[43] Lenders were responding to a shift in credit demand, and borrowers were reacting to price shifts and taking advantage of economies of scale. Farm income (capitalized into land values) may not be adequate to explain agricultural land's market value fluctuation in the 1980s.[44] Credit was one of several factors influencing farm land values.[45] Credit was more than a benign factor in the American farm land boom of the '70s and '80s.[46] Volatile interest rates impacted the viability of leveraged farmers' debt service.[47] Agricultural lenders vociferously opposed Chapter 12 on the grounds that few farmers had acquired unmanageable levels of debt, most farmers and lenders were able to achieve informal workouts through forbearance, planning, and reorganization, and that the granting of debt relief to the profligate few would impose a tax on the prudent majority.[48]

Chapter 12 has been criticized as a continuation of "the long-standing tradition of efforts to protect farmers against failure;"[49] and "a substantial

---

40. Although stripdown liens have been challenged in Chapter 7, Dewsnup v. Timm, 502 U.S. 410 (1992), and Chapter 13 home mortgage cases, Nobleman v. American Sav. Bank, 968 F.2d 483 (5th Cir. 1992), to date, the courts have accepted them in Chapter 12 cases, Oklahoma v. Crook (*In re* Crook), 966 F.2d 539 (10th Cir. 1992); *In re* Leverett, 145 B.R. 709 (Bankr. W.D. Okla. 1992).

41. Phillip Burns, *Let Chapter 12 Sunset on Schedule*, A.B.A. BANKING J., Dec. 1992, at 49.

42. Jerome M. Stam, U.S. Dep't of Agric., *Credit as a Factor Influencing Farmland Values: What Does the Evidence Show?*, *in* AGRICULTURAL INCOME AND FINANCE: SITUATION AND OUTLOOK REPORT 35, 39 (Feb. 1995).

43. *Id.*

44. *Id.*

45. *Id.* at 35.

46. *Id.*

47. *Id.* at 37. As T.N. Carver observed, "There is no magic about credit. It is a powerful agency in the hands of those who know how to use it. So is a buzz saw. They are about equally dangerous in the hands of those who do not understand them." WILLIAM G. MURRAY, AGRICULTURAL FINANCE: PRINCIPLES AND PRACTICE OF FARM CREDIT 1 (2d ed. 1947).

48. *Farm Hearings*, *supra* note 21, at 124-39 (statement of Oliver Hansen, representing Independent Bankers Association); *Farm Hearings 2*, *supra* note 21, at 23-24 (testimony of James Eatherly, on behalf of American Bankers Association).

49. Thomas O. Depperschmidt, *Disposable Income and the 'Best Interest of Creditors'*

and retroactive alteration of existing mortgagees"[50] that will reduce a farmer's capacity to buy credit.[51] The failure to include a "shared appreciation" requirement in Chapter 12 for the "crammed down" value has been criticized by agricultural lenders.[52]

Secured lenders to the agricultural sector may be criticized as failing to actively monitor borrowers[53] and for failure to pursue liquidation, leading to a less efficient realization of capital assets.[54]

D. *Chapter 12–Lien Stripping*

The Frazier-Lemke Act,[55] the Depression-era debtor-relief act, allowed "write down" or lien stripping. The debt is bifurcated into secured and undersecured debt of the lender, with a portion of the undersecured debt forgiven.[56] Like Frazier-Lemke, Chapter 12 allows debtors to shift the cost of falling farm values onto secured lenders by preventing secured lenders from foreclosing and holding onto the asset until value increases to recoup the "undersecured" portion of the loan.[57]

Although lenders have criticized the bifurcation of lender debt into secured and unsecured or undersecured debt and the subsequent loss associ-

---

in the Family Farmer Bankruptcy Act, 27 J. ECON. ISSUES 230, 230 (1993).

50. White, *supra* note 18, at 1-2.

51. *Id.* at 2.

52. Burns, *supra* note 41, at 49-50.

53. Michael Gronow, *Secured Creditors of Insolvent Companies: Do They Get Too Good a Deal?*, INSOLVENCY L.J., Dec. 1993, at 170. Critics of America's farm credit system have "pointed to its knee-jerk management philosophy in which the system encourages borrowers in boom years and then punishes . . . marginal borrowers when the economy fails." Chatz et al., *supra* note 31, at 25.

54. Chatz et al., *supra* note 31, at 25.

55. Frazier-Lemke Act of 1934, Pub. L. No. 73-486, 48 Stat. 1289.

56. *In re* Leverett, 145 B.R. 709, 712 (Bankr. W.D. Okla. 1992).

57. Unless the secured lender is into speculation, the lender would let the property go at foreclosure for fair market value and write the loss off against taxes. Depending on the market, it could be a long time before the undersecured amount is recouped. Because of the time-value of money, Chapter 12 bankruptcy disposition or immediate liquidation of the loan under foreclosure should be a neutral decision for the lender. The issue, however, is controversial as lenders feel cheated and there might be an unconstitutional impairment of a creditor's property right.

"The bankruptcy power is subject to the Fifth Amendment's prohibition against taking private property without compensation." United States v. Security Indus. Bank, 459 U.S. 70, 75 (1982) (citing Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555, 589 (1935)). At issue is the relationship between the Bankruptcy Clause, which grants Congress the power to "establish . . . uniform Laws on the subject of Bankruptcies throughout the United States," U.S. CONST. art. I, § 8, cl. 4, and the Fifth Amendment, which states that "No person shall . . . be deprived of . . . property, without due process of law; nor shall private property be taken for public use, without just compensation," U.S. CONST. amend. V. *But see* James S. Rogers, *The Impairment of Secured Creditors' Rights in Reorganization: A Study of the Relationship Between the Fifth Amendment and the Bankruptcy Clause*, 96 HARV. L. REV. 973, 997-1012 (1983) (arguing that the Bankruptcy Clause itself, not the Fifth Amendment, limits congressional bankruptcy power with regard to rights of secured creditors).

ated with that debt, farmers saw equity fall from a high of $1,140 billion in real value in 1979 to $610 billion in 1994, a reduction of $530 billion.[58] Although this provision rewrites the "adequate protection" rules, the result is not an unconstitutional deprivation of lender's property. "A mortgage may be voided to the extent it is unsecured without being an unconstitutional deprivation of property, since the result is the same as in foreclosure . . . . The secured creditor's only legitimate expectation [is] to get the value of its security."[59]

E. *Lien Stripping—Anecdote, Theory, and Practice*

The "lien stripping" or "write down" provisions of Chapter 12, allowing a farmer to strip down an undersecured mortgage to the current value, were controversial at time of passage[60] and remain so.[61] Professors White[62] and Bauer[63] provide a historical, philosophical and legal review of Chapter 12. They argue over the fairness of forcing the mortgagee to "share" the depreciation of the asset base, the redistribution of wealth, and the "taking" of mortgagees' "value." The ability to measure or quantify whether Bauer or White are right, however, does not exist in the dynamics of the agricultural sector.

---

58. ECONOMIC RESEARCH SERV., *supra* note 8, at 11.

59. *In re* Bullington, 80 B.R. 590, 594 (Bankr. M.D. Ga. 1987).

60. *In re* Zouhar, 10 B.R. 154, 156 (Bankr. D.N.M. 1981). Although bankruptcy is designed to encourage a "fresh start," some might argue that lien stripping under Chapter 12 is a "head start." Or, "phrased colloquially, when a pig becomes a hog, it is slaughtered." *Id.* at 157. On the issue of head start versus fresh start and "when does a pig become a hog" see Norwest Bank Nebraska v. Tveten, 848 F.2d 871 (8th Cir. 1988).

61. *Farm Bankruptcy Amendments: Hearings on H.R. 1397 and H.R. 1399 Before the Subcomm. on Monopolies and Commercial Law of the House Comm. on the Judiciary*, 99th Cong. 40 (1985) (statement of James Eatherly, First National Bank, Tonkawa, Oklahoma); *Id.* at 116, 188 (statement of Thomas J. Stanton); 132 CONG. REC. 28,592 (1986) (statement of Sen. Thurmond). Senator DeConcini observed:

> The provision of this bill that troubles me the most is the provision that will permit a family farmer to go into bankruptcy, write down the secured debt to the current value of the land, and then begin to pay the creditor based on what amounts to a new mortgage based on the value of the farm. The thought that a person cannot pay their debt and yet may retain their property and only continue payments based on the value of the property as of the filing of the bankruptcy is entirely new—and dangerous. Why won't every farmer with a substantially undercollateralized loan against his farm declare bankruptcy? . . . I fear that we have created a legal atmosphere that may well encourage farm bankruptcies and that farmers who can now manage to work things out with their creditors in some satisfactory manner to both will no longer have that incentive to reach mutual agreement . . . . This bill . . . has precluded a creditor from any hope of participating in an upswing in the value of its collateral.

132 CONG. REC. 28,609-10 (1986).

62. White, *supra* note 18, at 1-30.

63. Patrick Bauer, *Where You Stand Depends on Where You Sit: A Response to Professor White's Sortie Against Chapter 12*, 13 J. CORP. L. 33, 33-63 (1987).

Bauer observes that Chapter 12 is likely to have some material effect upon the mortgage security held by lenders.[64] Lenders are likely to respond by (1) increasing the interest rate to new borrowers to compensate for loss; (2) reducing loan-to-value ratios to offset the "loss of advantages" negated by Chapter 12; (3) avoiding making loans to borrowers who are likely to default; and/or (4) ceasing to lend to farmers and moving to other markets.[65] Lenders started looking more at cash flow lending practices and reduced collateral-based lending. It is always prudent to reduce credit to more risky borrowers. Removing funds from the agricultural market, however, could be counter productive for a farm lender because it is likely to result in further declines in property values and jeopardize other loan security. Moving into other markets might not be prudent unless staff is retrained, and the market rate of interest is likely to be set by the national and not the local market. New competitors are likely to enter the market, making it unlikely that current lenders would be able to pass the previous Chapter 12 losses to new borrowers.

Anecdotally,[66] theoretically,[67] and practically,[68] the impact of Chapter 12's "liberal" cramdown standards on farm credit has been most likely de minimis. In 1989, the Government Accounting Office (GAO) studied Chapter 12 and conducted participant attitude surveys, which included farmer credit availability and the cost of credit to farmers. At that time, the GAO reported that from its attitudinal survey of a small number of agricultural lenders,[69] a majority were less willing to lend to farmers who had filed for Chapter 12, had raised interest rates to all borrowers, and/or had lowered individual loan amounts or raised collateral.[70] Given the farm crisis of the mid-1980s and the stigmatism of bankruptcy in the farm and banking community, with or without Chapter 12, one would expect the same results.

In an empirical study, Collender[71] relates the Chapter 12 data on economic cost directly (such as legal and administrative costs) and indirectly (costs resulting from economic distortions associated with bankruptcy and threat of bankruptcy that cause inefficient resource allocation) to corporate finance theories. The direct costs were found to be low—as little as three per-

---

64. *Id.*

65. *Id.* at 54.

66. U.S. GENERAL ACCOUNTING OFFICE, FARM FINANCE: PARTICIPANTS' VIEWS ON ISSUES SURROUNDING CHAPTER 12 BANKRUPTCY (1989) [hereinafter GAO STUDY].

67. ROBERT N. COLLENDER, U.S. DEPT. OF AGRIC., BANKRUPTCY COSTS UNDER CHAPTER 12 (Staff Rep. No. AGES 9210) (1992).

68. *Extension of the Family Farmer Bankruptcy Act: Hearings on H.R. 5322 Before the Subcomm. on Econ. and Commercial Law of the House Comm. on the Judiciary*, 102d Cong. 21-22 (1992) (testimony of Bankruptcy Judge A. Thomas Small) [hereinafter *1992 Farmer Hearings*].

69. The GAO interviewed fifty-nine participants, including six judges, five trustees, eleven debtor attorneys, eight creditor attorneys, and twenty-nine creditors. GAO STUDY, *supra* note 66, at 4-5.

70. *Id.* at 14-20.

71. COLLENDER, *supra* note 67, at 1.

cent of asset value.[72] The indirect costs, however, were higher than the estimates of indirect cost for business bankruptcy under Chapter 11.[73] He interpreted this to mean that more debtors were filing for bankruptcy under Chapter 12 even when no economic benefit was produced.[74] Collender estimated that the larger number of unproductive filings would cause farmers to pay 0.25% to 1% more for credit than they would in the absence of Chapter 12.[75]

Although Maio reported that Chapter 12 caused 40% of the 749 farm banks surveyed to deny some farm credit,[76] and Fairferlich and Harl reported an impact on the "negotiating process between lenders and borrowers not in bankruptcy,"[77] others conclude that Chapter 12 is not a significant factor in loan approvals.[78] By the 1990s, lending in the agricultural sector had increased.[79] Total farm debt in 1995 is $47 billion below 1984 debt but $5 billion more than in 1994.[80] Commercial banks held 26.5% of farm debt in 1986 and 39.5% by 1994.[81] Bankruptcy Judge Small observed that there is little evidence of farmers taking advantage of the more generous cramdown provisions of Chapter 12.[82] The initial reaction of some lenders to reduce their exposure to farmers following Chapter 12 was modified when their fears were not realized.[83] The 1990's marketplace for agricultural credit is more disciplined, with commercial farmers rated on cash flow, business performance, collateral, and credit history.[84] The interest rate charged farmers and small businesses is the same or slightly better for the farmer when the level of loan performance is equal.[85] Traditional sources of agricultural credit have reacted to the 1980's credit crisis by implementing more conservative lending policies, including increasing the role of cash flow and decreasing the importance of security in lending decisions.[86]

---

72. *Id.* at 6.
73. *Id.* at 12-13.
74. *Id.* at 15-16.
75. *Id.* at 15.
76. Pat Maio, *Rise in Chapter 12 Filings Hurt Credit*, A.B.A. BANKERS WKLY., Sept. 12, 1989, at 4.
77. Chris Fairferlich & Neil Harl, *The Chapter 12 Bankruptcy Experience in Iowa*, 9 J. AGRIC. TAX. & L. 302, 333 (1988).
78. Bruce Dixon et al., *Impacts of Chapter 12 and Lender Liability Suits on Bankers' Propensity to Lend in Western Arkansas*, 25 J. AGRIC. & APPLIED ECONS. 183, 184 (July 1993).
79. *1992 Farmer Hearings*, *supra* note 68, at 47-48 (statement of Phil Burns, President and CEO, Farmers & Merchants National Bank, West Point, Nebraska).
80. ECONOMIC RESEARCH SERV., U.S. DEP'T OF AGRIC., *Balance Sheet Outlook*, *in* AGRICULTURAL INCOME AND FINANCE: SITUATION AND OUTLOOK REPORT 11, 12 (June 1995).
81. *Id.* at 13. Farmers went from 1.9% return on equity in 1986 to 3.2% in 1994 and a debt-to-asset ratio of 22.3 to 16. *Id.*
82. *1992 Farmer Hearings*, *supra* note 68, at 21.
83. Andrea Bennett, *Farm Lenders Say Their Habits Changed Because of Chapter 12 Bankruptcy Law*, AM. BANKER, Feb. 11, 1988, at 7.
84. Personal conversation with Prof. David M. Kohl, Agricultural and Small Business Finance, Virginia Tech, Sept. 10, 1995.
85. *Id.*
86. Timothy J. Sullivan, *Trends in Agricultural Lending*, FARMER'S LEGAL ACTION REP.,

Chapter 12's biggest impact has most likely come from setting the parameters of negotiated workouts.[87] The memories of the agricultural crisis that secured the passage of Chapter 12 should dampen the demand for unwarranted mortgage credit. Regardless of whether credit facilitates the changes in basic economic, social, and political conditions that directly affect the farm business borrowers,[88] it is not the duty of the credit extender as an entrepreneur to share in the risk of loss associated with the loans extended to the farm community. The lender's participation, just as the farmer's, was voluntary and discretionary. Collateral based security agreements may substitute for the transfer of information, immunize the secured creditor against debtor misbehavior, and reduce monitoring costs for secured creditors.[89]

Rights of secured creditors should be considered in relation to what they contribute to companies as well as in relation to broader economic and theoretical issues. Secured creditors should be afforded the high level of protection which they enjoy, because of the change in role of institutional lenders to include that of capital providers. If the farmers prosper, secured creditors do not stand to gain any more than their interest payments and the return of their principal. Why should they risk losing everything if the farm firm does not prosper? A key issue, however, is the duty, the merit, or the incentive of a secured or unsecured creditor to monitor for insolvency. In practice, does the lien over the farmer's production assets result in the lender failing to maintain a close watch over the debtor's affairs? Is this what happened in the 1980s?

F. *Chapter 12—By the Numbers*

By June 30, 1995, 15,863 Chapter 12 cases had been filed, with over one-half filed during the first twenty months after the Chapter became effective.[90] Nearly half of the cases filed by July 1993 were from ten states—Nebraska, South Dakota, Texas, Louisiana, Illinois, Ohio, Missouri, Oklahoma, California, and Indiana.[91] States with few farmers or urban pressure on land values, such as Rhode Island, Hawaii, Delaware, New Hampshire, Alaska,

---

Spring 1995, at 13.

87. White, *supra* note 18, at 26.

88. *1985 Farm Legislation: Hearings Before the Joint Econ. Comm. and the Subcomm. on Agric. and Transp. of the Joint Econ. Comm.*, 98th Cong. 349-56 (1983) (testimony of George D. Irwin).

89. Jochen Drukarczyk, *Secured Debt, Bankruptcy, and the Creditors' Bargain Model*, 11 INT'L REV. L. & ECON. 203, 219 (1991).

90. ANALYSIS & REPORTS BRANCH, U.S. COURTS STATISTICS DIVISION, tbl. F-2 (1995); *see generally* BUREAU OF THE CENSUS, U.S. DEP'T OF COMMERCE, *Bankruptcy Petitions Filed and Pending, by Type and Chapter: 1985 to 1993*, *in* 1995 STATISTICAL ABSTRACT OF UNITED STATES 553 (115th ed. 1995).

91. Ed Flynn, *Bankruptcy by the Numbers*, AM. BANKR. INST. J., Mar. 1994, at *1, *available in* LEXIS, Bkrtcy Library, Abij File. The number of cases filed were: 1278 (Neb.), 833 (S.D.), 788 (Tex.), 777 (La.), 737 (Ill.), 600 (Ohio), 578 (Mo.), 575 (Okla.), 547 (Cal.), and 535 (Ind.). *Id.*

Connecticut, Massachusetts, Maine, Nevada, and New Jersey, had few filings.[92] By 1992, approximately 60% of Chapter 12 cases filed had been confirmed and 90% of those successfully completed.[93] Dun and Bradstreet report agricultural production of crop and livestock failure from 1984 to 1993 as 1566; 2228; 2163; 3308; 1444; 913; 1045; 1205; 1717; and 1277 respectively.[94] From 1984 to 1992, 85,029 American farmers left agriculture with 13,972, or 16%, attributing their departure to financial failure.[95] Extrapolating, 7500 farmers were saved under Chapter 12 from 1984 to 1992.[96] See Table 1 in appendix.

G. *Interest Subsidy*

Cheaper loans for agricultural production are designed to provide a "start" for young farmers. Federal loan guarantees for lenders reduce "lender risk" and may encourage inefficient allocation of resources. It may, also, reduce farmer insolvency. In 1995, the Agricultural Credit Insurance Fund will provide $611,000,000 in direct loan obligations,[97] $1,354,000,000 in loan guarantee commitments,[98] and $393,000,000 in administration and subsidy outlays.[99] While young commercial farm operations with low resources can benefit from low interest loans, the extra money generated is not sufficient to make young low-resource farmers more competitive with established young farmers.[100] Such subsidies do not overcome lack of asset base to generate sufficient income.[101] "Subsidized credit tends to increase asset values and discourage prudent use of credit."[102] During the past ten years, the government has written off nearly $16 billion in farm loans.[103]

---

92. *Id.* at *2.

93. *1992 Farmer Hearings, supra* note 68, at 6.

94. DUN & BRADSTREET CORP., ECON. ANALYSIS DEPT., THE BUSINESS FAILURE RECORD (1984-1994). Business failure statistics include businesses that ceased operations following assignment or bankruptcy; ceased operations with losses to creditors after such actions as foreclosure or attachment; voluntarily withdrew leaving unpaid debts; were involved in court actions such as receivership, reorganization, or arrangement; or voluntarily compromised with creditors. *Id.*

95. *Id.*; *1992 Farmer Hearings, supra* note 68, at 6.

96. *Id.*

97. *Id.*

98. *Id.*

99. *Id.*

100. Charles Dodson & Steven Koenig, U.S. DEP'T OF AGRIC., *Young Commercial Farmers: Their Financial Structures and Credit Sources, in* AGRICULTURAL INCOME AND FINANCE: SITUATION AND OUTLOOK REPORT 40, 44 (June 1995).

101. *Id.*

102. Robert N. Collender & Steven Koenig, U.S. DEP'T OF AGRIC., *Role of Government in Agricultural Finance* 1 (June 1993).

103. Mark Drabenstott, *Capital for Agriculture and Rural America: Redefining the Federal Role*, 80 ECON. REV. 57, 60 (1995).

H. *Mediation and Moratorium—United States Style*

A number of states have enacted mandatory[104] or voluntary[105] mediation programs. The mediation statutes compel or encourage lenders to participate in mediation prior to enforcing foreclosure rights against agricultural collateral. Mediation acts generally require the parties to engage in mediation in good faith,[106] delay the enforcement of rights against the collateral for a set period of time to allow for mediation with extensions of the time period spelled out in the Act,[107] and require creditors to request mediation prior to initiating any proceedings to enforce debt collection against agricultural property.[108] The Agricultural Credit Act of 1987[109] provided financial assistance to states to conduct mediation programs and required Farm Credit, Farmers Home Administration, and USDA lenders to participate in the state program.[110]

During the American depression of the 1930s and the farm crisis of the 1980s, state legislation providing for a moratorium on foreclosure on farmland was passed.[111] The statutes provided for delay of foreclosure proceedings up to two years[112] for a variety of reasons, including defaults caused by climatic conditions (drought, flood, heat, hail) or pests[113] and "economic emergencies."[114] Specifically targeted at agricultural states, but not deed or trust states, logic argues that moratoriums raise the rate of interest in "moratorium" states, but by a *de minimis* amount.

III. THE AUSTRALIAN EXPERIENCE

Australia, like America, has had a series of farm crises in the 20th century. Professor Ian Burnley has observed that a common theme of agriculture crisis emerges from:

> irregular drought cycles and depressions or economic recessions. Sometimes the droughts and the economic downturns have occurred separately, sometimes . . . concurrently . . . and sometimes in close sequence. Through these phases, underlying technological and structural economic changes have taken place, exacerbated by fluctuations in world commodity prices.[115]

---

104. *See* MINN. STAT. ANN. §§ 583.20-.32 (West 1995); IOWA CODE §§ 654A.1-.14 (1995) (repealed 1995).
105. *See* NEB. REV. STAT. ANN. §§ 2-4801 to -4816 (Michie 1995).
106. ROGERS, *supra* note 14, ¶ 1.06.
107. *Id.*
108. *Id.*
109. Agricultural Credit Act of 1987, Pub. L. No. 100-233, 101 Stat. 1568 (1988).
110. 7 U.S.C. §§ 5102-5106 (1994).
111. ROGERS, *supra* note 14, ¶ 1.06.
112. *Id.*
113. IOWA CODE § 654.15(1) (1995).
114. *Id.* § 654.15(2); N.D. CENT. CODE §§ 28-29-04 to -06 (1995).
115. Ian Burnley, *Australia: Hard Lessons for the Hinterland*, SYDNEY MORNING HERALD,

Much of Australia has a climate with systematic droughts.[116] Selected areas produce crops such as wool and wheat dependent on cyclical world prices. Additionally, as a critic observed, Australia suffers from cyclical "Rural Crisis," rural protest, bank-bashing, and massive predictions of farmer bankruptcy.[117] "But instead of a massive Grapes of Wrath type exodus, the number of farmers only fell marginally."[118] Australian farmers have more than 80% equity in holdings and over 30% earn significant off-farm income.[119] One-third of broadacre farmers are dependent on off-farm income and produce 8% of the gross value of agricultural production (GVP), the middle one-third of the farmers (known as the "battlers") contribute 22% of GVP, and the top one-third produce 70% of GVP.[120] Rural producers' incomes vacillate, inefficient producers leave, marketing practices need constant repair, and politicians respond with programs to "reduce" producer risk.

A. *Rural Adjustment Schemes*

The Australian government has established a series of federally funded schemes carried out by the states with or without additional state funding to subsidize "risk" and to facilitate farmer exit from agriculture. The Australian Parliament has passed several measures under the Rural Adjustment Scheme (RAS) to provide "concessional credit for reconstruction and adjustment (Improving the Farm) . . . short-term carry on finance (Maintaining the Farm); and . . . household support and re-establishment assistance (Leaving the Farm)."[121]

RAS was substantially revived in 1992 (RAS 1992), adding a drought policy.[122] Prior Rural Adjustment Schemes date from 1935 and were periodically revised.[123] Later acts included programs of land alienation, settlement, structural adjustments, farm buildup, and expansion of farm production.[124] RAS 1992 replaced prior Rural Adjustment Schemes that emphasized assis-

---

Jan. 7, 1995, at 3.

116. BILL COPPELL, AUSTRALIA IN FACTS AND FIGURES 14-16 (1994).

117. David Clark, *Australia: Many a Dry Eye While the Farmers Cry*, AUSTL. FIN. REV., Oct. 29, 1990, at 34-35.

118. *Id.*

119. *Id.*

120. Chas Savage, *Money's Not the Answer to Drought*, AUSTRALIAN, May 31, 1995, at 11.

121. Bill Malcolm, *Australian Agricultural Policy Since 1992: New Emphasis, Old Imperatives*, 62 REV. MARKETING & AGRIC. ECON. 143, 157 (1994).

122. *Id.* at 158.

123. SENATE RURAL AND REGIONAL AFFAIRS AND TRANSP. REFERENCES COMM., PARLIAMENT OF THE COMMONWEALTH OF AUSTL., RURAL ADJUSTMENT, RURAL DEBT AND RURAL RECONSTRUCTION 1-4 (1994) [hereinafter RURAL ADJUSTMENT].

124. *Id.*

tance rather than structural adjustment for the farming sector.[125] The goals of the RAS 1992 are:

> (a) to promote better financial, technical and management performance from the farm sector; and
> (b) to provide support to farmers who have prospects of sustainable long-term profitability with a view to improving the productivity of their farm units; and
> (c) to provide that support in a way that ensures that the farmers who are supported become financially independent of that support within a reasonable period; and
> (d) to provide the support through: (i) grants for the purposes of subsidies for interest payable on loans and associated costs of loans, whether the loans are provided by a State or by another person; and, (ii) grants for the purposes of farm training, planning, appraisal, support services and rural adjustment research; and . . . grants to assist farmers who do not have prospects of sustainable long term profitability to leave the farm sector.[126]

The scheme also provides support to farmers during periods of adverse weather and exceptional economic circumstances for which they could not be expected to have planned.[127] Such determinations are left up to the discretion of appropriate governmental officials.[128]

The Commonwealth contributes 90% of funding for "normal" RAS 1992 and the states contribute 10%.[129]

> The emphasis of the new scheme was transferred from keeping farmers in by providing support of existing debt and therefore propping them up to continue in the industry, to providing support to enhance productivity, profitability and sustainability. So it [RAS 1992] was designed to make the farm industry more efficient, to enhance the skills of farmers by providing training grants and advisory grants. It was therefore a shift from the 50 per cent mark where farmers could go either way to higher up the scale where we make those that we know can survive in the industry more efficient and do it better than they have done it in the past. That may mean a bigger gap, it may mean more might fall out the bottom but the new scheme is intended to make the industry more efficient for those who can survive in the long haul.[130]

125. Senator Gareth Evans, Austl. Senate Proceedings, Nov. 11, 1992, at 2785.
126. Rural Adjustment Act 1992, § 3.
127. *Id.* § 21(3).
128. *Id.*
129. RURAL ADJUSTMENT, *supra* note 123, at 11.
130. *Id.* at 13.

B. *Improving the Farm*

Interest subsidies of up to 50% of the cost of commercial finance may be provided for productivity improvement measures such as adopting technological developments, increasing and improving resource use of land, labor, and capital; improving farm programs; and adopting sustainable farming programs.[131] Farmers may also be eligible for training grants to upgrade farm business and property management planning skills.[132] Training includes risk management, expert financial planning, and farm business advice.[133] From January 1, 1993 to June 30, 1994, the Commonwealth spent $15.8 million on productivity, $2.2 million on skills enhancement, $1.3 million on land trading, and $2.0 million on diagnostic programs, or 24% of the RAS 1992 budget.[134]

C. *Leaving the Farm*

Farmers without future prospects of profitability down on the farm may receive a "re-establishment" grant of up to $45,000.[135] Assets, excluding personal assets, may be held equal to the grant amount.[136] A farmer could theoretically leave the land with $90,000 in re-establishment grants and assets, plus Household Support funds.[137] The Farm Household Support grant is designed to provide family welfare for those who are unable to access commercial finance, for those who have decided to leave farming and need income while they liquidate, and for those who need family support to weather a downturn.[138] Farm Household Support is available as a loan for up to two years with the first nine months converted to a grant if the family leaves farming.[139] Although the Farm Household Support legislation is within the Department of Primary Industries and Energy (DPIE), it is administered by the Department of Social Security.[140] It is income tested, but farm assets are excluded under the assets test, in recognition of the asset-rich/income-poor status of many farmers.[141] From January 1, 1993 to June 30, 1994, $18.1 million, or 20.1% of the RAS 1992 budget expenditures, was spent on re-establishment of farmers.[142]

---

131. Evans, *supra* note 125, at 2785.
132. *Id.*
133. *Id.*
134. RURAL ADJUSTMENT, *supra* note 123, appendix 3.
135. Evans, *supra* note 125, at 2786.
136. *Id.*
137. DEP'T OF PRIMARY INDUS. & ENERGY, COMMONWEALTH OF AUSTL., IMPROVING FARM PRODUCTIVITY AND PROFITABILITY (1993).
138. Evans, *supra* note 125, at 2787.
139. *Id.*
140. *Id.*
141. *Id.* (comparing this to U.S. disaster payment program that transfers payments regardless of asset wealth).
142. RURAL ADJUSTMENT, *supra* note 123, appendix 3.

D. *Maintaining the Farm*

In 1992, recognizing that drought is a normal commercial risk which farmers must deal with through self-reliance, the Australian government adopted a new drought policy of "property management" and "risk management."[143] The objectives of the policy were:

> to encourage primary producers and other sections of rural Australia to adopt self-reliant approaches to managing for climatic variability;
> to maintain and protect Australia's agricultural and environmental resource base during periods of extreme climate stress;
> to ensure early recovery of agricultural and rural industries, consistent with long-term sustainable levels.[144]

Education, training, and property management were keys to farmer self-reliance.[145]

An Income Equalization Deposit (IED) scheme, to assist farmers to offset fluctuation in income from price and weather changes by building cash reserves for use during a downturn, was adopted to assist farmers in building financial reserves.[146] A voluntary effort, the program had 3500 or 1.5% of farmers participating in 1992.[147] The program was changed in 1992 to be more attractive to farmers and to encourage genuine farmers to build cash reserves for use during contingencies such as drought and significant falls in commodity prices.[148] IEDs are deposited or withdrawn in $1000 units with the DPIE.[149] A maximum of $300,000 may be deposited.[150] Deposits are tax deductible in the year of deposit and taxed upon withdrawal.[151] The IED deposit has two investment options—ordinary IED or Farm Management Bond (FMB). Interest on either is paid at the short-term Commonwealth Bond rate.[152] Interest is paid on the 61% investment component of the IED and on the 80% investment component of FMB.[153] Interest on the investment component is paid yearly or can be automatically reinvested.[154] Only primary producers with taxable nonfarm income of less than $50,000 are eligible and only $80,000 can be deposited in an FMB.[155] All deposits must be for twelve months unless a financial hardship can be proven.[156] FMB deposits

143. Malcolm, *supra* note 121, at 160.
144. *Id.*
145. *Id.*
146. Evans, *supra* note 125, at 2788.
147. *Id.*
148. *Id.*
149. *Id.*
150. *Id.*
151. *Id.*
152. *Id.*
153. *Id.*
154. *Id.*
155. *Id.*
156. *Id.*

can be withdrawn as an IED deposit at any time.[157] Otherwise, FMB can be withdrawn only if commodity prices fall 25% lower than the average prices received for the previous three years or if there is a hardship due to natural disasters.[158]

E. *Drought and Interest Rate Subsidy by the Government*

Recognizing that not all farmers had sufficient income or foresight to prepare in the "seven good years for the seven years of drought to follow," and in spite of criticism,[159] the Australian government recognizes that there may be "exceptional circumstances" such as "extraordinary drought conditions, for which farmers cannot reasonably be expected to plan and manage."[160] The Minister for Primary Industries and Energy may determine that exceptional circumstances exist such as severe drought or substantial commodity price downturns.[161] For exceptional circumstances, interest subsidies may be extended beyond 50%, with the states sharing the costs of the additional assistance or interest rate subsidy above 50% equally with the Federal Government.[162] Since 1992, exceptional circumstances have included a commodity price fall for wool growers, unseasonably heavy rain, and severe drought conditions.[163]

Interest subsidies for exceptional circumstances may be based on working capital and existing debt.[164] Limitations are placed on the amount of subsidized debt, and eligibility requirements are established.[165] From July 1,

---

157. *Id.*

158. *Id.*

159. Malcolm, *supra* note 121, at 160-61.

> The economists' questioning centered on whether drought meant inefficient allocation of resources or was it an event which people could plan for and even exploit. Furthermore, it was concluded that there was no evidence of a capital market failure which warranted concessional credit being supplied. The economists' criticisms went further, arguing that drought assistance worsened the situation by acting as a disincentive to prepare for drought (e.g., higher stocking rates are encouraged), and was inefficient and inequitable in that the most aid went to those who were worst prepared and the least aid went to the best prepared. Furthermore, drought should not be a welfare problem because an industry which has a long term future has to be able to provide adequate funds on average to meet satisfactory income levels, even though there are temporary downturns. Despite the claims about expected self-reliance of farmers under the new drought policy, whether things are to be much different from the past probably will be known as soon as the first dry spell, or rural by-election, arrives.

Id.

160. RURAL ADJUSTMENT, *supra* note 123, at 6.

161. *Id.* at 7.

162. Simon Crean, Australian Minister for Primary Industries & Energy, Nov. 3, 1992, at 2413.

163. RURAL ADJUSTMENT, *supra* note 123, at 7.

164. RURAL FIN. CORP., VICTORIAN GOV'T DROUGHT ASSISTANCE PACKAGE § 1 (1995).

165. *Id.* Examples of eligibility requirements include: financial difficulty due to drought conditions, a necessity to maintain long-term capacity and sustainability, present long-term

1993 to June 30, 1994, under the exceptional circumstances program, 7724 applications were received with 56% of the applications approved—2.5% of all farmers.[166] Exceptional circumstances accounted for 63% of RAS 1992 program expenditures in 1993-94.[167] From January 1, 1993 to June 30, 1994, the Commonwealth spent $48.3 million on exceptional circumstances or 55% of the RAS 1992 expenditures.[168] Ministers are encouraged to make an exceptional circumstances determination due to farm pressure.[169]

F. *Mediation*

The National Farmers Federation and the Australian Bankers established a debt mediation program.[170] The service is designed to help make farmers' operations more efficient and service debts, but more often, the "mediator's role is to negotiate an interest-relief package with the bank . . . or to come up with a workable exit package . . . ."[171]

G. *Foreclosure—Informal Moratorium*

Foreclosure is often not in the lender's interest in a drought or at times of low commodity prices.[172] In 1985, major farm groups and banking organizations announced that the banks would not foreclose on farmers suffering liquidity problems from interest rate increases and commodity price decreases.[173]

> The preferential treatment by banks toward agricultural industries provides evidence that the banks need the farmers as much as the farmers need the banks. . . . A run of loan foreclosures forces an unusual number of farm sales which in turn tend to force land prices down. Since farmland is used as collateral for most large rural loans, a sudden drop in land values would be catastrophic for lending institutions which do not wish to be encumbered with low-valued land.[174]

---

farm profitability, limited nonfarm assets, five years farming experience by the farmer, more than 50% of income from farming, and a lack of irrigation on the property. *Id.*

166. 1993-94 RURAL ADJUSTMENT SCHEME ADVISORY COUNCIL, DEP'T OF PRIMARY INDUS. & ENERGY ANNUAL REPORT at 22, 49 [hereinafter ANNUAL].

167. *Id.* at 22.

168. RURAL ADJUSTMENT, *supra* note 123, appendix 3.

169. *See, e.g.*, Minutes of the Sixteenth Annual General Conference, Victorian Farmers Federation, Melbourne, Victoria, Australia, June 27-29, 1995, at 16.

170. Margaret Lyons, *Early Advice Helps Farmers to Stay out of Trouble*, BUS. REV. WKLY., Feb. 22, 1991, at 28.

171. *Id.*

172. When auctioned property failed to attract a bid, it can be said that "[t]he farms have no market value at all." Lyons, *supra* note 170, at 30.

173. Sarah Sargent, *Farmers' Loan Fears Allayed by Banks*, AUSTL. FIN. REV., Oct. 7, 1985, at 15.

174. *Id.*

Similar banker behavior is observed in response to the 1994-95 drought.[175] Despite farmers' inability to service their debts, lenders were reluctant to "attract adverse publicity by forcing farm sales through loan foreclosures."[176] Federal "jaw boning" on the part of the Prime Minister is designed to keep the banks making and servicing farm and rural loans.[177]

It was reported in 1985 that 65% of the loans to Australian agriculture were provided by the commercial banks,[178] 26% by government institutions,[179] 8.5% by pastoral houses,[180] and 1.5% by assurance companies.[181]

H. *Arrangements Outside of Bankruptcy*

"Arrangements with creditors outside bankruptcy are used extensively" in Australia.[182] Part X of the Australian Bankruptcy Code encourages the administration of debtors' affairs outside of the rigid and strict code of bankruptcy and encourages freedom of arrangement of affairs.[183] Advantages to the debtor may include avoiding the stigma of bankruptcy, a release from some provable debts, restrictions on assignment of after-acquired property to creditors, and the avoidance of disclosure.[184] Creditors may prefer avoiding bankruptcy proceedings with the debtor because of lower costs, faster action on debts, continued provisions of goods or services to creditors, access to property or money from relatives or friends of the debtor, retention of preferential payments, improvement of the prepetition position of the creditor pending a future bankruptcy filing, and a better working relationship.[185]

The Code provides for deeds of assignment, compositions, and deeds of arrangement.[186] "A deed of assignment is a deed by which a debtor assigns all her or his 'divisible property' for the benefit of creditors—that is, all property that would be property divisible among the creditors if the debtor were to become bankrupt instead, but not including after-acquired property."[187] A deed of arrangement provides for carrying on of the

---

175. Comments to author by Professors Bill Malcolm, Agricultural Economist, Faculty of Agriculture and Forestry, and Greg Reinhardt, Bankruptcy and Commercial Law, Faculty of Law, University of Melbourne (Mar. 20, 1995).

176. *Id.*

177. Craig Thomas, *Banks Must Do More for Farmers, Says PM*, AGE, May 18, 1995, at 8; Tim Stevens & Ally Condren, *PM Accuses Banks of Ignoring Rural Sector*, AUSTRALIAN, May 18, 1995, at 3.

178. *Financial Jitters Start to Hit the Farmers*, AUSTL. FIN. REV., Sept. 19, 1985, at 23.

179. *Id.*

180. *Id.*

181. *Id.*

182. ARNDELL N. LEWIS, AUSTRALIAN BANKRUPTCY LAW 248 (10th ed. 1994).

183. Report of the Committee to Review the Bankruptcy Law of the Commonwealth 264-65 (1992).

184. LEWIS, *supra* note 182, at 248.

185. *Id.* at 248-49.

186. *Id.* at 249-50.

187. *Id.* at 249.

debtor's business by the debtor subject to the trustee's supervision.[188] Provisions may include giving the debtor time to pay and/or assigning all "divisible property."[189] A composition is "an arrangement by which the creditors of a debtor: (a) agree to accept payment by installments of the debts due to them; or (b) agree to accept, in full satisfaction of the debts due to them, less than the full amount of those debts, whether in the form of money or other property, and whether by installments or otherwise."[190]

Petitions against farmers and others engaged in rural industries, or petitions related to farmers or rural industry, may be stayed from bankruptcy proceedings[191] if the Governor-General proclaims a stay under Federal, State, or Territory law for this purpose.[192] The Governor-General may do so:

> (a) if [the law] provides for the giving of financial assistance for the purpose of discharging debts of persons who are "farmers" within the meaning of the *Loan (Farmers' Debt Adjustment) Act* 1935 (Cth); or (b) if it gives effect to any of a number of Commonwealth and State agreements that relate to Commonwealth grants to the States or the Northern Territory for rural reconstruction or adjustment (for example, the *States and Northern Territory Grants (Rural Adjustment) Act* 1988 (Cth).[193]

The authorities administering such laws must be notified and may petition for a stay for an indefinite or specified period.[194] The logic is to prevent the bankruptcy petition from stopping the implementation of federal adjustment programs.

In 1992-93, Australian agriculture contributed to 3.2% of GDP and 21% of the total value of exports.[195] Thirty-four percent of broadacre farms and 41% of Australian beef farms had no debt in 1994.[196] Thirteen percent of all broadacre farms and 19% of wheat and other crop farms are expected to have debts in excess of $250,000 at the end of June 1994.[197] Total Australian farm debt is reported at $17.323 billion.[198] As an example, in 1993 South Australia reported that, of 14,000 farm businesses, 26% owed no debt, 51% had 70% or more equity, 18% were experiencing debt service difficulties with an equity of 30-70% and 5% were nonviable with less than 30% equity and needed to leave the industry.[199]

The Senate committee on Rural Adjustment recently recommended that the Commonwealth, in consultation with the states and financial institutions,

188. *Id.*
189. *Id.* at 250.
190. *Id.*
191. Bankruptcy Act of 1966 Part XIA, §§ 253A-F.
192. *Id.*
193. LEWIS, *supra* note 182, at 72.
194. *Id.*
195. RURAL ADJUSTMENT, *supra* note 123, at 79.
196. *Id.* at 81.
197. *Id.*
198. *Id.* at 79.
199. *Id.* at 81-82.

examine the feasibility of establishing a farm debt mediation service and a Farm Code of Practice for Banks.[200]

The Annual Report by the Inspector-General in Bankruptcy[201] indicates that farm and farm managers from 1982 to 1992 filed for 47, 25, 97, 73, 111, 130, 159, 94, 90, 65, and 94 liquidations respectively.[202] In 1992, this represented less than 2% of business bankruptcies in Australia.[203] See Table 2 in appendix for details. In 1992, this represented .0004% of farmers. One could conclude that the headlines of farmer bankruptcy are most successful in preventing bankruptcy or in calling the government to order subsidization of farmer interest by declaring "exceptional circumstances."

IV. THE CANADIAN EXPERIENCE

As a major agricultural producer and an economic partner of the United States, Canada has suffered some of the same agricultural cycles as the United States. Market prices for food stuffs remain depressed and it has been reported that "farm bankruptcies [are] reaching high levels."[204] In September 1985, the Federal Farm Credit Agency undertook a 19-month moratorium on foreclosure when 670 farmers faced immediate foreclosure with 14,800 agency accounts in arrears, including 6000 farmers who were two or more years in arrears.[205] The government has made substantial grants available to farmers, but the costly policy is being challenged due to governmental budget deficits.[206] Two-tiered domestic and export pricing for some conditions and tariffs have protected domestic producers from competitive world prices.[207] Farmer bankruptcy fears make newspaper headlines while the statistics are not as alarming.[208] See Table 3 in appendix. As in the United States, voluntary liquidations are not recorded and account for a portion of the downward trend in farm operators.[209] By 1990, Canadian farmers were being frozen under a debt of $22 billion.[210] In a report of the House of Commons Standing Committee on Agriculture, however, the Committee estimated that $6 billion of debt was in excess of the capacity of farmers to

---

200. *Id.* at 100.

201. Bankruptcy Act 1966, Annual Report by the Inspector-General in Bankruptcy on the Operation of the Bankruptcy Act 1966, Commonwealth of Australia reports for 1 July 1981 to 30 June 1992, inclusive.

202. *Id.*

203. *Id.*

204. COUNTRY REPORTS–CANADA (Walden Publishing Ltd. 1995).

205. *Farm Foreclosures to Resume*, 1987 FACTS ON FILE, May 1, 1991.

206. *Id.*

207. Peter Morton & Eric Reguly, *Chretien Vows to Protect Farmers: But Assurances Fail to Soothe as Bankruptcy Fears Raised*, FIN. POST, Dec. 15, 1993, at 11.

208. *Id.*; Ashley Geddes, *Canada: NFU Sees Lingering Crisis Despite Fall in Bankruptcies*, FIN. POST, Mar. 9, 1994, at 65.

209. Geddes, *supra* note 208, at 65. In 1988, Statistics Canada reported 150 Canadian farm families were leaving the farm daily, or 1 every 10 minutes. Wayne Grady, *The Heartbreaks of Farming Today*, TORONTO STAR, July 6, 1991, at F14.

210. *Canada: Task Force Says Farmers Need Management Course*, FIN. POST, July 25, 1991, at 5.

repay.[211] The problem was thought to be acerbated by collateral based lending policies of the 1980s.[212] Repayment capacity lending practices were recommended for future farmer-loan decisions.[213] But how do you resolve the $6 billion question—shared depreciation of assets or a Farm Debt Review Act?

Canada has responded to farmer debt crisis with the passage of the Farm Debt Review Act (FDRA).[214] Under the Act, an "insolvent farmer" is a farmer "who is for any reason unable to meet his obligations as they generally become due;" who has leased pay obligations; or whose property is worth less than the farmer's obligations if sold under legal process.[215] By province or by region, a Farm Debt Review Board (FDRB) of not more than eleven members is established.[216] The Board is obligated to prepare a list of persons eligible and available to serve on review panels.[217] Knowledge and experience in agriculture or financial matters is required.[218] A member of the Review Board chairs a review panel consisting of the chair and two panel members.[219]

Any Canadian farmer who is in financial difficulty may apply to the Board for a review of financial affairs or for "assistance in facilitating an arrangement with his creditors."[220] The review panel shall examine the farmer's financial affairs, meet with the farmer and his creditors, and "assist the farmer and his creditors to enter into an arrangement."[221] In addition to the review of the insolvent farmer's financial affairs, the FDRA creates a stay of proceedings against the insolvent farm debtor by his creditors.[222] Secured creditors who intend to foreclose on secured property of the farmer must inform the farmer in writing, fifteen business days prior to the intended action, that the farmer has the right to apply for a stay of the proceedings against him by the secured creditor.[223] Upon receipt by the Board of an application by the farmer for a stay, no creditor may initiate or continue any legal action for the recovery of a debt, or realization of security interest from the property of the farmer.[224] When the insolvent farmer applies for a stay under the FDRA, the Board is required to appoint a guardian, who could be either (a) the farmer;[225] (b) any qualified person chosen by the Board;[226] or

211. W.G. Fulton, *Changes, Choices, Challenges: Servicing the Rural Economy*, CANADIAN BANKER, Nov.-Dec. 1989, at 15.
212. *Id.*
213. *Id.*
214. Farm Debt Review Act, R.S.C., ch. 25 (2d Supp. 1985) (Can.) [hereinafter FDRA].
215. *Id.* §§ 1-3.
216. *Id.* § 4.
217. *Id.* §§ 11(1)-12.
218. *Id.* § 11(2).
219. *Id.* § 13.
220. *Id.* § 16.
221. *Id.* §§ 17-19.
222. *Id.* § 20(1).
223. *Id.* §§ 22-23.
224. *Id.* § 23.
225. *Id.* § 24(1)(a). If the farmer is qualified in the opinion of the Board and no person is nominated by a secured creditor, the Board is required to appoint the farmer. *Id.* § 24(2).

(c) a qualified person nominated by any secured creditor or secured creditors.[227] The farmer guardian is required to take direction from the Board and other guardians are required to: (a) prepare an inventory of the assets of the farmer; (b) verify periodically the presence and condition of those assets; (c) advise the Board of any act or omission on the part of the farmer that would jeopardize those assets; and (d) comply with any directives issued to the guardian by the Board.[228] Failure on the part of the farmer to comply, or negligence in complying with the directives of the Board, will result in termination of the stay.[229] The stay can be extended for up to ninety days to facilitate an arrangement.[230] The Board is to facilitate "an arrangement between the farmer and his creditors,"[231] and may appoint a licensed trustee to assure that the arrangement is carried out according to the regulations of the Board.[232] Effective August 5, 1986, the Act requires the Board to file an annual report with Parliament.[233]

As in the United States, Canadian banks were accused of encouraging farmers to borrow in order to expand in the 1970s.[234] From 1988 to 1991, it has been reported that 20 to 30% of medium-to-high-income farmers in Ontario alone were not meeting their debt payments.[235] Banks and other creditors issued 4641 notices of intent to sell in Ontario alone from August 1986 to June 1991.[236] "In the same period, the Farm Debt Review Board received 2464 applications from Ontario farmers" with 1198 ending with "signed agreements."[237] Conversely, Bob MacKenzie, a private consultant dealing with strategic planning and debt restructuring for farmers, noted that only 10 to 20% of the farmers going through the FDRB get restructured.[238] The rest leave the farm, lease the land from creditors, or live in the house with others taking over the land.[239] By 1988, over 6000 farmers in Saskatchewan had applied to the FDRB.[240] By 1992, 7146 Farm Credit Corporation clients had applied to the Board,[241] and 83% or 5948 of the FCC cases were

226. *Id.* § 24(1)(b). The Board pays the cost of the guardian. *Id.* § 24(3).

227. *Id.* § 24(1)(c). The expense of a guardian appointed by the Board from the creditor's nomination is born by the creditor or creditors who nominated the guardian. *Id.* § 24(4).

228. *Id.* § 25.

229. *Id.* § 26.

230. *Id.* § 29(1)-(2).

231. *Id.* § 28.

232. *Id.* § 31(1). The Board will pay the expenses of the trustee. *Id.* § 31(2). Farmers, absent permission of the Board, may not make a new application for two years after an unsuccessful application, or after the termination of arrangements made under the Act. *Id.* § 33.

233. *Id.* § 38.

234. Warren Gerard, *Our Fields of Dreams Have Become Acres of Anguish*, TORONTO STAR, Oct. 5, 1991, at A1.

235. *Id.*

236. *Id.*

237. *Id.*

238. *Id.*

239. *Id.*

240. Grady, *supra* note 209, at F14.

241. *Agriculture Minister Bill McKnight Continues to Offer Alternatives to*

resolved.[242] Debt adjustment, including funds from the government, lease backers, loan losses, and reamortizations, greased the wheels of adjustment.[243] Litigation under the FDRA has centered on several issues, including proper notice,[244] second application filed within two years and without permission of the Board,[245] and waiver of right of notice.[246]

The Canadian Farm Debt Review Act is designed to protect farmers who are in financial difficulties from actions of their creditors.[247] The voluntary portion is designed to encourage revision of financial affairs by farmers on the slope of financial difficulty and to facilitate proactive arrangement with creditors.[248] The second portion, which applies to farmers who are already insolvent, is mandatory and restricts a creditor's ability to begin a proceeding against the debtor for a period of time.[249] The FDRA, however, does not mandate an outcome or an "arrangement."

V. CONCLUSION

Notwithstanding preferential treatment for farm debtors, the trend in agriculture in Canada,[250] Australia,[251] and the United States[252] is the continued decrease in farm operators. Agriculture represents 3% of Canadian GDP,[253] 4% of Australian GDP,[254] and 3% of the United States' GDP.[255] Political pressure has resulted in preferential treatment for farmers facing insolvency in all three countries. While cries are voiced and pictures of "bankrupt" farmers are painted with each drought or commodity price decline, in reality, the informal negotiation of loan deferral, mediation and debt review, voluntary exit, and use of insolvency protection schemes for farmers have kept the wolf at the door. Farmers have not been sold short by "government managers,"

Saskatchewan on Farm Debt Legislation, CAN. NEWSWIRE, June 8, 1992.

242. *Id.*

243. *Id.* Out of 2760 farms voluntarily transferred to the Farm Credit Corporation, 2243 farms, or 81%, were leased back or sold to the farmer. *Id.*

244. O'Rouke v. O'Hallorran [1994] 47 A.C.W.S.3d 170.

245. Agricultural Credit Corp. of Saskatchewan v. Canada [1991] 29 A.C.W.S.3d 54.

246. Sunyvale Farming Enter., Ltd. v. Lloyds Bank of Canada [1990] 23 A.C.W.S.3d 1117.

247. FDRA, *supra* note 214, at O § 1.

248. *Id.*

249. *Id.*

250. In Canada, from 1976 to 1991, farm operators decreased from 338,552 to 280,043. AGRIC. DIV. STATISTICS CANADA, CENSUS OVERVIEW OF CANADIAN AGRICULTURE: 1971-1991, Table 1.

251. In Australia, from 1975 to 1994, farm employers and self-employed farmers decreased from 238,700 to 220,900. FARM SECTOR, COMMODITY STATISTICAL BULLETIN, Table 24 (1994). Agricultural establishments declined from 182,250 in 1975 to 120,655 in 1993. *Id.*

252. In the United States, from 1974 to 1992, farm operators decreased from 1,427,368 to 1,053,150. BUREAU OF CENSUS, 1992 CENSUS OF AGRICULTURE (1992).

253. 2 ENCYCLOPEDIA BRITANNICA, *Canada* (1995).

254. 1 ENCYCLOPEDIA BRITANNICA, *Australia* (1995).

255. 12 ENCYCLOPEDIA BRITANNICA, *United States* (1995).

nor have bankers "suffered" projected losses. Resource misallocation and the unfettered operation of the free market have been the losers. Farmers who fail to plan, should plan to rely on government preferential insolvency treatment. But like the "manager" selling the farm, the very action of the government intervention may be to sell out other members of the sector. For as one wag has phrased it, "at the outside, it seems . . . [farmers must have] the skills of a Wall St. trader, the determination of a marathon runner, a soothsayer's way with the weather, the acumen of a scientist and the guts of Ned Kelly [to be] in with a chance."[256]

256. Genevieve Barlow, *Debt Puts Farmers in the Hot Seat*, WEEKLY TIMES, Mar. 8, 1995, at 11.

APPENDIX

TABLE 1. Chapter 12 Filings and Insolvent Farmer and Agricultural Firms' Exits from American Agriculture 1984-1994

	1984		1985		1986		1987		1988		1989	
Reported[a] cases	No. cases	Per 10,000 firms	No. cases	Per 10,000 firms	No. cases	Per 10,000 firms	No. cases	Per 10,000 firms	No. cases	Per 10,000 firms	No. cases	Per 10,000 firms
Exits from Agricultural Production —Crops	1033		1655		1717		2716		1045		708	
		200		306		264		309		131		44
Exits from Agricultural Production —Livestock	533		573		446		592		399		205	
		194		200		153		171		98		37
Total Exits[b] from Agric. Production	1566		2228		2163		3308		1444		913	
Chapter 12[c] Filings							4824		3099		1717	
Exits by Agricultural Services	391		430		452		433		559		600	
		83		84		84		64		78		65

	1990		1991		1992		1993		1994
Reported Cases	No. cases	Per 10,000 firms	No. cases	Per 10,000 firms	No. cases	Per 10,000 firms	No. cases	Per 10,000 firms	No. cases
Exits from Agricultural Production —Crops	774		859		1327		908		
		48		55		84		58	
Exits from Agricultural Production —Livestock	271		346		390		369		
		43		58		65		62	
Total Exits from Agric. Production	1045		1205		1717		1277		
Chapter 12 Filings	1351		1358		1634		1434		904
Exits by Agricultural Services	634		989		1085		942		
		55		82		82		69	

a DUN & BRADSTREET CORP., ECON. ANALYSIS DEPT., THE BUSINESS FAILURE RECORD (1984-1994).

b. Farm Operators: 1982—1,234,787; 1984—1,138,179; 1992—1,053,150. AGRICULTURE DIVISION, BUREAU OF CENSUS, 1992 CENSUS OF AGRICULTURE (1992).

c. ANALYSIS & REPORTS BRANCH, *supra* note 90, tbl. F-2.

TABLE 2. Australian Agricultural Establishments; Agricultural Employers and Self Employment; and Farmer Bankruptcy Filings. 1984-1992.

	1984	1985	1986	1987	1988	1989	1990	1991	1992
Agricultural Establishments	174,030	171,440	169,716	128,707	128,543	125,708	127,778	124,975	120,558
Employers[a] and Self-Employers	249,000	248,100	259,900	249,400	242,400	235,900	243,900	228,200	220,500
Farmers who[b] Filed for Bankruptcy	97	73	111	130	159	94	90	65	94

a. AUSTRALIAN BUREAU OF AGRICULTURAL & RESOURCE ECONOMICS, 1994 COMMODITY STATISTICS BULLETIN tbl. 24 (1994).

b. Bankruptcy Act 1966, Annual Report by the Inspector-General in Bankruptcy on the Operation of the Bankruptcy Act 1966, Commonwealth of Australia Reports for 1 July 1984 to 30 June 1992, inclusive.

TABLE 3. Canadian Farmer and Farm Services Bankruptcy[a]

	1981	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995[b]
Farms	318,361			293,089					280,043				
Farms/ Farmers		551	508	440	354	325	334	407	441	383	349	308	171
Agriculture Services		36	37	30	28	24	20	22	43	38	39	22	12

a. OFFICE OF SUPERINTENDANT OF BANKRUPTCY, BUSINESS BANKRUPTCY STATISTICS BY INDUSTRIAL CLASSIFICATION BY PROVINCE (1984-1995).

b. 1/1/95-7/31/95.