Introduction: A Financial Revolution in Agriculture

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INTRODUCTION

A FINANCIAL REVOLUTION IN AGRICULTURE

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Agriculture is going through the most wrenching financial revolution in a half century. Not since the 1930's have issues of debtor distress and creditor remedies gripped the farm community as they have in the 1980's. The debt-to-asset ratio for farm firms has been rising with one-quarter or more of the total farm debt held by farm firms with a debt-to-asset ratio over seventy percent.[1] Other indicators of debtor distress include the incidence of forfeiture, foreclosure, bankruptcy filings, and the mere disappearance of farm firms without judicial intervention. Quite clearly, the 1980's are setting modern day records for financial difficulties by farm and ranch firms that are eclipsed only by the Great Depression.

The current wave of financial problems has numerous roots: (1) adverse weather conditions in some areas, (2) high real rates of

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1. *See* E. MELICHAR, BOARD OF GOVERNORS OF THE FED. RESERVE SYS., DIV. OF RESEARCH AND STATISTICS, DELINQUENT FARM LOANS AT INSURED COMMERCIAL BANKS, DELINQUENT LOANS AT RURAL BANKS, AND LOAN-LOSS, PROFIT, AND CAPITAL LOSS RATIOS AT AGRICULTURAL BANKS 24, Table 21 (Mar. 19, 1984). The loan loss rates (in percent) for agriculture banks for the United States and for selected states are as follows:

interest,[2] (3) over-expansion in the 1970's under an assumption of continued inflation,[3] and (4) reductions in land values as the rate of inflation has declined.[4] The single most significant factor appears to be the Federal Reserve's decision in late 1979 to wring inflation out of the United States economy.[5] That action led to tight money, high interest rates, and a dramatic slowing of the rate of inflation. The result for farmers has been staggering real rates of interest and falling land values, sufficient to cause lenders to develop concerns about a substantial portion of their farm borrowers.

Falling land values have reduced the collateral value of farm property, creating an unfavorable market environment for the sale

	1970	1971	1972	1973	1974	1975	1976	1977	1978
United States	0.25	0.21	0.14	0.15	0.22	0.20	0.22	0.20	0.20
Michigan	0.17	0.18	0.16	0.19	0.26	0.22	0.29	0.16	0.13
Wisconsin	0.09	0.08	0.08	0.10	0.09	0.10	0.14	0.17	0.09
New Mexico	0.28	0.26	0.23	0.44	0.53	0.40	0.69	0.42	0.14
North Dakota	0.18	0.17	0.09	0.06	0.10	0.06	0.12	0.12	0.09

1979	1980	1981	1982	1983
0.19	0.32	0.41	0.68	0.93
0.16	0.23	0.45	0.56	0.49
0.08	0.15	0.19	0.32	0.49
0.22	0.56	0.63	0.38	2.01
0.06	0.20	0.25	0.80	1.03

Id.

2. The real rate of interest is the stated rate less the rate of inflation (or rate of increase in the general price level). *See* W. SICHEL, BASIC ECONOMIC CONCEPTS 298-99 (1974). *See also* E. NEMMERS, DICTIONARY OF ECONOMICS AND BUSINESS 368 (1974).

3. *See* Melichar, *A Financial Perspective on Agriculture*, 70 FED. RESERVE BULL. 1, 8-9 (1984). The commentator notes that inflation has adversely affected farmers and ranchers as follows:

> [H]ighly leveraged operators may have had operating losses equal to a fourth or a third of their equity in each of the past four years while similarly situated farmers with no debt were operating profitably. Unless such heavily indebted farmers had substantial financial reserves or other resources, they have had to liquidate assets in order to reduce their debt burden. In each recent year, according to surveys of lenders, perhaps 3 to 5 percent of farmers have been forced to liquidate productive assets. Smaller percentages were reported to have left farming through forced liquidations or foreclosures.

Id.

4. Real capital losses on farm real estate nationally have totaled about $149 billion (in 1983 dollars) in the first four years of the 1980's. *See* Melichar, *supra* note 3, at 6. In contrast, real capital gains on farm real estate totaled $447 billion (in 1983 dollars) from 1972 through 1979. *Id.* at 5. Purchasers of farmland after 1979 did not, however, share in the gains.

5. *Treasury and Federal Reserve Foreign Exchange Operations: Interim Report*, 65 FED. RESERVE BULL. 951, 953-54 (1979). The Bulletin indicates that: "On Saturday, October 6, the Federal Reserve announced a series of complementary actions to assure better control over the expansion of money and credit, to help curb speculation in financial foreign exchange and commodity markets, and thereby to dampen inflationary forces." *Id.*

of assets to improve financial positions and causing potential investors to be reluctant to invest in farmland.

Of the other major contributors to the financial problems of agriculture, the problem of high real interest rates has been among the most devastating. High real interest rates have four distinct effects on farm firms: (1) high interest rates increase the direct cost of production credit for use in a farming operation and raise the interest cost for land under variable rate mortgages; (2) high interest rates give strength to the dollar resulting in farm products being more expensive in export channels, causing a consequent drop in exports; (3) high interest rates become part of the cost of production for inputs purchased by farmers, and because of the competitive structure of most input supplying sectors, the added costs are passed along in the form of higher input prices; and (4) high interest rates increase the cost of carrying farm products in inventory with a short-term effect similar to increase in supply.[6]

The agricultural sector is substantially more vulnerable to financial stress than it was a decade ago. In 1971 the total outstanding farm debt in the United States was slightly more than $54 billion.[7] As recently as 1976, that figure stood at slightly more than $91 billion.[8] In the next eight years, the figure climbed to $215 billion.[9] As a percent of total farm assets, farm debt in the United States was at 20.1% in 1983,[10] but a special survey in 1984 placed the figure at 29.5% in Iowa.[11] However, more than one-third of the farmers have little or no debt. The relationship of farm debt to farm income is highly important inasmuch as indebtedness eventually must be paid out of income, except to the extent that one may satisfy indebtedness out of the principal value of assets. Unless inflation permits payment from increases in asset values, the opportunity for payment of indebtedness from assets is limited. As a percentage of net farm income, farm debt stood at 215% in 1960,

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6. *See generally* N. HARL, LEGAL AND TAX GUIDE FOR AGRICULTURAL LENDERS ch. 1 (1984). Before 1979 farm borrowers were virtually insulated from cyclical changes in interest rates on loans. The cost of loanable funds in rural banks tended to be relatively stable even as interest rates rose and fell in national money markets. *See* Melichar, *supra* note 3, at 7. Beginning in 1979, banks were authorized to accept smaller and shorter-term deposits bearing market-related interest rates. *Id.* Thus, the cost of loanable funds rose sharply for rural banks in the early 1980's.

7. *See* ECON. RESEARCH SERV., U.S. DEP'T OF AGRIC., AGRICULTURAL FINANCE: OUTLOOK AND SITUATION 10, Table 5 (Dec. 1983) [hereinafter cited as AGRICULTURAL FINANCE].

8. *Id.*

9. *Id.* The total farm debt figure includes Commodity Credit Corporation loans. *Id.*

10. *Id.* at 111. The ratio of debt to assets peaked at 30% in 1933. *See* Melichar, *supra* note 3, at 6. At present, nearly two-thirds of the total debt, however, is owed by operations with debt-asset ratios greater than 40%. *Id.* at 8-9.

11. IOWA CROP AND LIVESTOCK REP. SERV., IOWA FARM FINANCE SURVEY (1984).

rising to 334% of net farm income in 1975 and skyrocketing to 795% of net farm income in 1981.[12]

I. PROBLEMS IN AGRICULTURAL LENDING

The financial stress[13] in the agricultural sector in recent years has produced a greater sense of awareness of the adequacy of the legal structure governing debtor-creditor relationships than has been the case since the 1930's. The challenge of the 1980's is to adjust to more formal (and in some cases, more conservative) lending practices to adapt the institutional structure to the financial needs of the last part of the twentieth century, and to restructure debt and assets among farm firms as needed for economic survival.

A. ADJUSTING TO THE UNIFORM COMMERCIAL CODE

Forty-nine of the fifty states have enacted the Uniform Commercial Code (UCC),[14] with most states adopting the UCC in the late 1950's and 1960's. Article 9 of the UCC essentially replaced the rules pertaining to the old chattel mortgage, conditional sale contract, assignment of accounts receivable, and the pledge. In some instances, the documents formerly in use continued to be utilized for a time after the UCC became effective. Even though a lender used the old instruments, however, the transaction was treated under the UCC rules.

Some states had not fully absorbed the lending practices prescribed by the UCC when the lending crunch of the 1980's emerged. For example, agricultural lenders did not universally file financing statements (or security agreements as financing statements) even after the enactment of the UCC in the respective states. The adjustment, however, was greater than merely adopting the use of UCC instruments and UCC filing requirements. The proper classification of farm property for collateral purposes,[15] the

12. M. Boehlje, The 1980's: New Rules Require New Management Strategies 4, Figure 7 (1984) (unpublished manuscript, available at Iowa State University, Department of Economics).

13. For a report indicating the extent of financial stress in agriculture by region and by type of farming area, see AGRICULTURAL FINANCE, *supra* note 7, at 6-7.

14. Only Louisiana has not fully adopted the Uniform Commercial Code. Louisiana has adopted only articles 1, 3, 4, 5, 7, and 8 of the Uniform Commercial Code. Louisiana has not, however, adopted article 9, dealing with secured financing arrangements. *See* 13 N. HARL, AGRICULTURAL LAW ch. 115 (1983).

15. *See* U.C.C. § 9-109(3) (1972). Section 9-109(3) defines goods as:

> "Farm products" if they are crops or livestock or supplies used or produced in farming operations or if they are products of crops or livestock in their unmanufactured states (such as ginned cotton, wool-clip, maple syrup, milk and eggs), and if they are in the possession of a debtor engaged in raising, fattening,

description of farm property (including location),[16] and the use of after-acquired property clauses[17] were prominent among the problems in adjusting to the UCC.

With the increased competition among lenders for the collateral of borrowers in the 1980's, lenders more uniformly employed the UCC procedures, in some instances over the objections of borrowers who expected to borrow on an unsecured basis and yet have creditors treat them as though they gave security for the obligation.

B. SALE OF FARM PRODUCTS

As a general rule, purchasers of inventory property take free of security interests on the property even though perfected and even though the purchaser knew of the security interest.[18] A purchaser of farm property in the possession of a farmer generally does not, however, take free of perfected security interests in most states.[19] The special rule applicable to farm products in the possession of a farmer has led to concerns by purchasers of farm products and occasionally has resulted in a purchaser paying twice for the same farm products. While purchasers may, of course, protect themselves and avoid liability to secured lenders by checking the record for UCC filings applicable to the property in question, several states still follow county-level rather than state-level filing.[20] In those states, the burden of checking the record is much greater than in states with central filing.[21] Moreover, a purchaser in states

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grazing or other farming operations. If the goods are farm products they are neither equipment nor inventory. . . .

Id.

16. *See* 13 N. HARL, *supra* note 14, § 118.02[2][a][i].

17. U.C.C. § 9-204. *See, e.g., In re* Sunberg, 729 F.2d 561 (8th Cir. 1984).

18. U.C.C. § 9-307. *See also* 13 N. HARL, *supra* note 14, § 119.02[4].

19. U.C.C. § 9-307. Several states have adopted, by judicial decision, a modification of the general rule that purchasers of farm products in the possession of a farmer do not take free of a perfected security interest. In Arkansas, California, Iowa, Kansas, New Mexico, North Dakota, Texas, and Washington, if a lender permits sale of collateral without application of the proceeds from the sale on the loan, the lender has waived the right to recover from the purchaser. *See generally* Meyer, *The 9-307(1) Farm Products Puzzle: Its Parts and Its Future*, 60 N.D.L. Rev. 401 (1984).

20. *See, e.g.*, IND. STAT. ANN. § 26-1-9-9401(1) (a) (1974) ("equipment used in farming operations, or farm products, or accounts, contract rights or general intangibles arising from or relating to the sale of farm products by a farmer, or consumer goods, then in the office of the county recorder in the county of the debtor's residence. . . ."); S.D. CODIFIED LAWS § 57A-9-401(1) (1980 & Supp. 1983) (county-level filing for "equipment used in farming operations or consumer goods").

21. *See, e.g.*, IOWA CODE § 554.9401(1) (c) (1983); Legis. Bill 343, 1983 Neb. Laws ____; KAN. STAT. ANN. § 84-9-9401(1) (c) (1983). The Iowa act authorizes the secretary of state to adopt, charging no more than "reasonable estimate of cost," one or more of several methods of providing information concerning public filings in that office including: (a) subscription telephone service; (b) subscription summaries on a daily, weekly, or monthly basis; and (c) providing space for the preparation of written summaries and telephone service by those having a "legitimate interest in regular examination" of the records. IOWA CODE § 554.9407(3) (1983). The Iowa approach is in

with county-level filing is usually less certain that all security interests have been checked. Especially with the advent of electronic search and retrieval of information in records, a move toward central filing at the state level would seem to be highly desirable in all states.

Some states have changed the UCC rule on purchase of farm products and permit purchasers to take free of perfected security interests.[22] More states seem likely to follow suit as the arguments in favor of a purchaser of inventory taking free of a security interest arise in the context of the sale of farm products.

Any change in the rule, however, ideally should come on the high side of the prosperity cycle rather than at the nadir. Lenders who lose the privileged position of the traditional UCC rule could be expected to become more cautious in extending credit to marginal borrowers. The result would be increased difficulty in obtaining financing by the most vulnerable group of borrowers.

C. PRIORITIES OF LIENS

Enactment of the UCC provided a statutory overlay to a

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accord with the obvious need for electronic search of records and electronic transmittal of information.

22. CAL. COM. CODE § 9307 (West Supp. 1984) (UCC provision amended in 1974, effective in 1976, to remove special treatment for purchases of farm products from a farmer); GA. CODE ANN. § 109A-307(3) (Supp. 1982) (commission merchants protected from liability for selling livestock or agricultural products subject to liens in the ordinary course of business if the commission merchants did not receive notice); ILL. REV. STAT. ch. 26, §§ 9-307(4), 9-205.1, 9-307.1 (1983) (purchaser in ordinary course of business takes free of a security interest created by the seller unless, within five years prior to purchase, the secured party has given written notice of the security interest to the buyer; a secured party may require that a debtor include as part of the security agreement a list of persons to whom the debtor desires to dispose of the collateral and a debtor may not dispose of collateral to a person not on the list except on seven days' notice to the secured party; disposition in violation of the rules is a crime but payment of proceeds within 10 days is a defense); IND. CODE ANN. § 26-1-9-307 (West Supp. 1983); KY. REV. STAT. § 355.9-307 (Supp. 1982) (bona fide purchaser in ordinary course of business takes free of any liens and is not liable to holders of liens — unless given written notice of the lien — when a tobacco crop is sold at public auction, livestock is sold through licensed stockyards, or a grain or soybean crop is sold to a purchaser who holds a grain storage license); MONT. CODE ANN. § 81-8-301 (1983) (livestock market protected from liability for selling livestock subject to security interest unless notice of security agreement filed with State Department of Livestock); NEB. REV. STAT. § 69-109-01 (Supp. 1983) (commission merchants protected from liability for selling agricultural products subject to liens); N.D. CENT. CODE § 41-09-28 (1983) (merchant purchasing farm products must require the farmer as seller to execute a certificate of ownership listing prior owners and holders of security interests, purchaser then writes checks to include names of secured parties; also, giving of untrue statements is a crime); OHIO REV. CODE § 1309.26(B) (1983) (buyer of farm products from a person engaged in farming operations takes free of perfected security interest unless within 18 months prior to making payment, the buyer has received written notice; debtor engaged in farming operations must provide, if requested by secured party, a written list of potential buyers of farm products; without prior consent of the secured party, the debtor may not sell farm products to a buyer who does not appear on the list); TENN. CODE ANN. § 47-9-307 (1983) (bona fide purchaser in ordinary course of business takes free of security interest — unless actual written notice is given prior to sale — in the following circumstances: Livestock sold through public livestock market or licensed purchaser; grain or soybean crop when purchaser holds current state or federal warehouse license; and tobacco crops sold at public auction; notice must be given to parties in counties located within 75 miles of principal office of creditor).

For a more complete discussion of the problem area, see Meyer, *supra*, note 19.

network of liens in most states.[23] Article 9 of the UCC specifically excludes common law or statutory liens from coverage. In general, liens take priority over UCC security interests except when the lien is based upon a statute and the statute expressly declares the lien to be subordinate to the UCC security interest.[24]

Landlord's liens, typically arising under state statutory law,[25] pose special problems of competition in farm lending among landowners seeking assurances that rent will be paid, vendors who have advanced credit for needed inputs, and general lenders who may have a perfected security interest in crops grown or livestock produced.[26] Under the Iowa landlord's lien, one of the most expansive, a landlord has a lien "upon all crops grown upon the leased premises, and upon any other personal property of the tenant that has been used or kept thereon during the term and that is not exempt from execution."[27] The Missouri statute, by contrast, reaches only the "crops grown on the demised premises in any year, for the rent that shall accrue for such year."[28] Illinois, in 1983, modified the priority scheme for landlord's liens by providing that a good faith purchaser takes crops free of a landlord's lien unless, within six months prior to the purchase, the landlord provides written notice of the landlord's lien to the purchaser.[29] In

23. *See, e.g.*, N.D. CENT. CODE tit. 41 (1983) (Uniform Commercial Code); N.D. CENT. CODE tit. 35 (1980) (liens).

24. U.C.C. § 9-310. Section 9-310 provides:

> When a person in the ordinary course of his business furnishes services or materials with respect to goods subject to a security interest, a lien upon goods in the possession of such person given by statute or rule of law for such materials or services takes priority over a perfected security interest unless the lien is statutory and the statute expressly provides otherwise.

Id. See also U.C.C. § 9-104. Section 9-104 provides:

> This Article does not apply
> . . . .
> (b) to a landlord's lien; or
> (c) to a lien given by statute or other rule of law for services or materials except as provided in Section 9-310 on priority of such liens. . . .

Id. See also N.D. CENT. CODE §§ 41-09-31, 41-09-04 (1983).

25. *See* MO. REV. STAT. § 441.280 (1978) (lien "upon the crops grown on the demised premises").

26. North Dakota does not have a statutory landlord's lien. Contractual rights to the crop in favor of the landlord have been the subject of litigation in North Dakota. *See* Aronson v. Oppegard, 16 N.D. 595, 114 N.W. 377 (1907); Vincent v. Reynolds Farmers' Elev. Co., 53 N.D. 749, 208 N.W. 158 (1926).

27. IOWA CODE § 570.01 (1983).

28. MO. REV. STAT. § 441.280 (1978).

29. Pub. Act 83-70, § 1 (codified at ILL. CODE CIV. P. § 9-316 (1984)). A landlord may require that the tenant, prior to the sale of any crops grown on the rented land, disclose the names of persons to whom the tenant intends to sell the crops. When that requirement has been imposed, the tenant may not sell the crops to anyone not disclosed to the landlord as a potential buyer of the crops. In that situation, sale to an undisclosed person is a crime. It is a defense to a prosecution that the tenant paid the landlord proceeds from the sale of crops within 10 days from sale. ILL. CODE CIV. P. §§ 9-316, -316.1 (1984).

general, a party may create a contractual landlord's lien in a lease and may reach property exempt for purposes of the statutory landlord's lien.

The problem of priority for liens has arisen in numerous instances in recent years as farmers have been unable to obtain from general lenders sufficient credit for crop production and unable to obtain vendor financing because any lien that the vendor could obtain would be subordinate to outstanding security interests under the UCC. A special provision of the UCC was designed to aid farm debtors unable to obtain funds needed to put in a crop.[30] Under the UCC rule, a new creditor may provide funds for production credit and take back a priority security interest in the crops. If the new creditor obtains the security interest not more than three months before the crops become growing crops, the security interest takes priority over an earlier perfected security interest to the extent that the earlier security interest secures obligations due more than six months before the crops become growing crops.[31] In 1977 a United States district court in Ohio, however, held that if the debtor's obligations are less than six months overdue at the time the crops become growing crops, the new crop production lender does not have priority.[32]

Some states have enacted legislation requiring vendors seeking to obtain security for feed, seed, fertilizer, chemicals, and other farm inputs to follow special procedures when dealing with farmers already heavily burdened with debt.[33] In North Dakota, any person furnishing or applying fertilizer, farm chemicals, or seed may obtain a lien on all of the crop produced from those inputs to secure payment of the purchase price.[34] The lien must be filed within ninety days after the fertilizer, farm chemicals, or seed are furnished or applied.[35] The lien has priority concerning the crops covered over all other liens and encumbrances except for threshing liens[36] and production liens.[37]

In Iowa a vendor who wishes to obtain a security position in growing crops produced with seed, fertilizer, or chemicals provided by the vendor or animals to which purchased feed is to be fed may

30. U.C.C. § 9-312(2).
31. *Id. See* 13 N. HARL, *supra* note 14, § 118.02[3].
32. United States v. Minster Farmers Coop. Exch., Inc., 430 F. Supp. 566 (N.D. Ohio 1977).
33. *See* N.D. CENT. CODE § 35-09-01 (1980) (lien for "fertilizer, farm chemicals, or seed" upon "all the crop produced from the fertilizer, farm chemicals, or seed so furnished to secure the payment of the purchase price thereof"); MONT. REV. CODE ANN. § 71-3-701 (1983) (lien for seed).
34. N.D. CENT. CODE § 35-09-01 (1980).
35. *Id.* § 35-09-02.
36. *Id.* ch. 35-07 (Supp. 1983).
37. *Id.* ch. 35-08 (1980). *See id.* § 35-09-03 (1980).

ask the farmer for a waiver of confidentiality.[38] The vendor then may request financial information from the farmer's lender or lenders about the farmer's financial status and whether the farmer should be in a position to pay for the inputs requested. If the answer is in the affirmative, the lender's response serves as a letter of credit until thirty days after the due date for the inputs. In the event the response is in the negative, the vendor may advance credit for needed inputs and would have an equal claim to the farmer's collateral benefiting from the inputs, such as a growing crop, as to security interests perfected previously, except for creditors responding to the vendor's request for information or creditors who did not receive the request.

D. PROBLEMS OF INTERMINGLING

The drafters of the UCC obviously did not anticipate problems of agricultural lending. One area in which this is obvious is in the resolution of priorities between or among security interests if collateral is intermingled.[39] The problem may arise, for example, if crops subject to a security interest to one lender are fed to animals that are the subject of another security interest to a different lender. The rules for resolving the problem of priorities are not completely clear. It is not unreasonable to expect the UCC to reflect a modicum of reality with respect to agricultural lending.

II. THE CHALLENGE OF EDUCATION

In addition to reform of the UCC to better meet the needs of farmers, farm lenders, vendors, and purchasers of farm products, a substantial need exists for educational effort concerning the rules governing the extension of credit. For the foreseeable future, credit problems will continue for a sizable number of farm borrowers.[40] In many instances, the parties can adjust to almost any conceivable set of provisions respecting credit. Uncertainty about outcome has

38. S.F. 510, 2 Iowa Legis. Serv. 114 (West 1984).

39. U.C.C. § 9-315 (security interests rank equally according to the ratio that the cost of goods to which each interest originally attached bears to the cost of the total product or mass). In First Nat'l Bank v. Bostron, 39 Colo. App. 107, 564 P.2d 964 (1977), U.C.C. § 9-315 was held to be inapplicable to feed fed to livestock. *See also* Clark, *The Agricultural Transaction: Livestock Financing*, 11 U.C.C. L.J. 106, 129-31 (1978) (a prudent livestock lender should assure that: (1) no competing feed dealer is in the picture, (2) any competing feed dealer is paid off in cash, or (3) a subordination agreement is obtained with respect to the livestock).

40. For an indication of the percentage of farmers (by region and by type of farming area) who were loaned up to practical limit in 1983, see AGRICULTURAL FINANCE, *supra* note 7, at 6-7. The percentage of farmers loaned up in 1983 ranged from 40.5% in the South to 26% in the Cornbelt. By type of farming, the percentages ranged from 33.9% for cotton to 25.7% for dairy. *Id.*

been a problem in farm lending. A major contributor to this uncertainty is lack of knowledge by borrowers about the details of lending procedures, rules for perfecting security interests, and determining priorities and the governing provisions regarding the rights of purchasers of farm products. Practicing attorneys can play a key role in raising the level of understanding concerning important provisions of the UCC.

III. OPTIMALITY IN LENDING

In shaping a lending structure for the remainder of the twentieth century and for the twenty-first century, one should keep several basic guidelines clearly in mind:

1. An adequate amount of credit at reasonable rates and terms is essential to a prosperous and efficient agriculture.[41] The rules governing the extension of credit are, therefore, among the most important components of the legal system surrounding agriculture.

2. General lenders are in the best position to evaluate credit, administer credit, and deal with work-outs in the event of default. The credit system should preserve the traditional role of general lenders in providing a line of credit.

3. Vendors need assurance of payment or a security interest in the collateral produced by inputs provided to farm and ranch operations if the necessary inputs are to be available to the farmer.

4. Purchasers of farm products should be able to purchase goods in the ordinary course of business without concern for perfected security interests. The sale of farm products presumably does not represent a diminution of a farmer's asset position, only a change in form. The transformation of goods into cash leaves the seller with funds equivalent to the value of the collateral sold. Lenders customarily deal with the problems of assuring that the proceeds of sale are applied on loan amounts due in the nonfarm setting. Agricultural lending does not pose problems that are new or different. The major distinction between general and agricultural loans has been the relative size of the borrower and the practicalities of exercising surveillance over sales of property subject to a security interest. The average farm firm today is a substantial business and compares favorably in size to the scale of nonfarm firms served by the same rural banks providing

41. Interest rates have not, conventionally, been viewed as a component of farm policy. Yet policies influencing interest rates often have effects, mediately or immediately, that rival or exceed the importance of federal price and income support policies.

agricultural credit.[42] The Commissioners on Uniform State Laws should evaluate the adequacy of the framework within which agricultural credit is extended. A review of the lending framework should involve the family of liens, the UCC, and bankruptcy on an integrated, coordinated basis. Otherwise, a highly nonuniform system is in prospect.

5. Because of the vulnerability of farm and ranch operations to the effects of adverse weather, disease, pests, and other natural calamities, and because of the potential for low prices in years of high production levels, farmers and ranchers have historically been afforded special treatment as debtors. Thus, farmers may not be forced into bankruptcy involuntarily;[43] in a few states, they may be eligible for moratoria or continuances on farm mortgage foreclosures,[44] and in some states they may hold substantially more property exempt from execution than most other types of debtors.[45]

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42. Another justification for the special rule has been that farmers sell to buyers sophisticated enough to know that the seller may have granted a security interest. *See* Clark, *supra* note 39, at 112. This reasoning may be convincing compared to purchasers of consumer goods, but it is hardly convincing compared to other commercial transactions.

43. 11 U.S.C. § 303(a). *See* 13 N. HARL, *supra* note 14, § 120.02 [11].

44. *See* IOWA CODE § 654.15 (1950). Section 654.15 provides:

> [O]wners may apply for a continuance of the foreclosure action when and where the default or inability of such party or parties to pay or perform is mainly due or brought about by reason of drought, flood, heat, hail, storm, or other climatic conditions or by reason of the infestation of pests which affect the land in controversy, or when the governor of the state of Iowa by reason of a depression shall have by proclamation declared a state of emergency to exist within this state. . . .

Id. Section 654.15 was recently invoked by the Iowa District Court for Lucas County, Iowa because of two years of inclement weather. *See* Mutual Life Ins. Co. of N.Y. v. Zahrobsky, No. 21135 (Lucas County Dist. Ct., Iowa, Mar. 13, 1984).

The present Iowa statute providing for a moratorium or continuance on real estate mortgage foreclosures is the fourth such statute in that state. The first enactment, chapter 182 of the 1933 Iowa Acts, was held constitutional in *Des Moines Joint Stock Land Bank v. Nordholm*. *See* Des Moines Joint Stock Land Bank v. Nordholm, 217 Iowa 1319, 253 N.W. 701 (1934) (an emergency was considered to exist at that time). The second enactment was chapter 115 of the 1935 Iowa Acts. The third enactment, chapter 80 of the 1937 Iowa Acts, was held unconstitutional in *First-Trust Joint Stock Land Bank v. Arp*. *See* First-Trust Joint Stock Land Bank v. Arp, 225 Iowa 1331, 283 N.W. 441 (1939) (emergency no longer deemed to exist). The current statute, § 654.15 of the Iowa Code, was enacted as chapter 245 of the 1939 Iowa Acts. *See* IOWA CODE § 654.15 (1950). *See also* Home Building & Loan Ass'n v. Blaisdell, 290 U.S. 398 (1934) (mortgage moratoria applicable in time of economic emergency not unconstitutional). *See* Case Comment, When Does an Emergency End?, 24 IOWA L. REV. 607 (1939) (discussion of *First-Trust Joint Stock Land Bank v. Arp*).

45. *See* IOWA CODE § 627.6 (1950). Section 627.6 provides:

> A debtor who is a resident of this state may hold exempt from execution the following property:
>
> . . . .
>
> 6. Two cows and two calves.
>
> 7. Fifty sheep and the wool therefrom and the materials manufactured from such wool.
>
> 8. Six stands of bees.
>
> 9. Five hogs and all pigs under six months.
>
> 10. The necessary food for all animals exempt from execution for six months.
>
> . . . .
>
> 20. Poultry to the value of fifty dollars. . . .

Id.

The special treatment accorded farmers and ranchers poses two important policy issues. The first is whether justification continues to exist for the special treatment.[46] To maintain a unique set of rules governing farm debtors will require continuing political support by the nonfarm population. In order to merit that support, it will be necessary for agriculture to demonstrate that the lending structure applicable to agriculture is responsibly conceived with long-term results in the public interest.

The other policy issue involves the impact of special treatment on the cost and availability of credit to farmers and ranchers. If a moratorium can be invoked, for example, lenders would be expected to make less credit available or to make credit available on less favorable terms for those most likely to be eligible for a moratorium. The result may be to disadvantage those in greatest need of financial assistance. Special treatment does not come without a price. The necessity for research to determine the effects of the capital lending structure on lenders, on borrowers, and on the structure of agriculture is thus apparent.

On the other hand, farm policy for the past half century has tended to provide relief for farmers under financial distress when the distress was attributable to factors not within the farmers' control, such as prices and weather.[47] Moratoria or continuances are within the spirit of that policy if limited to extreme cases of economic distress not attributable to management decisions made by the farmer.[48] Attention should be given to developing a program that would shift the costs to the general public in the manner of various other provisions affording relief to those in financial distress for reasons attributable to factors other than poor management decisions by the individual. A federal loan guaranty program has been proposed. This program would provide for a stretch-out in principal repayment period, partial or total waiver of interest or principal or both for up to three years, a give-up by creditors of up to twenty percent of the amount owed as the price for obtaining the loan guaranty and to help fund the program, but with no forgiveness of amounts owed by borrowers.[49]

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46. *See* Harl, *The Future of Government Regulation of Agriculture: Implications of Tax Policy for Agriculture*, 3 N. ILL. L. REV. 279, 298 (1983).

47. *See, e.g.*, 7 U.S.C. § 1961 (1982) (emergency loans for natural disasters "or emergency designated by the President under the Disaster Relief Act of 1974").

48. See *supra* note 44.

49. H.R. 5854, 98th Cong., 2d Sess. (1984). *See* N. Harl, Restructing Debt in Agriculture (June 27, 1984) (available at Dep't of Economics, Iowa State University, Ames, Iowa).

IV. CONCLUSION

Credit plays a significant role in a modern farm or ranch business.[50] Capital availability affects the productivity of other inputs. Contractions in capital availability can inflict substantial economic damage that farmers and the rest of society may feel for years to come. It is this pervasive economic influence that sets credit apart from other inputs used in the production process.

Stability in lending patterns, both in times of prosperity and in times of economic distress, are important to the long run vitality of farm and ranch operations. Forced adjustments made in haste may impair the economic viability of the operation and damage the confidence of the borrower and the lending relationship.

This Symposium makes a major contribution toward fine tuning the legal framework within which lending activity takes place and defaults are resolved. The evaluation of the efficacy of the institutional system is properly a continuous process as needs and circumstances change. The time has come for work to commence on development of a more comprehensive set of rules governing agricultural lending.

50. For a general discussion of the role of credit in farm and ranch business, *see* N. HARL, *supra* note 6, ch. 1.