Farm Credit Amendments Act of 1985: Congressional Intent, FCA Implementation, and Courts' Interpretation (And the Effect of Subsequent Legislation on the 1985 Act)

by

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STUDENT PAPERS

FARM CREDIT AMENDMENTS ACT OF 1985: CONGRESSIONAL INTENT, FCA IMPLEMENTATION, AND COURTS' INTERPRETATION (AND THE EFFECT OF SUBSEQUENT LEGISLATION ON THE 1985 ACT)*

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I. INTRODUCTION

The first part of this paper discusses the Farm Credit Amendments Act of 1985 [hereinafter referred to as the Act].[1] The paper reviews the implementation of the Act by the Farm Credit Administration [hereinafter abbreviated as FCA][2] and interpretations of the Act and the FCA's rules by the courts.[3] The analysis determines if the FCA's implementation and the courts' interpretations of the Act are consistent with congressional intent. The first part of the paper closes with questions and answers which provide some practical guidance for attorneys who represent either borrowers or lenders.

Subsequent to the passage of the 1985 Act, Congress twice amended the 1971 Act. A supplement to this paper discusses *some* of the aspects of recent

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1. 12 U.S.C. §§ 2001-2276 (1982 & Supp. III 1985).

2. This paper will discuss the Farm Credit Administration's [hereinafter FCA] implementation of the 1985 Amendments Act as published in the *Federal Register* [hereinafter FED. REG.].

3. As of the date the author began writing this paper there had been four significant cases decided involving the interpretation of the 1985 Amendments Act [hereinafter the Act]: Bailey v. Federal Intermediate Credit Bank, 788 F.2d 498 (8th Cir. 1986); Federal Land Bank v. Farm Credit Admin., 676 F. Supp. 1239 (D. Mass. 1987); Sikeston Prod. Credit Ass'n v. Farm Credit Admin., 647 F. Supp. 1155 (E.D. Mo. 1986), and Aberdeen Prod. Credit Ass'n v. Jarrett Ranches, Inc., 638 F. Supp. 534 (D.S.D. 1986).

post-1985 amendments. Also, footnotes in the first part update some of the changes made by the 1987 Act, especially relative to reorganization of the Farm Credit System.

II. The Farm Credit System

The modern Farm Credit System [hereinafter FCS] is a system of borrower owned, federally chartered banks and associations that operate on a cooperative basis.[4] The FCS serves the credit needs of farmers, ranchers, and aquatic producers and harvesters.[5] Three types of lending entities comprise the FCS: (1) the federal land banks and the local federal land bank associations, (2) the federal intermediate credit banks and the local production credit associations, and (3) the banks for cooperatives.[6]

The FCA, an executive branch agency, regulates the FCS.[7] There are twelve farm credit districts in the United States with a federal land bank, federal intermediate credit bank, and a bank for cooperatives in each district.[8] A seven-member district farm credit board operates the district banks.[9] The Governor of the FCA appoints one member of the board of directors and the other six are elected—two each by the federal land bank associations, the production credit associations, and the cooperatives that borrow from the FCS cooperative banks.[10]

A. *Federal Land Banks and Land Bank Associations*

The federal land banks make first mortgage loans through 505 local federal land bank associations.[11] The loans are secured by first liens on borrowers' interests in real estate[12] with repayment periods of five to forty years.[13] The loans must be used for purchasing farmland, refinancing mortgages, paying other debts, purchasing equipment and livestock, and constructing and repairing buildings.[14] The land banks also may make loans to rural homeowners and persons furnishing farm-related services to farmers and ranchers.[15]

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4. H.R. Rep. No. 1287, 96th Cong., 2d Sess., *reprinted in* 1980 U.S. Code Cong. & Admin. News 7095, 7098 [hereinafter cited as H.R. Rep. No. 1287].
5. *Id.*
6. *Id.*
7. *Id.*
8. *Id.*
9. *Id.*
10. *Id.*
11. *Id.*
12. *Id.* at 7099.
13. *Id.* at 7098.
14. *Id.* at 7099.
15. *Id.*

B. *Federal Intermediate Credit Banks and Production Credit Associations*

The production credit associations [hereinafter abbreviated as PCA] receive funds from the federal intermediate credit banks.[16] With these funds, the PCAs make loans to eligible farmers, ranchers, and fishermen for operating and capital credit needs.[17] The PCAs also make loans to persons furnishing farm-related services to farmers and ranchers, and to rural homeowners.[18] The federal intermediate banks discount notes representing agriculture-related loans made by other financial institutions.[19]

C. *Banks for Cooperatives*

Cooperative banks extend credit to eligible cooperatives.[20] Eligible cooperatives include associations of farmers, ranchers, or aquatic producers or harvesters, or federations of such associations.[21] The cooperative banks make loans for construction, remodeling or expanding of facilities, and current or seasonal operating expenses.[22] The banks for cooperatives provide a vehicle for member banks to accept loan applications for large risks.[23] The Central Bank for Cooperatives participates with district banks to spread the risk of large loans throughout the FCS.[24]

The preceding is a fundamental review of the organization and operation of the FCS. The operation and organization of the Farm Credit System has evolved over the years by amendments and reenactments of various farm credit programs and acts. (The organization of the FCS was changed substantially by the 1987 Agricultural Credit Act; *see* Appendix.)

III. Background

The Farm Credit System was developed by Congress between 1916 and 1935[25] in response to "high interest rates, short repayment periods and aggressive foreclosure policies."[26] The Federal Farm Loan Act of 1916[27] established the Federal Farm Loan Board which divided the country into twelve districts with a federal land bank in each district.[28] The function of the fed-

16. *Id.*
17. *Id.*
18. *Id.*
19. *Id.*
20. *Id.*
21. *Id.*
22. *Id.*
23. *Id.*
24. *Id*
25. 11 N. Harl, Agricultural Law § 100.01[1] (1986) [hereinafter N. Harl].
26. *Id.* at § 100.01[2].
27. Pub. L. No. 64-158, 39 Stat. 360 (1916).
28. N. Harl, *supra* note 25, at § 100.01[2].

eral land banks was to provide real estate loans to farmers.[29] The Agricultural Credits Act of 1923[30] established twelve intermediate federally funded credit banks that served as a conduit to pass funds to individual farmers by financing and discounting the paper of agricultural credit organizations, commercial banks, savings institutions, and cooperatives.[31] Disuse of the intermediate credit banks by the private banking sector caused Congress to enact the Farm Credit Act of 1933[32] [hereinafter 1933 Act] after the President had created the Farm Credit Administration.[33]

Using federal funds, the 1933 Act made short-term credit available to farmers for farming operations.[34] Local production credit associations and corporations were established to provide the loans.[35] Through stock purchases, the original federal funds were repaid and the Farm Credit System became fully member-owned in 1968.[36] In the late 1960s Congress began to rewrite the Farm Credit Acts of 1933 and 1953.[37]

A. *The Farm Credit Act of 1971*

The Farm Credit Act of 1971 [hereinafter 1971 Act]:[38]

> represents a complete rewriting of the farm credit laws and a fundamental reworking of the statutory basis for the farm credit system. In connection with such reworking of the material, the existing statutory provisions covering this area were repealed and their substance revised, reenacted and expanded by Pub. L. 92-181.[39]

The objective of the 1971 Act was to:

> encourage farmer- and rancher-borrowers, participation in the management, control and ownership of a permanent system of credit for agriculture which will be responsive to the credit needs of all types of agricultural producers having a basis for credit, and to modernize and improve the authorizations and means for furnishing such credit . . . .[40]

This objective was manifested by several major changes.

Under Title I, the federal land banks and associations were given permission to merge voluntarily.[41] The 1971 Act also provided for variable in-

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29. 2 J. DAVIDSON, AGRICULTURAL LAW § 10.01 (1981) [hereinafter J. DAVIDSON].
30. Pub. L. No. 67-503, 42 Stat. 1454 (1923).
31. N. HARL, *supra* note 25, at § 100.01[2].
32. Pub. L. No. 73-10, 48 Stat. 31 (1933).
33. Exec. Order No. 6084, March 27, 1933.
34. N. HARL, *supra* note 25, at § 100.01[2].
35. *Id.*
36. *Id.* at n.14.
37. Pub. L. No. 83-202, 67 Stat. 390 (1953).
38. Farm Credit Act of 1971, 12 U.S.C. §§ 2001-2259 (1982).
39. N. HARL, *supra* note 25, at § 100.01[1].
40. 12 U.S.C. §§ 2001-2259 (1982).
41. *Id.* at § 2104.

terest rates and allowed for reasonable charges for services rendered to borrowers.[42] To broaden borrower eligibility, the 1971 Act raised the available credit limit from 65% to 85% of the appraised normal value of a farm.[43] Further, the banks and associations were allowed to take title to equipment (other than on default of the borrower), thus allowing them to enter into leasing arrangements to serve their borrowers.[44]

The federal land bank associations were allowed to strengthen their capitalization by requiring that borrowers purchase stock equal to between 5% and 10% of the loan.[45] The banks and associations also were given authority to issue additional classes of stock with differing voting rights and dividend payments.[46]

The 1971 Act enacted provisions for the federal intermediate banks and PCAs similar to those enacted for the federal land banks and associations. Under Title II of the act, the federal intermediate banks and PCAs also were allowed to issue differing classes of stock to non-borrowers.[47] Further, the federal intermediate banks were allowed to participate with the PCAs in direct loans.[48] Previously, the federal intermediate banks were allowed only to discount PCA paper.[49] Along with giving FCS lenders more extensive authority and increasing the number of potential eligible borrowers, Congress made provisions allowing the federal intermediate banks to distribute a portion of their net earnings to contingency reserve accounts.[50] This amended the formula for earnings distribution and was enacted to provide the federal intermediate banks with a better ability to meet unanticipated expenses that might arise from their broadened authority.[51]

Congress made several major changes for cooperative banks under the 1971 Act. The major changes were geared toward encouraging greater private investment in the banks and strengthening their capital base. Accordingly, the banks were allowed to issue non-voting stock with the option to exchange it for voting stock in an eligible association.[52] Also, the 4% limit on dividends on non-voting stock was removed.[53] This was a significant change, because it encouraged those other than borrowers to invest while preserving the voting control of current member-borrowers. However, the

42. *Id.*
43. *Id.* at § 2105.
44. *Id.*
45. *Id.* at § 2106.
46. *Id.* at § 2107.
47. *Id.* at § 2108.
48. *Id.*
49. *Id.*
50. *Id.*
51. *Id.*
52. *Id.* at § 2111.
53. *Id.*

1971 Act required that borrowers own 80% of the voting stock.[54]

Title IV of the 1971 Act also provided guidelines for the services to be provided to borrowers. These services included "prompt and reasoned action and notice and reason for action on applications."[55] Also, if a borrower was dissatisfied with action taken on his application, the 1971 Act gave the borrower the right to an informal hearing before an officer authorized to act on his loan.[56]

Thus, the thrust of the 1971 Act was two-pronged. First, the 1971 Act intended to increase the authority of the banks and other lenders in the FCS to make larger loans to a greater number of borrowers for more purposes. As this would increase the capital requirements of the FCS's lenders, they were also given authority to increase their capital bases. Indeed, recognizing the potentially large need for more capital, the 1971 Act mandated that Agricultural Marketing Act[57] funds be preserved for use by the Governor of the FCA for the purchase of stock in the FCS's banks.[58]

B. *The Farm Credit Act of 1980*

The Farm Credit Acts Amendment of 1980[59] [hereinafter referred to as the 1980 Act] was a congressional effort to further achievement of the goals of the 1971 Act. The stated purpose of the 1980 Act was to "permit Farm Credit System institutions to improve their services to borrowers."[60] Specifically, the 1980 Act sought to increase the ability of the FCS to loan money to eligible borrowers.[61]

A major change produced by the 1980 Act allowed federal land banks,[62] federal intermediate banks,[63] PCAs[64] and cooperative banks to sell interests in loans to lenders not members of the FCS. This increased the available amount of funds for lending. This modification required several ancillary amendments.

The 1980 Act increased the amount individuals may borrow. This was done by increasing to 97% the ceiling that the appraised value of the real estate collateral bears to the amount of the loan, if the loan is guaranteed by federal, state, or other governmental agencies and approved by the FCA.[65] The 1980 Act also did not require that the borrower purchase association

54. *Id.* at § 2112.
55. *Id.* at § 2116.
56. *Id.*
57. Pub. L. No. 87-494, 76 Stat. 109 (1962).
58. 12 U.S.C. § 2114 (1982).
59. Pub. L. No. 96-592, 94 Stat. 3437 (1980).
60. H.R. REP. No. 1287, *supra* note 4, at 7095.
61. *Id.*
62. *Id.* at 7110.
63. *Id.* at 7115.
64. *Id.*
65. *Id.* at 7111.

stock for that portion of the loan held by a lender not a member of the FCS.[66]

The 1980 Act also made a major change when it specified that "loans for basic processing and marketing directly related to the applicant's operations" are valid purposes for loans by FCS members if the applicant's operation provides at least 20% of the total processing.[67] Prior to the 1980 Act, the applicant had to provide 50% of the total processing.[68] The impact of this was to increase the number of potential borrowers.

The 1980 Act expanded the pool of lender-users of its services when it allowed the federal intermediate banks to lend to and discount the paper of lenders not members of the FCS.[69] Such non-member lenders were required to: be significantly involved in lending for agricultural or aquatic purposes; demonstrate a continuing need to meet the credit requirements of their borrowers; have limited access to capital markets; and refrain from using such services to provide themselves with a capital base to expand lending in non-agricultural areas.[70] The impact of the amendment was to increase the capital available for loans for agricultural purposes.

The 1980 Act made two major changes relative to cooperative banks. The first change authorized cooperative banks to make loans to foreign or domestic parties for transactions by such parties for the import or export of agricultural or aquatic commodities or farm supplies.[71] Such loans could not be made for speculative futures transactions in foreign currencies.[72] Congress assumed that most of such loans would be used for interim financing of foreign purchasers.[73]

Another change was that cooperative banks were allowed to make loans to cooperatives whose voting control was held, to the extent of 60% or more, by farmers, producers, or harvesters of aquatic products.[74] This figure had formerly been 80%, but was reduced because of the diminishing number of farmer-members in coops.[75]

The 1980 Act also made miscellaneous changes. Young, beginning, and small farmers and ranchers were targeted for assistance. Each federal land bank association and PCA was required to prepare programs for providing credit services to such persons.[76] Also permitted was the sale of insurance by

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66. *Id.* at 7113.
67. *Id.* at 7112.
68. *Id.*
69. *Id.* at 7115.
70. *Id.*
71. *Id.* at 7121.
72. *Id.*
73. *Id.* at 7122.
74. *Id.* at 7123.
75. *Id.*
76. *Id.* at 7125.

FCS institutions.[77] However, FCS institutions were prohibited from underwriting insurance programs for borrowers, and all FCS lenders underwriting insurance had to cease such activities within one year of the enactment of the amendment.[78]

The result of the changes was to increase the number of potential borrowers and lenders, increase the capital base of the lenders and channel the use of the lenders' assets into activities directly related to extending credit. This exacerbated the latent conditions that made the 1985 Amendments Act necessary. As the 1971 and 1980 Acts expanded the group of potential borrowers and lenders, they created the potential for any financial crisis to be of greater severity and magnitude. More borrowers and lenders would be involved, and concomitantly there would be much larger sums of money loaned and subject to default.

IV. Legislative History of the 1985 Amendments Act

The total amount of farm debt as of September 30, 1985, was $210 billion.[79] Of this amount, the FCS had about $73 billion in outstanding loans to 965,000 ranchers and farmers and 3,200 agricultural and rural utility cooperatives.[80] The federal land banks carried approximately $29 billion of the debt and the PCAs about $16 billion.[81] The 1971 Act and 1980 Amendments allowed FCS borrowers to secure larger loans by using for collateral a larger percentage of the appraised value of the borrowed farm assets.[82] As the larger portion of farm assets is land and equipment, falling land prices in the early eighties decreased total farm assets, and concomitantly lenders' collateral, by $150 billion.[83] In 1985 a special study of federal land banks found that they held $6 billion in loans on which the face amount of the loan was in excess of the collateral.[84] There were several causes of this situation.

The farm credit crisis had its origins in the early 1970s.[85] Producers based business decisions on three factors: (1) continued inflation, (2) rising land values, and (3) strong export growth.[86] These three economic assump-

77. *Id.* at 7127.
78. *Id.*
79. H.R. Rep. No. 1287, *supra* note 4, at 2593.
80. *Id.*
81. *Id.*
82. *See supra* note 43 and accompanying text.
83. H.R. Rep. No. 1287, *supra* note 4, at 2593.
84. *Id.*
85. *Farm Debt: Hearings Before the Subcomm. on Financial Institutions Supervision, Regulation and Insurance of the House Comm. on Banking, Finance and Urban Affairs*, 99th Cong., 1st Sess. 84 (1985) [hereinafter *Farm Debt*] (statement of Jonathan L. Fiechter, Director for Economics and Policy Analysis, Office of the Comptroller of the Currency).
86. *Id.*

tions caused farm debt to double between 1976 and 1981.[87] Though farmers' net incomes were not increasing at a rate high enough to justify large capital expenditures, they were able to leverage their capital gains in land to finance expansion of their operations.[88] A sudden decline in inflation and exports, coupled with rising interest rates, increased producers' production costs and caused a severe decline in land values.[89]

The precipitous drop in inflation and exports, and the resultant drop in land values, impacted different segments of the farm economy.[90] The midwestern and central states suffered more than other regions of the country, because they produced many export crops such as corn, soybeans, cotton, and wheat.[91] Midsized[92] farms also suffered disproportionately for though they comprised only 30% of all farms, they accounted for 64% of all farm debt.[93] Large farms[94] continued to have the earnings and resources necessary to weather the storm.[95]

Not surprisingly, liquidations, foreclosures and bankruptcies increased as the debt/asset ratio increased. For all sales size categories of borrowers with debt/asset ratios over 70% there was an overall cash shortfall to repay debts.[96] Borrowers with debt/asset ratios between 40% and 70% had a cash shortfall in all sales size categories except for the $250,000 to $499,000 and over $500,000 categories.[97] Those borrowers with a debt/asset ratio of less than 40% had a cash surplus in all categories except the four sales categories below $100,000.[98]

Any optimism that could be evoked by the above ratios was dispelled by the fact that the 40% to 100% debt/asset ratio categories, along with those borrowers classified as technically insolvent, accounted for 66% of all farm debt in 1985, up from 46.3% in 1984.[99] Other farm financial indicators showed similar ominous changes. Farm assets had decreased to $322.9 bil-

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87. *Id.*

88. *Id.* at 85.

89. *Id.* at 86.

90. *Id.* at 87.

91. *Id.*

92. The USDA classifies farms with annual sales of between $50,000 and $500,000 as midsized farms. *Id.*

93. *Id.*

94. The USDA classifies farms with annual sales of over $500,000 as large farms. *Id.*

95. *Id.*

96. USDA, Agricultural Information Bulletin No. 490.

97. *Id.*

98. *Id.*

99. *Reauthorization of the Agricultural and Food Act of 1981: Hearings Before the Senate Comm. on Agriculture, Nutrition, and Forestry*, 99th Cong., 1st Sess. 838, Table 5 (1985) [hereinafter *Reauthorization of Food Act*] (statement of Melvin Todd, Jr., Member, Board of Directors of the Farm Credit Council and Member, Board of Directors of the Farm Credit Banks of Omaha).

lion in 1985 from $407.3 billion in 1980.[100] The number of highly leveraged farmers increased dramatically to 624,000 in 1985 from 363,000 in 1984.[101] Not only had farm assets decreased and debt/asset ratios worsened because of the decrease in assets, but farm income decreased 32.5% to $6.75 billion from $10 billion between 1984 and 1985.[102]

The combination of all of the above factors made the crisis severe. Farmers had less income to service current debts and thus had to borrow to make payments on old debts at a time when interest rates were double digit and their assets and income were decreasing rapidly.[103] With less collateral available for loans,[104] defaults increased.[105]

The increase in defaults had a ripple effect on the FCS and commercial agriculture lenders. What is more, in 1984 the FCS sold $104 billion of its consolidated date securities to investors.[106] Thus, the ripple effect of a collapse of the FCS would extend well beyond the farm sector of the economy.

Three of the FCS's major lenders, the Federal Land Bank, the federal intermediate banks and the PCAs, held nonperforming debt amounts of $4 billion, $2.2 billion and $2.4 billion, respectively.[107] Commercial agricultural banks[108] had a higher percentage of their loans in past due status than nonagricultural banks.[109] The agricultural banks also had lower loan to asset ratios than nonagricultural banks.[110] Thus, the FCS could not depend on help from the commercial agricultural banking sector for relief from the

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100. *Id.* at 837, Table 3.

101. *Id.*, Table 4.

102. *Id.* at 836, Table 1.

103. *Views of Budget Proposals for Fiscal Year 1986: Hearings Before the House Comm. on the Budget*, 99th Cong., 1st Sess. 232 (1985) [hereinafter *Budget*], (statement of Honorable John R. Block, Secretary of the Dep't of Agriculture).

104. *Id.*

105. There are different statistics on this. The reason the statistics vary is because some loans carried as past due should be classified as in default. As different lenders have different management practices, one lender may carry a loan that another lender would consider to be in default. *See Farm Credit Problems and Their Impact on Agricultural Banks: Hearings Before the Subcomm. on Small Business: Family Farm of the Senate Comm. on Small Business*, 99th Cong., 1st Sess. 80-97 (statements of Ray Moss Tucker and John Harling on behalf of the Farm Credit Council) and *Agriculture, Rural Development and Related Agencies Appropriations*, 99th Cong., 1st Sess. 849 & 855 (1985) [hereinafter *House Agric. Rural Development Hearings*, Donald Wilkinson] (testimony of Donald E. Wilkinson, Governor of FCA).

106. *Reauthorization of Food Act, supra* note 99, at 366 (statement of Honorable Donald E. Wilkinson, Governor of FCA).

107. *Id.* at 365.

108. An agricultural bank is defined as a bank in which agricultural loans comprise 25% or more of the bank's total loan portfolio. *See Farm Credit Problems and their Impact on Agricultural Banks: Hearings Before the Subcomm. on Small Business: Family Farm of the Senate Comm. on Small Business*, 99th Cong., 1st Sess. 47 (1985) [hereinafter *Farm Credit Problems*] (statement of Charles Thacker, Associate Director, Division of Bank Supervision, FDIC).

109. *Id.* at 27.

110. *Id.*

credit crisis.[111] Commercial agricultural bank failures had increased to twenty in 1984 from six in 1983.[112]

The status of the Federal Land Bank's loan portfolios was deteriorating. Though the federal land banks had fewer loans outstanding in September 1984, than in March 1984, the outstanding amount of money loaned had increased.[113] The most alarming changes were in the number of: bankruptcies (to 1,798 in September 1984 from 834 in March 1984); foreclosures (to 2,413 in September 1984 from 705 in March 1984); loans in process of liquidation (to 3,943 in September 1984 from 3,293 in March 1984); and acquired property (to 1,157 in September 1984 from 759 in March 1984).[114]

The financial situation of the PCAs was worse.[115] The number of delinquencies decreased, but the total dollar amount of delinquent loans did not decrease proportionately.[116] The PCAs also experienced worsening changes in the number of: bankruptcies (to 1,102 in September 1984 from 417 in March 1984); foreclosures (to 495 in September 1984 from 221 in March 1984); loans in process of liquidation (to 5,461 in September 1984 from 4,932 in March 1984); loans charged off (to 2,069 in September 1984 from 461 in March 1984) and acquired property (to 770 in September 1984 from 703 in March 1984—but the dollar amount increased to $170,076 from $153,710).[117]

Though the preceding numbers show the real story of the farm credit crisis, the real tragedy of the crisis was the havoc it wrought on individuals and families. The farm credit crisis tore at the social fabric of rural America. Suicides and incidents of domestic turmoil increased.[118]

It was against the background of a credit system and rural society collapsing that many witnesses representing diverse interest groups testified. Some witnesses testified as to the impact of the farm credit crisis on them-

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111. *Id.* at 9-13.

112. *Id.* at 19, Table 2 (statement of Lynn Nejezchleb, Financial Economist, FDIC).

113. *House Agric. Rural Development Hearing*, Donald Wilkinson, *supra* note 105, at 854, appendix A.

114. *Id.*

115. From September 1983 to November 1984, eleven PCAs failed and during the first eleven months of 1984, thirty-nine PCAs were merged with stronger PCAs. The PCAs had a total of $2.4 billion in non-performing loans out of a total loan portfolio of $18.4 billion. Compare this with the federal land banks that had a total of $4 billion in non-performing loans out of a total loan portfolio of $52.3 billion. *See Reauthorization of Food Act*, *supra* note 99, at 365 (statement of Donald Wilkinson).

116. *House Agric. Rural Development Hearings*, Donald Wilkinson, *supra* note 105, at 855, appendix A.

117. *Id.*

118. "A Kansas study found that 7 out of the 10 Kansas counties with the highest divorce rates were rural; 9 of the top 10 counties with confirmed cases of child abuse were rural . . . . In Missouri, the suicide rate for farmers was higher than for any other single occupation. The 10 Kansas counties with the highest suicide rate in 1980 were rural." *Reauthorization of Food Act*, *supra* note 99, at 454 (statement of Kenneth Wittrock, representing the Lutheran Council in the U.S.A.).

selves or their communities. Many presented solutions or programs that they wanted Congress to implement.

Frank Naylor of the USDA recommended that the FmHA move away from direct lending activities and instead become a guarantor of the loans of commercial and FCS lenders.[119] Dale Lockner of the Ohio Department of Agriculture requested that the Industrial Development Bond Program's funding be continued at increased levels as Ohio used the bonds to fund a state agricultural bond program.[120] Mr. Lockner also requested that the FmHA and FCS lenders review their loan approval standards to reduce the number of loan application declinations.[121]

Many bankers who testified expressed concern that Congress was considering reorganizing the FLBs and PCAs under one federal authority. Such a reorganization would make it difficult for commercial banks to work with the FCS in financing long-term loans.[122] The American Bankers Association also supported the establishment of a secondary mortgage market for agricultural loans.[123]

Melvin Todd, Jr. of Omaha, Nebraska suggested the formation of an Agricultural Conservation Corporation [hereinafter abbreviated as ACC].[124] The ACC would purchase real property from "financially distressed farmers" and inventoried properties from lenders.[125] This would allow lenders more money to restructure farm loans.[126] However, the ACC would not extend credit.[127] The proposed ACC would provide hard pressed farmers with a market for their land and equipment.[128] This market was depressed because of the large supply of such property for sale.[129] To give distressed farmers an opportunity to continue farming, they would be allowed right of first rental.[130] One benefit of an ACC to the FCS would be that the PCAs could reduce their interest rates.[131] By reducing their interest rates, PCAs would become more competitive and attract a financially stronger clien-

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119. *Id.* at 356 (statement of Honorable Frank W. Naylor, Under Secretary for Small Community and Rural Development, USDA).

120. *Id.* at 369 (statement of Dale L. Lockner, Director, Ohio Dep't of Agriculture).

121. *Id.* at 370-71.

122. *Id.* at 374 (statement of Alan R. Tubbs, Chairman, Agricultural Bankers Division Executive Comm., and President, First Central State Bank, DeWitt, Iowa, representing American Bankers Association).

123. *Id.* The idea behind this recommendation was to increase competition in the long-term agriculture loan market by increasing the number of lenders.

124. *Id.* at 380 (statement of Melvin Todd, Jr.).

125. *Id.*

126. *Id.*

127. *Id.*

128. *Id.*

129. *Id.*

130. *Id.*

131. *House Agric. Rural Development Hearings*, Donald Wilkinson, *supra* note 105, at 741.

tele.[132] This would improve the financial strength of the PCAs.[133]

Several witnesses had recommended that Congress allow the issuance of net worth certificates by FCS and commercial lenders.[134] However, the Federal Deposit Insurance Corporation [hereinafter abbreviated as FDIC] opposed the issuance of net worth certificates,[135] because: (1) the losses of farm banks are the result of loan losses caused by the inability to collect principal and not losses caused by low yields on loans; (2) the banks that would receive net worth certificates are stockholder owned and this would be a subsidy to stock investors who should take risks; and (3) they would assist banks on the brink of insolvency and thus reward incompetence.[136]

Other witnesses emphasized that the FCS and commercial lenders would have to re-examine loan portfolios to determine if loans should be recalled.[137] The Office of the Comptroller of the Currency recommended that all bank examiners review loan portfolios and reclassify them based on their prospects for timely repayment.[138] The Comptroller's office was careful to state that reclassification of credit in a loan portfolio should not be viewed as a request for foreclosure.[139] The most extensive testimony was given by Donald Wilkinson, Governor of the FCA. Mr. Wilkinson made several recommendations. Wilkinson testified that many of the FCS's problems were caused by the FCA's lack of regulatory authority.[140] To correct this problem Wilkinson requested that the FCA be given regulatory powers similar to other federal regulatory agencies such as the Federal Reserve Board.[141] Such powers would give the FCA local control over management decisions to correct abnormal or risky situations without facing legal action by association stockholders or directors.[142] These powers would be intermediary in that they would allow the FCA to take action before damage occurred.[143]

An increase in the FCA's enforcement powers would allow the FCA to

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132. *Reauthorization of Food Act*, *supra* note 99, at 380 (statement of Melvin Todd, Jr.) and *Reauthorization of Food Act*, *supra* note 99, at 386 (statement of Gene Swackhamer, President, Farm Credit Banks of Baltimore, Representing the Farm Credit Council).

133. *Id.*

134. *Id.* at 374-75 (statement of Alan Tubbs) (net worth certificates would be issued to stockholder banks to compensate for low returns caused by loan defaults; the certificates would increase a lender's unallocated retained earnings so that it could give stockholders assurance).

135. *Farm Debt*, *supra* note 85, at 183 (statement of A. David Meadows, Assoc. Director, Div. of Bank Supervision, FDIC).

136. *Id.* at 183-84.

137. *Id.* at 92 (statement of Jonathan L. Fiechter).

138. *Id.*

139. *Id.* at 93.

140. *Reauthorization of Food Act*, *supra* note 99, at 819 (statement of Donald Wilkinson).

141. *Id.*

142. *Id.*

143. *Id.*

command mergers, consolidations and realignment of territories.[144] The goal of strengthening FCA authority would be to consolidate its capital base, "while preserving the decentralization of credit service delivery."[145] A more important goal of such an increase in FCA enforcement powers would be to inject more discipline into the system.[146]

Wilkinson also testified that the FCA favored the development of an ACC.[147] Such an organization would take excess agricultural land off the market.[148] The ACC would hold the land until land prices stabilized.[149] While holding such land, the ACC could lease it to farmers or conserve it.[150] Some of the land that would be held by the ACC could be put to less erosive uses.[151] Many of the FCA's recommendations would become part of the 1985 Act.

V. Congressional Intent and Goals

Congress had four major objectives in passing the 1985 Act. The 1985 Act would:

> I. Give the Farm Credit System broader authority to use its own resources to shore up weak system units.
> II. Reshape the Farm Credit Administration, an independent federal agency, to make it a stronger, arm's-length regulator of the system.
> III. Provide new protection for System borrowers.
> IV. Provide that if the Farm Credit Administration certifies that if the System needs financial aid and has made the maximum practicable effort to deal with financial stress, the Secretary of the Treasury would have discretionary power to backstop the System's finances by purchasing obligations of a System unit called the Farm Credit System Capital Corporation.[152]

A. *System Self-Help*

To institute FCS self-help, Congress created the Farm Credit System Capital Corporation [hereinafter abbreviated as FCSCC].[153] The purpose of the FCSCC is to: (1) use stock purchases, loans, or contributions made in accordance with FCA regulations to provide aid to FCS institutions; (2) buy

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144. *Id.* at 821.
145. *Id.*
146. *Id.*
147. *Id.*
148. *Id.*
149. *Id.*
150. *Id.*
151. *Id.*
152. H.R. Rep. No. 425, 99th Cong., 1st Sess. *reprinted in* 1985 U.S. Code Cong. & Admin. News 2587 [hereinafter H.R. Rep. No. 425].
153. *Id.* at 2588.

and sell acquired properties from FCS entities and restructure, hold, guarantee, refinance, administer or liquidate the loans such properties underlie; (3) assist or participate with individual FCS lending institutions in restructuring, refinancing, guaranteeing or holding at the local level nonperforming loans; (4) receive and administer aid coming from outside the FCS.[154] The FCSCC also may require a troubled FCS lender to sell nonperforming loans to it before it will provide assistance to the lender.[155]

The FCSCC is financed by required stock purchases by FCS members whose financial strength allows them to make such purchases.[156] A secondary source of FCSCC funding is by the sale of obligations to the Secretary of the Treasury.[157]

B. *Stronger Independent Regulation*

Stronger independent regulation is a euphemism for greater control of the FCS by the FCA. A review of the new powers and responsibilities of the FCA confirms this statement. Examinations of FCS member institutions are now conducted by the FCA instead of individual FCS members.[158] Each FCS member must now publish independently audited annual financial reports.[159]

To enforce its new powers, the FCA may issue cease and desist orders to FCS institutions if it finds them engaging in any "unsafe or unsound practices *or violating FCA regulations.*"[160] The FCA also may set minimum capital levels through agency regulations for FCS members.[161] Furthermore, the FCA may appoint a conservator or receiver not only for insolvent FCS institutions, but also for any member institution that is threatened by unsafe or unsound practices or violates a cease and desist order.[162] These FCA actions are subject to court review.[163]

The FCA also gained several miscellaneous powers. These powers are designed to control investment in the FCS. The FCA must approve the issuance of FCS securities and set the criteria for determining interest rates.[164] The FCA also regulates the preparation of FCS reports to stockholders and investors.[165] This means that the FCA, and not the FCS members, controls investment in the FCS by non-borrowers.

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154. *Id.*
155. *Id.*
156. *Id.*
157. *Id.* at 2589.
158. *Id.*
159. *Id.*
160. *Id.* at 2589-2590 (emphasis added).
161. *Id.* at 2590.
162. *Id.*
163. *Id.*
164. H.R. REP. No. 425, *supra* note 152, at 4.
165. *Id.*

C. *Borrowers' Rights*

Testimony before House and Senate committees dealt with borrowers' perceptions that they had been treated high-handedly by FCS member institutions.[166] To alleviate this problem, Congress added provisions to the 1985 Act to protect borrowers. FCS members must now disclose to borrowers the amount or frequency of variable interest rate changes on loans and the factors to be used in determining the changes.[167] The 1985 Act also requires more stringent notices regarding loan application actions, borrowers' rights of appeal and FCS institution retirement or cancellation of stock.[168] Also, Congress now requires that FCS lenders provide their stockholder-borrowers with documents relating to their loans.[169] Last, to protect stockholders of local associations who have rejected mergers creating new district-wide associations, the FCA may not grant the newly created unit a charter.[170] Thus, the newly created association would be prevented from operating in a district in which association members had rejected merging with it.

D. *Additional Federal Backup*

The 1985 Act places the FCS on equal footing with other federal institutions,[171] because additional federal assistance may be obtained from the Department of the Treasury. First, the FCA certifies that the FCS needs financial assistance after it has already committed its own funds.[172] Second, the Department of the Treasury, at its discretion, may purchase obligations issued by the FCSCC.[173]

E. *Analysis of Congressional Intent*

Congress acknowledged the severe financial crunch the FCS was experiencing.[174] It also acknowledged that an FCS default would surge through

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166. *See generally Review of Operations of the Farmers Home Administration Farm Loan Programs: Hearings Before the Subcomm. on Conservation, Credit, and Rural Development of the House Comm. on Agriculture*, 98th Cong., 2d Sess. 79-86 (1984) (statement of M. C. Jenkins, Farmer, Orrville, Ala.) and 89-92 (statement of Charles L. Frazier, National Farmers Organization); and *Consecutive-Disaster Emergency Loan Act of 1984 and General Issues Relating to Agricultural Credit: Hearings Before the Subcomm. on Conservation, Credit, and Rural Development of the House Comm. on Agriculture*, 98th Cong., 2d Sess. (1984) (generally, all statements taken at this hearing dealt with the problems farm borrowers had had with various federal lenders).

167. H.R. REP. No. 425, *supra* note 152, at 4.

168. *Id.*

169. *Id.*

170. *Id.*

171. *Id.*

172. *Id.*

173. *Id.*

174. *Id.* at 6.

the entire financial sector affecting the cost and availability of credit for all sectors of the economy.[175] The combined effect of an FCS default and the repercussions of that default on the entire financial community would reduce income and the growth of the general economy and increase unemployment.[176] Viewing these somber scenarios, Congress commented that "American society has an important stake in the continued viability of the [Farm Credit] System."[177]

Congress used the word "viability" to describe the result it sought from the 1985 Act. This indicates an intent to do what is necessary to keep the system functional and that would mean avoiding defaults. Indeed, Congress stated that:

> H.R. 3792 recognizes that in addition to *tighter Federal regulation*, much can and should be done by the System itself before outside financial assistance is warranted. At the same time, the Committee understands that if circumstances continue to deteriorate, the *Federal Government must be in a position to act expeditiously to provide a safety net* for the System . . . .[178]

Congress intended to implement its intent through stronger regulation of the FCS by the federal government.[179] This would require cutting the structural ties between the FCA and the FCS.[180] Congress wanted to cut the structural ties, because the situation was the classic "tail wagging the dog" wherein the FCA was intimidated by the FCS members.[181] Also, the FCS members were unresponsive to the demands[182] often made by individual congressmen and senators as they dealt with FCS members while providing constituent services.[183]

To establish the FCA as an arm's-length regulator, Congress removed from the FCA many of its supervisory duties.[184] These duties included approving the salaries of FCS members' presidents.[185] The FCA was to be an overseer of the FCS, and not a manager.

The 1985 Act gave the FCA power to issue cease and desist orders.[186] Previously, the FCA had to rely on jawboning or negotiation to stop unsafe practices.[187] The continued use of such tactics did not comport with Con-

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175. *Id.* at 9-11.
176. *Id.*
177. *Id.* at 11.
178. *Id.* at 11-12 (emphasis added).
179. *Id.* at 12.
180. *Id.*
181. *Id.*
182. *Id.*
183. *See supra* note 166 and accompanying text.
184. H.R. REP. No. 425, *supra* note 152, at 12.
185. *Id.*
186. *Id.* at 13.
187. *Id.*

gress' intent to have a responsive regulator that could act expeditiously. Also, Congress perceived that regulation, rather than supervision, of the FCS by the FCA would enhance investor confidence in the FCS.[188] Congress acknowledged that many FCS members had responded to the farm credit crisis by designing and implementing assistance for some federal intermediate credit banks.[189] However, Congress stated that such FCS relief was too inefficient and unwieldy to be effective.[190]

To establish effective system-wide relief, Congress created the Farm Credit System Capital Corporation.[191] The FCSCC was put under the control of the FCA instead of the general membership of the FCS.[192] The FCSCC was to be used as "a limited tool" that could more "adequately and efficiently" manage the FCS's problems and resources.[193] The FCSCC was expected to use its authority "cautiously and prudently."[194] The obvious impact of the FCSCC is more centralized regulation of the FCS. What is more, the centralized regulatory power is strongest in the area of managing weak or problem FCS members. The conclusion is that Congress intended that management of FCS problems should be removed from the FCS's members and placed with the FCA.

Congress intended that the FCS be strengthened by self-help from strong members. However, Congress intended that the FCA would determine who provided help, and to what extent. The FCSCC was created to be a vehicle to shift money within the FCS to shore up weaker units. The vehicle is driven by the FCA.

VI. Analysis of the FCA's Implementation of the 1985 Act

Most of the FCA's rules published to implement the 1985 Act underscored Congress' desire for stronger, independent regulation of the FCS by the FCA. However, because of the urgent need to bolster tenuous FCS member institutions, the first rule published chartered the FCSCC.

On February 24, 1986, the FCA promulgated a regulation setting forth the charter and articles of incorporation of the FCSCC.[195] It was Congress' intent to establish the FCSCC within sixty days after the passage of the 1985 Act.[196] The charter states that the purpose of the FCSCC is to implement a program, "of financial and technical assistance to System institu-

188. *Id.*
189. *Id.*
190. *Id.*
191. *Id.*
192. *Id.* at 14.
193. *Id.*
194. *Id.*
195. 51 Fed. Reg. 7,121 (1986).
196. H.R. Rep. No. 425, *supra* note 152, at 17.

tions and their borrowers which are experiencing financial difficulties."[197] This provision embodies Congress' intent to give the FCS assistance to keep its institutions viable and thus enhance investor confidence.[198]

The FCSCC's charter also complied with Congress' intent to strengthen the FCS through self-help.[199] The charter provides that the FCSCC may require other institutions in the FCS to make funds available to it through stock purchases or the purchase of other obligations.[200] The FCSCC also has authority in its charter to assess FCS members to cover its operating expenses excluding interest expense.[201] In keeping with congressional intent that the FCA be an arm's-length regulator of the FCS (and the FCSCC is a member institution of the FCS), the FCSCC's charter stipulates that the method of assessment must be in conformity with FCA regulations.[202] Its charter also gives the FCSCC the authority to exercise all powers which may be necessary to perform its duties and functions in accordance with the 1985 Act and the FCA.[203]

The final rules establishing the organization of the FCSCC were published without the usual public notice and publication of proposed rule for comment that the 1985 Act required.[204] The FCA stated that the final rules for organization of the FCSCC were published without notice, because of the urgency impressed upon the FCA by the 1985 Act to establish the FCSCC as a functioning entity.[205] The FCA reasoned that notice and publication for comment were "unnecessary, impracticable and contrary to public interest."[206] This was contrary to congressional intent that the FCA rules be published with notice to allow FCS members to comment.[207]

To comply with Congress' objective of stronger, independent regulation of the FCS by the FCA,[208] the FCA published the rules of practice and procedure before it.[209] These rules comported with Congress' intent to make the FCA a regulatory and adjudicative authority, because they set procedures to ensure due process.[210] A governmental agency that is to assume a regulatory role must have clearly delineated procedural rules. Such rules are a hallmark

197. 51 Fed. Reg. 7,122 (1986).
198. H.R. REP. No. 425, *supra* note 152, at 13.
199. *Id.* at 1.
200. 51 Fed. Reg. 7,123 (1986).
201. *Id.*
202. *Id.*
203. *Id.*
204. 51 Fed. Reg. 8,665 (1986).
205. *Id.*
206. *Id.*
207. 12 U.S.C. § 2252(b)(2) (1987).
208. H.R. REP. No. 425, *supra* note 152, at 3.
209. 12 C.F.R. §§ 622-623 (1988). Surely, this was the least controversial of the FCA's acts under its new cloak of regulator. Only one letter was received from FCS members regarding the proposed rules. *See* 51 Fed. Reg. 21,139 (1986).
210. 12 C.F.R. §§ 622-623 (1988).

of a regulatory agency.

The first rules promulgated by the FCA complied with Congress' intent that the FCS remain a viable institution. This was accomplished by providing system self-help (via the FCSCC) and by making the FCA a regulator of the FCS. However, the FCA deviated somewhat from Congress' intent that the FCA give proper notice to FCS members regarding rules publications. Also, after initially substantially complying with the basic objective of Congress, the FCA began to publish more detailed rules in accordance with its new regulatory role. Though the FCA is no longer involved in the functional aspects of the day-to-day operations of the FCS, it now sets the guidelines under which the day-to-day operations are conducted.

A. *Stronger Independent Regulation*

The FCA published rules establishing the responsibilities and conduct of FCS employees.[211] The FCA set rules for employees; conflicts of interest;[212] fees for teaching, writing and lecturing;[213] outside employment;[214] political activity;[215] and disclosure of financial interests.[216] These rules showed that the FCA assumed a regulatory role. Even more, these rules showed that the FCA is complying with Congress' intent to "enhance investor confidence" in the FCS. Such rules will enhance investor confidence, because they will reassure investors that the FCA is watching closely the conduct of employees who process the large amounts of money and confidential information that pass through the FCS.[217]

The FCA's regulation extends to such matters as loan documentation related to borrowers' financial statements.[218] The 1985 Amendments Act provides for interest rate reductions on some loans.[219] The FCA has issued regulations that require that FCS members have on file current financial statements from all borrowers requesting interest rate reductions.[220] Such a requirement was made a condition to FCA approval of interest rate reductions.[221] For loans made after September 1, 1986, the FCA gave all FCS institutions the right to require verified annual financial statements from all borrowers and required the FCA to obtain verified annual financial statements from all current borrowers with loan balances over $100,000 or where

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211. 12 C.F.R. §§ 600-604, 611-618 (1988).
212. *Id.* at § 601.110.
213. *Id.* at § 601.126.
214. *Id.* at § 601.127.
215. *Id.* at § 601.140.
216. *Id.* at § 601.170.
217. *See id.* at § 602; *see also id.* at § 612.
218. 51 Fed. Reg. 30,123 (1986).
219. H.R. Rep. 425, *supra* note 152, at 8.
220. 51 Fed. Reg. 30,123 (1986).
221. *Id.*

pledged collateral comprises more than 25% of production facilities.[222] Such detailed guidance shows the FCA's strong regulatory bent in two ways. First, the FCA regulates the manner in which loans are processed. Second, the FCA gains information that it can use to examine the financial soundness of an institution's loan portfolio.

Regulation of loan documentation for interest rate reductions borders on management of member institutions' everyday operations. This apparent contravention of Congress' intent to reduce FCA involvement in the management of detailed operational aspects of FCS members may be explained as follows: the FCA does not decide whether or not a borrower may receive an interest rate reduction (for such an action would constitute involvement in the everyday operations of FCS members); rather the FCA sets uniform standards for the type of information that FCS institutions must have in a loan file before deciding to grant an interest rate reduction.

The FCA also implemented rules that governed the financial management of the member institutions. Under the Act, FCA regulation of the financial management of the member institutions has been substantial, covering the areas of consolidation and merger; appointment of receivers or conservators and their powers; sale and transfer of loans; retirement of stock and participation certificates; setting minimum capital reserves; and regulating dividends and patronage refunds.

The FCA regulation of consolidations and mergers provoked controversy.[223] The FCA now allows stockholders of all affected associations to vote on mergers.[224] The power to approve mergers formerly rested with the directors of associations.[225] This regulation is consistent with Congress' intent that the FCA use its regulatory powers to encourage stockholder involvement in the merger of FCS associations.[226] The extent of the FCA's new regulatory role is highlighted by this ruling, because under general corporate legal principles, it is the board of directors that must approve mergers, not the stockholders.

The FCA also published a rule that a conservatorship may be terminated and management of the institution turned over to the FCA rather than the institution's board of directors.[227] This is a strong regulation that showcases the FCA's regulatory power. Usually after termination of a conservatorship, the standard practice is to return management to the board of directors. However, in such situations, to avoid involvement in the management of FCS members, the FCA merely appoints new directors.

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222. *Id.* at 30,124.

223. *See generally* 51 Fed. Reg. 32,431 (1986) (beginning on 32,432 *see* "Section-by-Section Analysis and Response to Comments").

224. 12 C.F.R. § 611.1122 (1988).

225. *Id.*

226. H.R. Rep. 425, *supra* note 152, at 4.

227. 12 C.F.R. § 611.1157(1) (1988).

Dividends and patronage refunds are now regulated more closely by the FCA despite the fact that institutions need no longer obtain prior approval before paying dividends or distributing patronage refunds.[228] Such disbursements now must conform to FCA established capital adequacy regulations and the institution's financial plan,[229] and may not be made during any period in which the institution is a net recipient of FCSCC assistance.[230] In conjunction with this regulation, the FCA required that all retirements of stock, participation certificates and unallocated reserves must be made in accordance with the FCS member's financial plan.[231] These rules are explicitly regulatory, because the FCA sets the standards FCS members must achieve before making disbursements to stockholders. This comports with congressional intent, because in setting such standards, the FCA uses its regulatory powers to insure FCS viability by controlling when FCS members may make disbursements.

The setting of capital adequacy and minimum capital requirements is the FCA's greatest regulatory inroad into the financial management of the FCS.[232] This proposed regulation requires that all FCS members set interest rates at a level sufficient to maintain their capital above the minimum capital requirements.[233] The proposed minimum capital requirements formula would take into account an institution's obligation to provide assistance to other FCS members.[234]

The capital adequacy of the FCS members is to be measured on the basis of unallocated retained earnings percentage and total capital percentage.[235] The board of directors of each FCS association is responsible for the maintenance of adequate capital.[236] However, the FCA may adjust the capi-

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228. 12 C.F.R. § 615.5350 (1988).

229. *See id.* (such plans must be approved by the FCA); 51 Fed. Reg. 26,403 (1986) (proposed rules).

The requirements of the plan are: proposed regulation § 615.5220 requires each System institution to adopt a financial plan and to conduct its operations in accordance with the plan. Each financial plan shall describe the institution's financial goals for the following 3 fiscal years and the institution's strategies for achieving its net worth, earnings, and other financial objectives. The financial plan shall include the financial objectives of the institution relating to profitability, liquidity, loan growth, loan mix, credit quality, and other key objectives. In addition, each financial plan must contain quarterly standards, pro forma financial statements, and monthly operating budgets. The board of directors of each bank and association is required to approve the institution's financial plan no later than 30 days prior to the beginning of the fiscal year. Each institution is required to operate in accordance with the board-approved financial plan and all changes to the plan must be approved by the board of directors.

230. 12 C.F.R. § 615.5350 (1988).

231. *Id.*

232. 12 C.F.R. §§ 614-615 (1988).

233. *Id.*

234. *Id.*

235. 51 Fed. Reg. 26,404 (1986) (to be codified at 12 C.F.R. § 615.5204) (proposed July 23, 1986).

236. *Id.*

tal adequacy requirements as needed.[237] Thus the FCA, through its power to adjust capital adequacy requirements,[238] determines what levels of capital FCS members must maintain to be viable. The importance of these regulations is that the formulas promulgated determine which institutions receive help from the FCSCC, which must contribute to help others, and the amount which each receives or contributes.

The capital adequacy rules should result in less FCA involvement in the daily operations of FCS members, because FCS members' financial strength will not be determined on a case-by-case basis. However, to achieve such a result, the FCA will have to audit FCS members to ensure compliance with uniform accounting standards established or adopted by the FCA. Thus, the FCA will be engaged in the detailed management of members' operations to the extent that it requires the correction of non-complying accounting procedures.

B. *System Self-Help and Additional Federal Backup*

The FCSCC is the organization Congress created to allow the FCS to help itself out of the crisis. It is Congress' most ambitious plan. This provision of the 1985 Act has created controversy and many lawsuits.[239] Most of the controversy and the majority of the lawsuits have arisen from the FCA's final rule of June 12, 1986.[240]

The FCA, after defining how the unallocated retained earnings percentage was to be determined,[241] established four zones (A through D).[242] Zone A represents FCS members with a strong unallocated retained earnings posi-

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237. *Id.*

238. The methods for determinations of unallocated retained earnings, unallocated retained earnings percentage and total capital percentage are listed at 51 Fed. Reg. 26,404-05 (1986) (to be codified at 12 C.F.R. § 615.5202) (proposed July 23, 1986).

239. *See* Federal Land Bank v. Farm Credit Admin., No. H-86-3137, slip op. (D. Md. Oct. 31, 1986) (preliminary injunction entered); Sikeston Prod. Credit Ass'n v. Farm Credit Admin., 647 F. Supp. 1155 (E.D. Mo. 1986) (permanent injunction entered); Caprock-Plains Federal Land Bank Ass'n v. Farm Credit Admin., No. CA-5-86-202, slip op. (N.D. Tex. Oct. 16, 1986) (preliminary injunction entered); Colorado Springs Prod. Credit Ass'n v. Farm Credit Admin., No. 86-K-1948 (Sept. 26, 1986) (TRO entered). *But see* Northwest Louisiana Prod. Credit Ass'n v. Farm Credit Admin., No. 86-3164, slip op. (W.D. La. Oct. 16, 1986) (TRO denied); Production Credit Ass'n of Eastern New Mexico v. United States, No. 86-1137 JC, slip op. (D.N.M. Oct. 10, 1986) (preliminary injunction denied); Central Kentucky Prod. Credit Ass'n v. United States, No. 86-2056, slip op. (D.D.C. Oct. 3, 1986) (TRO vacated and preliminary injunction denied); Great Plains Production Credit Ass'n v. Farm Credit Admin., No. 86-2119-A, slip op. (Oct. 3, 1986) (preliminary injunction denied); Federal Land Bank v. Farm Credit Admin., 676 F. Supp. 1239 (D. Mass. 1987) (permanent injunction granted).

240. *See* Federal Land Bank v. Farm Credit Admin., 676 F. Supp. 1239 (D. Mass. 1987).

241. *See supra* note 238.

242. 51 Fed. Reg. 26,404 (1986) (to be codified at 12 C.F.R. § 615.5206(b)) (proposed rule).

tion.[243] Zones B, C and D represent FCS members with decreasing levels of unallocated retained earnings.[244]

Prior to the publication of the zone classifications, the FCA had issued a final rule without first issuing a proposed rule and request for comment.[245] Later, another final rule was issued that extended the comment period even though the rule was published as final.[246] The failure of the FCA to give notice before publication of the final rule has created lawsuits.[247]

The method of assessing FCS members to fund the FCSCC was published in the June 12, 1986 final rule.[248] The purpose of the assessment provision was to:

> (1) Provide for an equitable sharing of the burden among institutions, (2) ensure that the financial positions of institutions providing funds are maintained so that reasonable and competitive credit continues to be available to System borrowers, and (3) ensure that each bank is able to borrow and repay funds in the public financial markets. In providing for an equitable sharing of the burden of assessments or purchases, the Cor-

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243. *Id.*

244. *Id.* See chart below for zone classifications, 51 Fed. Reg. 26,495 (1986) (proposed rule):

REGULATORY ZONES UNALLOCATED RETAINED EARNINGS PERCENTAGE†

	Zone			
Institution	A	B	C	D
1. Federal Land Bank††	6.6	5.4	1.5	0
2. Federal Land Bank Association	6.6	5.4	1.5	0
3. Federal Intermediate Credit Association	1.0	0.7	0.4	0
4. Production Credit Association	16.1	9.2	2.3	0
5. Districtwide Production Credit Association	11.0	7.9	4.8	0
6. Combined District Federal Intermediate Credit Bank and Production Credit Association†††	12.0	8.5	5.0	0
7. Bank for Cooperatives	2.2	1.5	0.8	0
8. Central Bank for Cooperatives	1.5	1.0	0.5	0

† Percentages represent the bottom of the indicated zone.

†† A federal land bank may compute the unallocated retained earnings and percentage by including the unallocated retained earnings of the federal land bank associations in the district of such retained earnings are, by contract or otherwise, available to the federal land bank. The combined group shall be determined on the basis of a combined financial statement after elimination of intercompany accounts.

††† The combined group rating for the district federal intermediate credit bank and production credit associations is determined on the basis of a combined financial statement after elimination of intercompany accounts.

245. 12 C.F.R. §§ 611.1140-.1142 (1988).

246. 12 C.F.R. § 611 (1988).

247. *See, e.g.*, Federal Land Bank v. Farm Credit Admin., 676 F. Supp. 1239 (D. Mass. 1987).

248. 12 C.F.R. § 611.1142(h)(6)(i) (1988).

> poration must consider the institutions' relative financial strength and ability to pay, the effect on loan interest rates of each System institution, and the impact of prior assistance provided to institutions.[249]

The FCA rule stated that the burden was to be distributed using the zones established by an earlier FCA ruling. The assessments were to be levied first against those institutions in Zone C and above.[250] Finally, the FCA regulation provided that the FCSCC was to assess FCS members:

> based on each contributing institution's relative financial strength and ability to pay, taking into consideration the effect that obtaining funds has on borrowers and the contributing institution's ability to continue to provide credit. These requirements are designed to ensure that financially stronger System institutions bear a greater share of the burden of providing funds to the Corporation until the available capital and reserves of all institutions have been utilized. In taking those factors into consideration, as the relative financial strength of the entire System declines, the impact of assessments on individual institutions must be weighed against the increasing funding needs of each System institution when compared with the other institutions in the System.[251]

A controversial aspect of the FCA regulations was that the FCSCC would assess FCS members if they were charging interest rates below an FCA determined FCS average.[252] FCS institutions in Zones A and B were not allowed to increase the interest rates they charged to offset the loss of capital caused by an FCSCC assessment.[253] Indeed, why would stronger members want to increase interest rates? Such an action would make them less competitive with non-member institutions. Further, FCSCC capital adequacy requirements would make it difficult for stronger FCS members to reduce interest rates after paying an FCSCC assessment.

Surely, this rule published by the FCA complied with Congress' intent to charter the FCSCC within sixty days of passage of the 1985 Act and get it funded and operating as soon as possible. The rule showed a strong regulatory bent. However, the FCA may have overstepped the authority Congress wanted it to exercise as a regulator.

C. *Borrowers' Rights*

Many of the hearings held by Congress featured borrowers who had experienced difficulty with FCS members.[254] This resulted in the expenditure of millions of dollars in litigation.[255] To protect and enhance the rights of

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249. *Id.*
250. *Id.*
251. *Id.*
252. *Id.*
253. *Id.*
254. *See supra* note 166.
255. 12 C.F.R. § 614.4366 (1988).

borrowers, Congress wanted the FCA to promulgate clear rules for loans by FCS members.[256]

The FCA published a final rule stating that each borrower was to be provided with the effective interest rate of his or her loan.[257] The rule states that the effective rate of interest means the current rate of interest taking into account the effect of the purchase of stock on the rate.[258] Some borrowers wrote the FCA to complain that the rule did not comply with congressional intent, because the effective rate of interest did not include all factors that comprise the effective rate of interest.[259] Some commentators wanted discount points included in the definition of the effective interest rate.[260] The FCA's response to this was that the disclosure of interest rates was to serve a limited purpose and that Congress did not intend that all factors which can affect interest rates be included in the disclosure regulations.[261]

The FCA also published rules that listed the rights of persons who seek loans.[262] The FCA now requires that FCS members act expeditiously on loans and promptly notify applicants of the action taken.[263] Under the published rules, FCS members also must have credit review committees.[264]

An applicant[265] who receives an adverse decision on a loan request may submit other information to the review committee for reconsideration.[266] The information submitted must be information that was available when the applicant first applied for the loan.[267] New information may not be submitted for review.[268] The applicant may use the new information to reapply for a loan.[269]

The FCA's new rules list the procedures FCS members must follow regarding borrower requests for forbearance.[270] FCS members must develop forbearance policies that are approved by their district banks.[271] Each FCS member must provide borrowers with a copy of its forbearance policy at

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256. *Id.*
257. *Id.*
258. *Id.*
259. 12 C.F.R. §§ 614.4440-614.4444 (1988).
260. *Id.*
261. *Id.* (some commentators even wanted the effective interest rate to include such factors as the term of the loan and the effect of automatic versus nonautomatic stock retirement).
262. *Id.*
263. *Id.* at § 614.4441.
264. *Id.* at § 614.4442.
265. *Id.* at § 614.4440 (for the definition of an applicant).
266. *Id.* at § 614.4443.
267. *Id.*
268. *Id.*
269. *Id.*
270. *Id.* at § 614.4513.
271. *Id.*

least ten days prior to commencing collection action against the borrower.[272]

The new forbearance policy is a constriction of the FCS's forbearance policy prior to the 1985 Act. Under Curry v. Block, 738 F.2d 1556 (11th Cir. 1984), notice of an FCS member's forbearance policy had to be given to borrowers at the beginning of the loan term and each production season. The new rule does not comply with Congress' intent to provide greater disclosure to borrowers to protect their rights and thus avoid litigation. The new rule provoked many comments from interested parties who contended that the new rule did not provide sufficient protection for borrowers.[273]

The new forbearance rules have provisions that indicate failure to comply with Congress' intent. First, the new rules do not require an FCS member to consider forbearance before foreclosing a loan.[274] Also, when considering forbearance, the lending institution is to consider foremost the factors that will "maximize" collection of the debt rather than the ability of the borrower to repay.[275]

It appears that the FCA's rules for implementing new forbearance procedures may not strictly comply with Congress' intent to provide more borrowers' rights. This may mean continued litigation and confusion in this area. On the other hand, the FCA can argue that its new forbearance policies comport with Congress' intent to ensure the long-term viability of the FCS by emphasizing stronger collection policies for nonperforming loans. The "proof of the puddin's in the eatin' " and only time will tell which route will or would have been most effective in accomplishing Congress' intent.

D. *Analysis of FCA Compliance with Congressional Intent*

Overall, the first FCA regulations published under the aegis of its role as a regulatory agency comply with Congress' intent to strengthen the FCS through stronger, independent regulation; system self-help; more definitive borrowers' rights; and additional federal backup. Also, as the comments the FCA solicited to most of its published rules show, there is controversy over what is effective in implementing Congress' intent.

The assumption by the FCA of its new role as regulator is evidenced by the new and detailed regulations it has published. However, whenever an aggrieved party seeks to reverse the decision of an FCS member, it may look for rules the FCA has not published to argue that there should be a rule in the area it is litigating. Such parties could contend that lack of FCA rules in the area they are litigating shows FCA failure to fully regulate and thus shows non-compliance with congressional intent. Such litigants may then petition the courts to act to fill what they perceive as a void that Congress

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272. *Id.*
273. *Id.*
274. *Id.*
275. *Id.*

intended to be regulated. Thus, Congress' goal of reducing litigation may not be achieved to the extent it wants. However, because the language of the 1985 Act is explicit in urging stronger FCA regulation of the FCS, the courts may be reluctant to rule where the FCA has not acted.

Congress' goal of system self-help may generate litigation and controversy. This may occur because the goals of system self-help and protection of borrowers' rights will often conflict. The concept of system self-help requires that the FCA implement rules that will improve the loan portfolio of the FCS. The loan portfolio can be improved only through tougher qualifications for FCS loans and more definitive and decisive foreclosure policies by FCS members. On the other hand, greater protection of borrowers' rights would imply more safeguards to ensure that loan applicants receive a thorough review of their loan requests and that refusals are based on published guidelines. More procedural rights for borrowers means more areas in which they may be able to force favorable action on their loan requests by FCS institutions. This would make it difficult for FCS members to avoid assuming potential nonperforming loans, and to foreclose those which are already in a nonperforming state. If FCS members cannot avoid the assumption of or readily foreclose nonperforming loans, the concept of system self-help would fail, because one of the problems of the past—poor lending practices by FCS members—would be perpetuated.

In the end, the courts will decide which goal should be dominant—system self-help or protection of borrowers' rights. The courts will decide this by performing the ubiquitous balancing test. Under such a procedure, it will be system self-help that prevails as the more important congressional goal. System self-help will prevail, because Congress' ultimate goal is to keep the FCS as a viable lending institution. To remain a viable lending institution, the FCS's needs must prevail over those of the borrowers. Even the legislative hearings on the 1985 Act show an emphasis on protecting lenders from bankruptcy. Ultimately, the courts will reason that borrowers' rights are secondary to protecting the solvency of the system. The logic behind such reasoning is compellingly simple: the FCS must be kept strong, because if it were not, borrowers' rights would be meaningless—there would be no lenders to lend to the borrowers.

In the area of system self-help and additional federal backup there has been, and will continue for a while to be, litigation.[276] The cause of this is complicated. The system self-help theory required that the FCA establish the FCSCC. The purpose of the FCSCC was to purchase the underlying collateral of nonperforming loans and, if required, purchase nonperforming loans from FCS members.[277] To fund the FCSCC the FCA established a system to assess FCS members.[278] If the assessments were insufficient, the

276. *See supra* note 239.
277. 12 U.S.C. § 2216f, 99 Stat. 1682.
278. *Id.*

Department of the Treasury would purchase FCSCC obligations only after all other funding means had been exhausted by the FCSCC.[279]

The assessments may be made only against FCS members whose financial strength allows them to be assessed.[280] However, the assessment itself will weaken the financial position of a lending institution. As the assessments will reduce unallocated retained earnings of assessed FCS members, they will contend that the assessments are too high because they threaten either the members' solvency or their ability to service borrowers. If the FCSCC defers to such arguments it will have to seek assistance from the Department of the Treasury. The Department of the Treasury may refuse to assist if it believes that the FCSCC should enforce more vigorously its assessments of FCS members.

The result will be resort to the courts to arbitrate assessments.[281] This will involve costly and complex litigation, because reams of financial data will have to be analyzed to determine whether an assessment imposes an undue financial burden.[282] Once the numbers are established, the court will have to balance the burden of the individual FCS member against the needs of the FCS.

E. *Summary of FCA Implementation*

Implementation of the 1985 Act will involve head-on collisions between competing factors within the FCS. If one views Congress' primary goal as maintaining a viable FCS, resolution of the issues will have to be by application of a balancing test—the FCS's needs versus the borrowers' interests. The first regulations published by the FCA and the FCA's responses to comments indicate that the FCA's emphasis is on maintaining a strong, viable FCS, even to the occasional detriment of individual FCS members' and borrowers' interests. The FCA has acted in this way because it perceives this as Congress' most important reason for passage of the 1985 Act. The question is: What are the courts' perceptions of Congress' intent?

VII. Analysis of Case Law and the 1985 Amendments Act

Most cases interpreting the 1985 Act have involved FCSCC assessments.[283] The most recent was *Federal Land Bank v. Farm Credit Administration* [hereinafter *Texas Bank*][284] In *Texas Bank* the FCSCC assessed the

279. 12 U.S.C. § 2216i, 99 Stat. 1686.

280. 12 U.S.C. § 2216f(a)(15)(B)(i), 99 Stat. 1682.

281. This is already occurring. *See supra* note 239.

282. This language is the statutory criterion. *See* 12 U.S.C. § 2216f(a)(15)(B)(i), 99 Stat. 1682.

283. *See supra* note 239.

284. Federal Land Bank v. Farm Credit Admin., 676 F. Supp. 1239 (D. Mass. 1987) (Texas Bank for Cooperatives was one of the parties).

Texas Bank for Cooperatives [hereinafter Texas Bank] $6,444,725; most of the assessment went to the purchase of FCSCC obligations.[285] The court held that the FCA's rules for FCSCC assessment of FCS members were procedurally and substantively invalid.[286]

Texas Bank opposed the assessment on two theories. The first was that the assessment was not procedurally valid, because the regulations governing assessments were published without notice.[287] The publication without notice was alleged to be invalid because the FCA did not have good cause to dispense with the notice requirements.[288] Good cause did not exist, because the FCA had ample opportunity to give notice and accept comments and still comply with congressional intent.[289] The court agreed with Texas Bank's argument.[290] The court reasoned that though Congress intended that the FCA quickly establish and make operative the FCSCC, Congress did not intend that the FCA dispense with the notice requirement.[291]

The FCA had requested that the June 12, 1986, rules be allowed to stand even if they were found to be procedurally invalid.[292] The FCA stated that it had corrected the procedural deficiency because it had published a request for comments subsequent to the June 12, 1986, regulation publication.[293] The court, stating that procedurally invalid interim rules may remain in effect if an emergency exists, noted that the FCA had acknowledged that an emergency did not exist, because the 1985 Act allowed FCS members to defer loan losses over a twenty-year period.[294] The FCA conceded that the deferment of loan losses averted an emergency.[295] Therefore, the court denied the FCA's request.[296]

Texas Bank's second theory was that the assessment formula developed by the FCA for the FCSCC was substantively invalid,[297] because the regulations: (1) deem that assessments will have no impact on available credit services offered; (2) state that nothing shall prevent the FCSCC from assessing or requiring an institution to purchase FCSCC obligations when it has available capital and reserves; and (3) fail to take into account the effect on a

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285. *Id.*
286. *Id.* at 1245.
287. *Id.* at 1253.
288. *Id.* at 1247.
289. *Id.*
290. *Id.* at 1248.
291. *Id.*
292. *Id.*
293. *Id.* at 1249.
294. *Id.*
295. *Id.*
296. *Id.*
297. *Id.* at 1250.

member's interest rate of prior financial assistance it has provided.[298]

The court agreed with Texas Bank and held the assessment regulations invalid. The court stated that the 1985 Act required that the FCA consider the impact of assessments on interest rates and current borrowers.[299] The court reasoned that the FCA could not ignore this mandate from Congress by "deeming" that assessments will not affect an FCS member's interest rates and borrowers.[300] The court stated that any assessment formula used cannot leave FCS members unable to offer reasonable and competitive terms to their borrowers.[301] The court noted that Congress required that assessments not prevent FCS members from offering borrowers reasonable and competitive loan terms.[302]

The court concluded that FCA zone classifications based solely on the relation between an institution's unallocated retained earnings and its total assets did not adequately include all factors that Congress wanted used to determine FCSCC assessment of FCS members.[303] Also, as the interim rules were not published with notice or under emergency conditions and could irreparably harm Texas Bank, the FCA was permanently enjoined from taking any action pursuant to its June 12, 1986, regulation.[304]

The court's reasoning in *Texas Bank* was identical to that of the court in *Sikeston Production Credit Association v. Farm Credit Administration*[305] In *Sikeston*, the court disallowed FCSCC assessments of several PCAs. The court stated that the FCA's regulations were unconstitutional because they did not provide an opportunity for hearing or appeal from an assessment.[306]

The *Sikeston* court also held that the June 12, 1986, FCA regulations and the subsequent FCSCC assessments were substantively invalid, because they did not comply with Congress' intent.[307] The court stated that some FCS members would have to borrow or liquidate productive investments to make the assessment payments.[308] This would force FCS members to increase interest rates, thus becoming less competitive.[309] Such a result is con-

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298. *Id.*

299. *Id.*

300. *Id.* at 1251.

301. *Id.*

302. *Id.*

303. *Id.*

304. *Id.* at 1253.

305. Sikeston Prod. Credit Ass'n v. Farm Credit Admin., 647 F. Supp. 1155 (E.D. Mo. 1986). These assessments are not insubstantial. For two of the six plaintiffs in *Sikeston*, the assessments were $151,118.00 and $1,239,624.00. The second assessment amounted to 44% of the assessed party's unallocated retained earnings. *Id.* at 1157.

306. *Id.* at 1164.

307. *Id.*

308. *Id.* at 1160.

309. *Id.*

trary to Congress' mandate.[310]

Texas Bank and *Sikeston* show that the issues under the 1985 Act will involve determining what actions best benefit the FCS. In *Texas Bank* and *Sikeston*, the courts decided that Congress wanted a viable FCS. The courts emphasized the fact that Congress mandated that the FCSCC assessments should not affect FCS members' interest rates and concomitantly their competitiveness. Such reasoning is beneficial to financially solid borrowers, because the courts, by stressing the importance of competitiveness of FCS lenders, will ensure a supply of credit at competitive rates.

It is also important that the courts have taken the position that there does not exist an emergency situation regarding farm credit.[311] This will be beneficial for borrowers, because the courts will not be pressured by the FCA to act out of urgency. Thus, the courts will look closely at the substance of borrowers' arguments to determine if they fit within Congress' mandate to maintain a viable (meaning competitive) FCS.

Sikeston and *Texas Bank* also show that the FCA has interpreted Congress' mandate for a viable FCS to mean not competitiveness, but financial strength, with an even stronger self-help system—the FCSCC. This portends trouble even for financially strong borrowers, because the FCA will regulate to encourage conservative loan practices and high interest rates, the result of having a strong backup system. This means less credit available at higher prices. Thus, the issues in the courts will be whether Congress clearly intended viable to mean competitive, or financially strong but conservative and non-competitive.

Two other cases have addressed the issues of stronger, independent FCA regulation and borrowers' rights. In *Bailey v. Federal Intermediary Credit Bank*, the Eighth Circuit Court of Appeals stated that the 1985 Act did not implicitly or explicitly change any relationships between members within the FCS except for the relationship of the FCA to all FCS members.[312] This statement seems to ignore the impact that the self-help system will have on relationships among members within the FCS. The assessment of FCS members by the FCSCC will eventually become a battle between the haves and the have-nots. Thus, there will be an implicit change in the relationships between FCS members.

One case has involved borrowers' rights under the 1985 Act. In *Aberdeen Production Credit Association v. Jarrett Ranches, Inc.*, the plaintiff sought foreclosure of a security interest in certain real and personal property of Jarrett.[313] Jarrett counterclaimed against Aberdeen PCA on the grounds of misrepresentation and negligent financial advice, breach of im-

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310. *Id.*

311. Federal Land Bank v. Farm Credit Admin., 676 F. Supp. at 1251.

312. Bailey v. Federal Intermediary Credit Bank, 788 F.2d 498, 499 n.3 (8th Cir. 1986).

313. Aberdeen Prod. Credit Ass'n v. Jarrett Ranches, Inc., 638 F. Supp. 534, 535 (D.S.D. 1986).

plied contract to renew a loan, breach of a loan contract, breach of a duty of good faith and fair dealing, and violation of the Farm Credit Act.[314]

Jarrett's theory was that it had a private cause of action under the 1985 Act to require the PCA to grant it forbearance.[315] The court examined the legislative history of the 1985 Act, noting that Representative De la Garza stated he understood the 1985 Act to provide for the courts to enforce borrowers' rights in court.[316] The court, however, stated that borrowers' rights referred only to the borrowers' rights to full disclosure and loan documents and not to forbearance.[317] Dismissing the third party counterclaim against the Federal Intermediary Credit Bank, the court stated:

> Nevertheless, "the Farm Credit Act merely establishes the mechanism by which alternative forms of credit may be available to farmers and ranchers." *Bowling v. Block*, 602 F. Supp. 667, 671 (S.D. Ohio 1985), *aff'd*, 785 F.2d 556 (6th Cir. 1986). Because the Farm Credit Act does not proscribe any conduct as unlawful or create specific enforceable rights on behalf of borrowers, there is no support for an implied private cause of action.[318]

The court's reasoning in *Aberdeen PCA* was consistent with the holdings of other courts that had addressed the private cause of action issue as raised under the 1985 Act.[319] These holdings also are consistent with the FCA's more restrictive rules on forbearance.[320] Such reasoning complies with Congress' intent regarding forbearance, because the 1985 Act is silent on forbearance.[321]

These holdings and regulations portend trouble for borrowers in financial difficulties. They suggest that the thrust of the 1985 Act is, first, to strengthen the financial condition of the FCS; second, to maintain the competitiveness of the FCS for borrowers who are good loan risks, and to provide a self-help system for banks in trouble; and third, to create rules that promote openness and full disclosure to reduce friction between the FCS and its borrowers.

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314. *Id.*

315. *Id.* at 536.

316. *Id.* at 537.

317. *Id.*

318. *Id.*

319. Smith v. Russellville Prod. Credit Ass'n, 777 F.2d 1544, 1548 (11th Cir. 1986) (Farm Credit Act creates no specific duties or prohibitions for the benefit of a special class); Spring Water Dairy, Inc. v. Federal Intermediate Credit Bank, 625 F. Supp. 713, 719 (D. Minn. 1986) (Act does not contain specific rights for farmers); Apple v. Miami Valley Prod. Credit Ass'n, 614 F. Supp. 119, 122 (S.D. Ohio 1985) (no private right of action for breach of fiduciary duty under Act).

320. 12 C.F.R. § 614.4513 (1988).

321. *Id.*

VIII. Conclusion

Congress' intent in passing the 1985 Act was to create a viable FCS. A viable FCS requires that lenders offer competitive interest rates and loan terms. Competitive interest rates and loan terms can be provided only if the borrowers are financially strong. Thus, there will be a shake-out of weak borrowers.

The shake-out of weak borrowers will mean writing off many bad loans. This will weaken the financial positions of many FCS members. To prevent mass liquidations of such members, Congress mandated creation of the FCSCC. Congress did not emphasize forbearance, because liberal forbearance would make it difficult for FCS members to foreclose loans. If FCS members had to continue to carry nonperforming loans, the FCSCC would require more funds to help the system. Thus, the 1985 Act will result in foreclosure of many loans. The loan portfolios that remain will receive the benefit of the relief Congress intended for borrowers who can demonstrate the management potential to repay their FCS loans.

The ultimate test of the efficacy of the 1985 Act will be how it performs during different economic cycles. Consider this scenario: Export prices rise and surplus commodities drop. This will create a greater demand for agricultural products. Once again, farmers will expand their operations. Land prices will rise, increasing producers' borrowing needs.

How will the FCS react? If it tries to restrain borrowing, the good operators will borrow from commercial lenders outside the FCS. The borrowers who stay with FCS will be the less efficient operators. The result would be another farm credit crisis, at least for the FCS sector. If the FCA can manage the FCS through the inevitable economic cycles without major shake-outs of FCS members and borrowers, the 1985 Act will have accomplished Congress' ultimate goal: a long-term viable FCS.

IX. Question and Answer Supplement

A. *Borrowers' Rights*

1. *Does the new full disclosure law give the total cost of an FCS loan?*

No, the full disclosure law does not include the cost of stock retirement. If an interest note is variable, the disclosure reveals only the cost of the loan based on the interest in effect at the time of disclosure. 12 C.F.R. § 614.4366.

2. *What costs are included in the full disclosure law?*

Only the cost that includes the rate of interest at the time of disclosure and the cost of association stock purchase. 12 C.F.R. § 614.4367.

3. *Is there any disclosure of the variable interest rate cost?*

Yes, but it's limited to disclosing the standard adjustment factors used to compute the variable interest rate. 12 C.F.R. § 614.4366.

4. *What else is excluded under full disclosure?*

Full disclosure does not require a loan officer to explain different loan terms and options. *Caveat:* Borrowers should exercise their business judgment in deciding whether a financial package is best suited for them. The FCS lender is not their financial advisor. 12 C.F.R. § 614.4367. *See also* 51 Fed. Reg. 39,488 (1986).

5. *When must the FCS lender make disclosure?*

There is no point at which the terms must be disclosed. Usually they are disclosed after the parties have agreed to the terms and conditions. *Caveat:* Sometimes this will be after the loan agreement is executed. This is a permitted practice. 12 C.F.R. § 614.4367. *See also* 51 Fed. Reg. 39,488 (1986).

6. *Is there a notice requirement before an FCS lender can change the interest rate on a loan with a variable interest rate?*

Yes, there is a requirement that the new interest rate and the factors used to determine the new interest rate be disclosed ten days prior to the effective date of the change. 12 C.F.R. § 614.4367(c) & (d).

7. *Does the 1985 Act provide a formal process for an applicant whose loan was denied to seek review?*

Yes, all FLBs and PCAs must establish credit review committees. The applicant must submit information to the committee that will show that he/she qualifies for the loan under the *lender's* credit standards. 12 C.F.R. §§ 614.4442-614.4443. *See also* 51 Fed. Reg. 39,493 (1986).

8. *May an applicant whose loan is refused submit new information to the lender's credit review committee?*

No, the information submitted must be that which was originally submitted for the loan. If an applicant wants the lender to consider new information, he/she must re-apply for a loan. 12 C.F.R. § 614.4443. *See also* 51 Fed. Reg. 39,495 (1986).

B. *Forbearance*

This section has been changed substantially by the 1987 Farm Credit Act. *See* Part XI, questions 1-16, *infra.*

9. *Does an FCS lender have to develop a forbearance policy?*

No, institutions do not have to develop their own forbearance policy, but their forbearance related procedures must be approved by the district board. 12 C.F.R. § 614.4510. (This has been changed by the 1987 Farm Credit Act. *See* Part XI, question 11, *infra.*)

10. *So how does one discover what a lender's forbearance policy is?*

Ask. All lenders must keep a copy of their forbearance policy at their office even if it is only a copy of the district board's guidance for FCS members' forbearance. 51 Fed. Reg. 39,496 (1986).

11. *Do lenders have to give notice of their forbearance policy prior to collection?*

Yes, they must give notice at least ten days prior to commencement of *any* collection action. 12 C.F.R. § 614.4513. *See also* 51 Fed. Reg. 39,495 (1986).

12. *Does a lender have to provide forbearance if forbearance would be less costly than liquidation?*

No, the granting of forbearance is left solely to the discretion of the lender. Forbearance must only be actively considered and consistently applied. 51 Fed. Reg. 39,496 (1986). (This is changed under the 1987 Farm Credit Act. *See* Part XI, question 10, *infra.*)

13. *What must the lender actively consider in evaluating forbearance requests?*

The 1985 Act contemplates that the lender will consider all relevant matters when considering forbearance. However, of foremost consideration should be the factors that enable a lender to maximize the collection of debt and protect borrower/stockholders. 51 Fed. Reg. 39,496 (1986). (This is changed under the 1987 Farm Credit Act. *See* Part XI, question 10, *infra.*)

C. *Miscellaneous*

14. *If a borrower is in default may a lender retire the borrower/stockholder's stock and apply it to the debt?*

Yes, but the lender must give at least ten days' notice prior to the effective date of retirement. (This is changed somewhat by the 1987 Farm Credit Act. *See* Part XI, question 4, *infra.*)

15. *May a borrower and/or stockholder receive a list of all borrowers and stockholders?*

Lists of borrowers may only be disclosed to dealers in agricultural products for the purpose of informing such persons of the lender's security interests. 12 C.F.R. § 618.3310.

Stockholder lists must be provided to a stockholder who wants to communicate with other stockholders regarding the business operations of the institution. In lieu of disclosure, the institution may, with the agreement of the requesting stockholder, mail the communication the stockholder wants to convey to the other stockholders. 12 C.F.R. § 618.3310.

16. *May a borrower/stockholder prevent his loan from being sold to another lending institution?*

Yes, by refusing to become a stockholder in the purchasing institution, the borrower can void such a sale. 12 C.F.R. § 611.1165. *See also* 51 Fed. Reg. 32,437 (1986). (This is changed by the 1987 Farm Credit Act. *See* Pub. L. 100-233, 1988 U.S. CODE CONG. & ADMIN. NEWS (100 Stat.) ____, 2785-2788).

X. APPENDIX

Twice since 1985 the 1971 Farm Credit Act has been amended.[322] In 1986 Congress passed Pub. L. 99-509, the Omnibus Budget Reconciliation Act of 1986 [hereinafter the 1986 Farm Credit Amendment]. A year later Congress made substantial changes in the 1971 Farm Credit Act with the passage of Pub. L. 100-233, the Agricultural Credit Act of 1987 [hereinafter the 1987 Farm Credit Act]. Both acts were passed to correct farm credit problems left unresolved by the 1985 Act.[323] This Appendix reviews some of the major aspects of the 1986 and 1987 farm credit legislation.

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322. Pub. L. 99-509, 100 Stat. 1874, 99th Cong., 1st Sess., *reprinted in* 1986 U.S. CODE CONG. & ADMIN. NEWS [hereinafter 1986 U.S. CODE CONG.], and Pub. L. 100-233, 101 Stat. 1568, 100th Cong., 1st Sess., *reprinted in* 1988 U.S. CODE CONG. & ADMIN. NEWS [hereinafter 1988 U.S. CODE CONG.].

323. This statement will be substantiated with more specificity in the subsequent textual and note material. For a general overview of the problems left unresolved by the 1985 Act *see: Current Financial Condition of the Farm Credit System: Hearings Before the Comm. on Agriculture, Nutrition, and Forestry, United States Senate*, 99th Cong., 2d Sess. 91,986 [hereinafter *Senate Farm Credit Hearing*]; *Review of Implementation of the Farm Credit Amendments Act of 1985; GAO Report Assessing the Financial Condition of the Farm Credit System; and the Farm Credit System Borrower Interest Rate Relief Act of 1986: Hearings Before the Subcomm. on Conservation, Credit, and Rural Development of the Comm. on Agriculture, H.R.*, 99th Cong., 2d Sess. (1986) [hereinafter *H.R. Farm Credit Hearing*]; *Agricultural Credit: Hearings Before the Subcomm. on Agricultural Credit of the Comm. on Agriculture, Nutrition, and Forestry, United States Senate*, 100th Cong., 1st Sess. (1987) [hereinafter *Senate Ag. Credit Hearing*]; 1988 U.S. CODE CONG., *supra* note 322, at 2822-2936.

A. *1986 Farm Credit Legislation*

The 1986 Farm Credit Amendment was passed to encourage member institutions of the FCS to serve the needs of their eligible borrowers by providing competitive and equitable interest rates.[324] Congress did not specifically direct how FCS members were to provide competitive rates. Instead, Congress gave general directions, stating that the lenders should:

> take action . . . in such manner that borrowers . . . derive the greatest benefit practicable from the Act: *Provided*, That in no case is any borrower to be charged a rate of interest that is below competitive market rates for similar loans made by private lenders to borrowers of equivalent creditworthiness and access to alternative credit.[325]

The 1985 Act centralized the FCS because it made the FCA a regulator of the FCS's members and created the FCSCC to make assessments upon stronger members of the FCS and use the money to shore up weaker units.[326] Furthermore, the 1985 Act allowed the FCA to approve interest rates charged by System institutions.[327] The 1986 Farm Credit Amendment retreated from the strong regulatory position taken by the 1985 Act and removed the FCA's authority to approve FCS members' interest rates. This was the strongest indication that the efficacy sought by the 1985 Act had not been achieved by stronger centralized regulation. The 1986 Amendment also gave FCS members authority to act to reduce their borrowing costs in order to provide competitive interest rates.[328] This, too, was an inroad into the

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324. 1986 U.S. CODE CONG., *supra* note 322, at 1877.

325. *Id.*

326. *See supra* notes 152-253 and accompanying text.

327. *See supra* notes 232-34 and accompanying text.

328. 1986 U.S. CODE CONG., *supra* note 322, at 1878. Specifically, the law provided two avenues for FCS members to act to reduce their borrowing costs. The 1986 Farm Credit Amendment stated:

> (b) Through December 31, 1988, each bank of the System, in addition to purchasing obligations as authorized by this Act, may, with the prior approval of the Farm Credit Administration and subject to such conditions as it may establish, (1) reduce the cost of its borrowings by doing one or more of the following: (A) contracting with a third party, or an entity that is established as a limited purpose System institution under Section 4.25 and that is not to be included in the combined financial statements of other System institutions, with respect to the payment of interest on the bank's obligations and the obligations of other banks incurred before January 1, 1985, in consideration of the payment of market interest rates on such obligations, plus a premium, or (B) for the period July 1, 1986, through December 31, 1988, capitalizing interest costs on obligations incurred before January 1, 1985, in excess of the estimated interest costs on an equivalent amount of Farm Credit System obligations at prevailing market rates on such obligations of similar maturities as of the date of the enactment of this subsection, or (C) taking other similar action; and (2) amortize, over a period not to exceed 20 years, the capitalization of the premium, capitalization of interest expense, or like costs of any action taken under clause (1).

Id.

FCA's regulatory power.

The 1986 Farm Credit Amendment was passed one month after congressional hearings assessing the financial condition of the FCS and the implementation of the 1985 Act. The hearings produced evidence that one major problem for the FCS members was that their costs of money were above current costs for nonmembers.[329] The FCS's cost of money is high because 53% of the FCS's total bonds outstanding bear interest rates of 11% or more and half of these do not mature until between 1990 and 2005.[330] Furthermore, none have call provisions.[331] Thus, FCS members could not lend at competitive rates. Many of them had to loan at rates of 11% plus their costs. Such rates were not (and are not) competitive.

Other testimony showed that the FCA's capital adequacy requirements allowed it to determine the interest rates charged by individual members.[332] This fact, combined with FCSCC assessments, precluded stronger FCS members from charging competitive interest rates.[333] High borrowing costs caused the more creditworthy borrowers to seek lower-cost loans from non-FCS members.[334] Other testimony stated that the 1985 Act might have reduced creditworthy borrowers' confidence in the FCS. If the FCS needed money from outside the FCS, it had to obtain the Treasury Department's approval, and there was no assurance that such approval would be given readily.[335]

The 1986 Farm Credit Amendment was an attempt to remedy problems left unresolved, or *created*, by the 1985 Act. More important, the 1986 Farm Credit Amendment and the testimony given before Congress were strong indicators that the predicted result—a battle between the haves and the have-nots of the FCS—was occurring. Indeed, a worst case scenario was developing.[336]

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329. *Senate Farm Credit Hearing*, *supra* note 323, at 7 (statement of Hon. Frank Naylor, Chairman, Farm Credit Administration).

330. *Id.*

331. *Id.*

332. *Senate Farm Credit Hearing*, *supra* note 323, at 11 (statement of H. Brent Beesley, President and Chief Executive Officer, Farm Credit Corp. of America). The FCC of America was organized by FCS members in 1985 to establish policy on national issues. It is not part of the FCA. *Id.*

333. *Id.* at 11-15. This, of course, was disputed by the FCA. *See Senate Farm Credit Hearing*, *supra* note 323, at 7-10 (statement of Hon. Frank Naylor, Chairman, Farm Credit Administration).

334. *H.R. Farm Credit Hearing*, *supra* note 323, at 97 (statement of William J. Anderson, Asst. Comptroller General, General Government Programs, United States General Accounting Office); 1988 U.S. CODE CONG., *supra* note 322, at 2822-23.

335. *H.R. Farm Credit Hearing*, *supra* note 323, at 101 (statement of William J. Anderson, Asst. Comptroller General, General Government Programs, United States General Accounting Office).

336. *See generally supra* note 323.

B. *1987 Farm Credit Act*

1. *Introduction*

The 1987 Farm Credit Act is the most comprehensive farm credit legislation since the 1971 rewrite of the Farm Credit Act. This section of the Appendix briefly reviews some of the legislative history and the major aspects of the 1987 Farm Credit Act, exclusive of Farmer's Home Administration loan programs. It is followed by a Question and Answer Supplement.

2. *Legislative History*

All witnesses who testified concerning the 1987 Farm Credit Act agreed that the FCS was deteriorating.[337] The witnesses also agreed that the 1985 Act and the 1986 Farm Credit Amendment had been ineffective in stemming further FCS losses and resolving the structural[338] and operational[339] problems which were contributing to the losses. Of course, the witnesses offered different solutions.

Extensive review of the FCS was conducted by the General Accounting Office during 1986.[340] In opening remarks Comptroller General Charles A. Bowsher stated that more competitive loan rates and protection of borrowers' stock were needed to stabilize the FCS's customer base.[341] Furthermore, he stated that a funding reserve was needed to ensure repayment of FCS debt and underwrite its losses.[342]

Other witnesses testified that the FCSCC needed to be replaced by another method for allocating capital among FCS members.[343] Several witnesses spoke about the problem of borrower flight and stated that such flight would be halted or lessened by loan restructuring for distressed borrowers.[344] Ironically, some witnesses attributed the need for debt restructuring to excessive decentralization and local decision-making,[345] while others

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337. 1988 U.S. CODE CONG., *supra* note 322, at 2820-2955.

338. Structural changes would refer to the organizational aspects of the FCS and the FCA. FCA Board member Marvin R. Duncan stated that there were "three broad problems. First, the cost of FCS debt was too high, averaging 10.6 percent in interest. Second, as noted earlier, nearly one-fourth of its assets were troubled. *Third, the System needs to modernize and streamline its management and delivery mechanisms.*" 1988 U.S. CODE CONG., *supra* note 322, at 2823 (emphasis added). *See also id.* at 2824.

339. *Id.* (also see items one and two in the statement of Marvin R. Duncan, *supra* note 338).

340. *Id.* at 2824.

341. *Id.*

342. *Id.*

343. *Id.* at 2829, 2837, and 2848.

344. *Id.* at 2831, 2835, 2838, and 2844. The above cites are representative of debt restructuring programs suggested by different witnesses. Though the specifics of the debt and/or loan restructuring plans differed, nevertheless several witnesses representing diverse groups agreed that debt and/or loan restructuring was necessary.

345. *Id.* at 2824.

attributed it to the centralization which the 1985 Act instituted when it gave the FCA a regulatory role.[346]

After hearing extensive testimony, Congress reached several conclusions. First, it concluded that the 1985 Act had not been successful.[347] Second, it determined that the 1986 Act had only bought more time.[348] Third, it stated that the 1987 Farm Credit Act "accepts the inevitability of Federal financial assistance to the Farm Credit System."[349]

C. *1987 Farm Credit Act Provisions*

The most ambitious aspect of the 1985 Act was the establishment of the FCSCC. The 1987 Farm Credit Act abolished the FCSCC and replaced it with the Temporary Assistance Corporation [hereinafter TAC].[350] The TAC is responsible:

> for administering the guarantee of the farmer-owned Class B Stock as provided for in H.R. 3030. It would essentially provide assistance to System institutions that are experiencing problems such as impairment of stock, inadequate capital, the danger of default on its obligations, or financial burdens relating to high interest rate obligations.
>
> The TAC would have authority to provide a wide range of financial assistance services such as direct assistance, technical assistance, purchase of nonaccrual assets at the request of the institution, assumption of the debt of institutions, and a requirement that institutions sell to it loans or assets over $500,000.[351]

This provision is acknowledgment by Congress that the complicated capital preservation agreements have not worked.[352]

To complement the TAC Congress established the Farm Credit System Insurance Corporation [hereinafter FCSIC].[353] The purposes of the FCSIC are to enhance the marketability of FCS bonds and to provide assurance to

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346. *Id.* at 2838 and 2841.

347. *Id.* at 2731.

348. *Id.*

349. *Id.*

350. *Id.*

351. The Temporary Assistance Corporation [hereinafter TAC] requires an infusion of federal funds into the FCS. Thus, the FCS no longer will be borrower-owned. This is a temporary situation. The 1987 Farm Credit Act contemplates repayment of federal money and a return to a fully borrower-owned system. *Id.* at 2732.

Because of the federal infusion, there is more centralized control. Specifically:

> H.R. 3030 requires that each System Bank and PCA submit to the TAC its business plan and update the plan annually. Institutions applying for or receiving assistance must include provisions describing the manner in which they will meet minimum capital standards established by FCA. The business plans will be the primary tool used by TAC to monitor the recovery of ailing institutions.

Id.

352. *Id.*

353. *Id.*

borrowers and investors.[354] The FCSIC would be funded:

> with $270 million from an old System revolving fund, now held by the Treasury and controlled by the FCA. It would be supplemented over the next 5 years by assessing System banks .0015 percent of the average annual value of their accrual loans and .0025 percent of their nonaccrual loans. This risk-based assessment procedure is designed as continuing encouragement to lenders to deal with problem loans early, thereby maintaining a very high percentage of accrual loans that are assessed at the lower rate.
>
> The fund would be maintained at 2 percent of the value of all System loans outstanding or such other level deemed appropriate by the board. The 2 percent level is within the range now used by other similar insurance pools, but adjustments may be needed due to the long-term cyclical nature of the agricultural economy.[355]

With the TAC and FCSIC, Congress made an end run around the FCSCC litigation. These two corporations shift capital funds within the System, as did the FCSCC. However, this shift places a greater burden on members having non-accrual loans, because they are assessed at a higher rate by the FCSIC. This raises some interesting points.

First, despite the loan restructuring aspects of the 1987 Farm Credit Act, the higher assessment of non-accrual loans will be strong motivation for member institutions to foreclose such loans.

Second, under the Act's restructuring criteria, an institution could reasonably anticipate additional costs, in the form of higher FCSIC assessments, if its restructured loans fall into non-accrual status. FCS lenders could use these additional costs to tip the scales in favor of foreclosure.[356]

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354. *Id.* at 2732-33.

355. *Id.*

356. Borrowers may be protected from this because the assessment is based on the annual average principal outstanding for the year. Smaller outstanding loans would have a minimal effect on the average annual outstanding balance, and thus, a minimal effect on the cost to the FCS member of restructuring the loan even if the potential for return to non-accrual is high.

However, where non-accrual loans are of substantial sums, and their foreclosure early in the year would substantially reduce the average annual non-accrual principal outstanding, there is obvious incentive to foreclose.

A bank could present an argument structured thus: assume foreclosure of several borrowers' loans would, if aggregated, reduce the average annual non-accrual principal outstanding. Further, assume that the bank has reliable data that in the past, loans exhibiting such characteristics reverted to non-accrual status 80% of the time. Since 80% is greater than .0015 (the accrual assessment rate)/.0025 (the non-accrual assessment rate), lenders would benefit by foreclosing all non-accrual loans which, after restructuring, would have a 60% or greater probability of reverting to non-accrual status. The lender could contend that it should be allowed to aggregate the amount by which the .0025 assessment on such loan amounts increases the non-accrual annual average, times the probability of their return to non-accrual status (which in this scenario is 80%), *and* 20% (*i.e.*, 100%-80%) of the .0015 assessment, times the amount such loans would increase the average annual accrual principal outstanding. The additional cost would be added to each loan in the proportion which that loan bears to the total amount of loans of its

The result will be litigation. The courts will have to decide if individual cases have been handled in compliance with Congress' intent. The issue will be whether such costs are reasonable costs[357] as allowed by the 1987 Farm Credit Act. The policy issue will be the same as it was in the litigation under the 1985 Act: how to strike a balance between the rights of borrowers and the need for a viable FCS.

Third, the philosophy of the FCSIC is the inverse of that of the FCSCC. The theory of the FCSCC was that the haves would help the have-nots. The theory of the FCSIC is that the have-nots pay a premium for being have-nots. The irony is that the FCSIC may be a contributing factor in the downfall of some weaker members. In the long run the remaining FCS members (presumably the haves) will pay for such failures. But the FCSIC will buy time for the haves to pay for the failures of the have-nots.[358]

The 1987 Farm Credit Act also deals extensively with loan restructuring and borrowers' rights. The loan restructuring provisions require that restructuring be granted if the cost is equal to or less than the cost of foreclo-

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class (*i.e.*, loans in need of restructuring). This additional cost could be enough to tip the scales in favor of foreclosure over restructuring. Of course, this simple model ignores (1) other transactional costs that may be incurred in the reversion of such a loan to non-accrual status, and (2) opportunity income lost by failing to liquidate the collateral and restructuring instead. On the other hand, because the model is concerned only with FCSIC assessment, it ignores the value of the 20% of loans which would not revert to non-accrual and the amounts that would be collected in a restructuring.

357. After a qualified lender has reviewed *a loan that is in nonaccrual status* to determine if it is suitable for restructuring and considered any restructuring proposals offered by the borrower, the lender would be required to restructure the loan if the following conditions are present: (a) The present value of the loan restructured to enable the borrower to meet the loan obligations exceeds the liquidation value of the loan (taking into consideration the lender's estimate of the borrower's repayment capacity and the liquidation value of any interests in property securing the loan less reasonable and necessary costs and expenses, including attorneys' fees, court costs, collateral asset depreciation, and other commonly incurred costs, that would be incurred by the lender to obtain payment on the loan or title to the interests, to preserve the value of any interests that may depreciate, and to dispose of the interests in the course of a liquidation); and (b) the borrower has acted responsibly in the management of his business affairs, has pledged or agreed to pledge all available assets of more than nominal value to the extent required to increase the value of the collateral for the loan to the amount required under the Act and has acted in good faith with the lender.

After a qualified lender has reviewed *a high risk loan* to determine whether steps (including restructuring) may be taken to reasonably ensure that it will not become a nonaccrual loan and considered any proposals offered by the borrower to so ensure that it does not become nonaccrual, the lender would be required to take any steps (including restructuring) that the lender deems necessary to so ensure that the loan does not become nonaccrual, if the borrower has acted responsibly in the management of his business affairs and has acted in good faith with the lender.

H.R. REP. No. 295(I), 100th Cong., 1st Sess. 77, *reprinted in* 1987 U.S. CODE CONG. & ADMIN. NEWS 2748.

358. 1988 U.S. CODE CONG., *supra* note 322, at 2733-2735, 2804.

sure.[359] However, if default occurs after restructuring, in all instances the full amount of the debt *before* restructuring will be restored.[360]

Borrowers' rights were enhanced by the 1987 Farm Credit Act. Much of the testimony heard by Congress concerned the abuse borrowers suffered at the hands of some FCS members.[361] The 1987 Farm Credit Act added the following provision for borrowers:

> Guaranteed rights to receive a copy of property appraisals; Notification of the institution's restructuring program; Notification of the denial of restructuring and an in-person meeting with the credit review committee; Guarantee of an in-person meeting prior to foreclosure actions; Prohibition of foreclosure or additional required principal payments if the borrower has made all payments; Right to rent, lease or purchase the homestead or principal residence in the case of a farm foreclosure; and Certain rights of first refusal to prior borrowers regarding the disposal of the acquired property.[362]

The Farm Credit Act also made several other major additions and changes to the FCS. The 1987 Act established the Federal Agricultural Mortgage Corporation.[363] The purposes of the Agricultural Mortgage Corporation [hereinafter AMC] are to:

> (1) establish a corporation chartered by the Federal Government;
> (2) authorize the certification of agricultural mortgage marketing facilities by the corporation; and
> (3) provide for a second marketing arrangement for farm real estate mortgages to increase the availability of long term credit for farmers at stable interest rates; provide a greater liquidity and lending capacity in extending credit to farmers; and provide an arrangement to facilitate capital market investments in providing long term agricultural funding, including funds at fixed rates of interest.[364]

It is significant that the outstanding common stock of the AMC must be equally divided between FCS institutions and non-members. This is important because it spreads the investment risk equally between the two types of institutions. As a result, one-half of the investment risks fall outside the system. However, because the par value of the stock is guaranteed for five years, the ultimate risk is with the federal government for at least that length of time.[365]

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359. *Id.* at 2733.
360. *Id.* at 2734.
361. *Id.* at 2735.
362. *Id.*
363. *Id.* at 2804.
364. *Id.*
365. The 1987 Farm Credit Act, § 102, provides that the par value of all borrower stock will be protected for five years. *Id.* at 2745. Borrower stock is defined to include "other forms and types of equities, issued by an institution of the FCS and held by a person other than an

The AMC will produce System efficiency and more cautious loan underwriting by FCS members, because it is a market driven vehicle. The AMC will be used by FCS members to reliquify or obtain more cash to lend. To lend at competitive rates, the members must themselves borrow at the lowest possible cost. To borrow at low cost, the underlying obligations of mortgages must be financially strong. FCS members may pool the mortgages of borrowers ascertained to be financially strong. Thus, as the underlying mortgages have a low risk factor, the obligations which cover such mortgages should be sold at a low rate of interest. This will reduce the FCS members' cost of money and allow them to loan at more competitive rates.

The AMS will cause stronger FCS members to pool interests to produce securities covering underlying mortgages of financially strong borrowers. Since part of the interest rate paid by investors will be determined by the creditworthiness of the loan originators, it will be natural for stronger institutions to band together to issue paper. This prediction is supported by the fact that each mortgage loan originator must "absorb any losses on loans it has originated up to the total amount it has contributed to the reserve *before such losses are absorbed by the contributions of the other originators participating in the pool.*"[366] Stronger member institutions will avoid pooling with weaker institutions, because the FCSIC will not assist defaulting institutions with repayment of debt until calls have been made on all non-defaulting banks in proportion to such banks' pro rata share of the aggregate available collateral held by all banks.[367]

FCS institution." *Id.* The Agricultural Mortgage Corporation is deemed a member institution of the FCS. *Id.* at 2805.

366. *Id.* at 2811.

367. *Id.* at 2776-77 (emphasis added). The passage reads:

> Under current law, subsection (a) of section 4.4 of the Act provides that each bank of the System will be fully liable on notes, bonds, debentures, or other obligations issued by it individually, and will be liable for the interest payments on long-term notes, bonds, debentures, or other obligations issued by other banks operating under the same title of the Act. Each bank will also be primarily liable for the portion of any issue of consolidated or System-wide obligations made on its behalf and be jointly and severally liable for the payment of any additional sums as called upon by the Farm Credit Administration in order to make payments or [sic] interest or principal which any bank primarily liable therefore is unable to make. The calls will be made first upon the other banks operating under the same title of the Act as the defaulting bank, and second on banks operating under other titles of the Act, taking into consideration the capital, surplus, bonds, debentures, or other obligations which each may have outstanding at the time of the assessment.
>
> Section 106, in paragraph (1) of subsection (b), will amend subsection (a) of section 4.4 by striking out the last sentence and inserting a new provision to require that calls first must be made on all nondefaulting banks in proportion to each bank's proportionate share of the aggregate available collateral held by all of the banks. The term *available collateral* means the amount (determined at the close of the last calendar quarter ending before the call) by which a bank's collateral, as described in section 4.3, exceeds the collateral required to support the bank's outstanding notes,

The last major change instituted by the 1987 Farm Credit Act was a total reorganization of the FCS.[368] The 1987 Act dissolves the federal land and intermediate credit banks.[369] The new system will charter six regional Farm Credit System Service Banks [hereinafter FCSSBs]. These banks will service FLBA and PCAs.[370] However, the FCSSBs will not have authority to engage in or supervise interest rate or loan approval policies.[371] The 1987 Farm Credit Act also allows FCS members, whether or not organized under the same title of the 1972 Act, to merge upon approval of a majority of their boards of directors and stockholders. The effect will be to streamline the FCS by reducing cost, thus increasing efficiency. This will assist FCS members in providing competitive interest rates, because if their costs are lower, they can price their products lower.

D. *Summary*

The goals of the 1987 Farm Credit Act are the opposite of those of the 1985 Act in the area of System self-help. The 1985 Act sought to preserve all FCS members through System self-help; the stronger members were to assist the weaker. The 1987 Act allows individual FCS member institutions more discretion in setting policy and making long-term plans. This will cause the stronger members to act in concert to solidify their positions at the expense of the weaker members. The weaker members will have to be supported by the TAC, the FCSIC, and the federal money which supports the TAC. Eventually the weaker members will be eased out or they will ease out their weak borrowers to improve their positions.

As in the case of the 1985 Act, passage of the 1987 Act was a battle between the haves and the have-nots. Both Acts were intended to preserve borrowers' rights by delineating specific standards and procedures involved in loan restructuring, credit denial, and general loan applications. But both will have the same result: weak borrowers will be washed out of the system and the losses will be absorbed by the various mechanisms the 1987 Act

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bonds, debentures, and other similar obligations. If the Farm Credit Administration makes a call and the available collateral of all the banks does not fully satisfy the liability necessitating the calls, calls must be made on all nondefaulting banks in proportion to each bank's remaining assets. Any System bank that, pursuant to a call by the Farm Credit Administration, makes a payment of principal or interest to the holder of any consolidated or System-wide obligation issued on behalf of another System bank must be subrogated to all rights of the holder against the other bank to the extent of the payment. On making the call with respect to obligations issued on behalf of a System bank, the Farm Credit Administration must appoint a receiver for the bank which must expeditiously liquidate or otherwise wind up the affairs of the bank.

368. *Id.* at 2817.

369. *Id.* at 2818.

370. *Id.*

371. *Id.*

established to absorb such losses—the TAC, the FCSIC, and capitalization and amortization of losses over a twenty-year period. The clearest sign that this result will occur is the fact that the 1987 Act streamlines the System. If Congress believed that the current situation would improve enough to keep the number of agricultural producers and their lenders stable, it would not have streamlined the FCS and established entities to cope with losses resulting from borrowers' defaults and lenders' failures.

The 1987 Act strengthens the position of the FCS's strong members. It also provides detailed procedures which allow attrition of financially weak borrowers. The 1987 Act recognizes that the goal of the 1985 Act—to save as many FCS member institutions and borrowers as possible—was unrealistic.

Finally, the 1987 Act establishes foreclosure procedures which are detailed enough to ensure that there will be less court interference with the inevitable washout of weak FCS members and borrowers. This time, the final product will be a stronger FCS.

XI. 1987 Agricultural Credit Act: Question and Answer Supplement

A. *Borrowers' Rights*

1. *Does the 1987 Act require lenders to provide borrowers with greater access to documents?*

Not really. The only new provisions are those which give borrowers access to lenders' appraisals of the borrowers' property. Pub. L. 100-233, 1988 U.S. Code Cong. & Admin. News (100 Stat.) 2723, 2751.

2. *Does the 1987 Act change the notice which borrowers must receive concerning lenders' actions?*

Yes, but the Act requires only prompt notice to borrowers with *distressed* loans of any actions taken by lenders in regard to restructuring or prevention, and of the borrowers' rights to a review of those actions. *Id.*

3. *What is a distressed loan?*

A distressed loan is any loan having high-risk or non-accrual status. *Id.* at 2747.

4. *What is a high-risk loan?*

A loan is high-risk if: (a) *the FCS member* has determined that the borrower probably will not be able to repay fully, or (b) the value of the security is less than the amount required by the Act. *Id.* at 2747 (emphasis added).

5. *Does the 1987 Act pre-empt states' agricultural loan mediation programs?*

No. The 1987 Act *prohibits* any FCS member from requiring borrowers to waive any rights under such programs. Furthermore, the 1987 Act requires *each* FCS member to participate in good faith in such programs. *Id.* at 2753 (emphasis added).

B. *Loan Restructuring*

6. *What does restructuring include?*

Restructuring includes rescheduling, reamortization, renewal, deferral of principal or interest payments, monetary concessions, and any other actions to modify the terms of, or forbear on, a loan in any way which will make it probable that the operations of the borrower will become financially viable. Pub. L. 100-233, 1988 U.S. CODE CONG. & ADMIN. NEWS (100 Stat.) 2723, 2746-47.

7. *Who may restructure a loan?*

Any borrower whose loan is classified as distressed may have the loan restructured. (See question 3 under Borrowers' Rights for a definition of distressed loan.) *Id.* at 2747.

8. *What are the restructuring procedures?*

Once a loan has become distressed, the lender must provide written notice to the borrower that the loan is eligible for restructuring. The lender must also provide the borrower with a copy of the lender's policy concerning distressed loans and all material necessary for the borrower to make a proposal for restructuring or preventive action on the loan. *Id.* at 2747.

9. *Distressed loans are defined as high-risk OR non-accrual loans (see Question 3, Borrowers' Rights); are there any procedural differences between the two?*

Yes. If a loan is in the high-risk category, the lender must personally meet with the borrower to review the status of the loan, the financial condition of the borrower, and the suitability of the loan for restructuring *or preventive action.* But if the loan is in non-accrual status, the lender need only personally meet with the borrower to determine the suitability of restructuring the loan. Furthermore, when a lender reclassifies a loan to non-accrual from high-risk, the lender must arrange for another personal meeting with the borrower to review the reclassification. *Id.* at 2747-48 (emphasis added).

10. *Are there any differences between the criteria to be applied by the*

lender to high-risk loans and those to be applied to non-accrual loans?

Yes. The legislative history of the statute explains the differences as follows:

> After a qualified lender has reviewed *a loan that is in nonaccrual status* to determine if it is suitable for restructuring and considered any restructuring proposals offered by the borrowers, the lender would be required to restructure the loan if the following conditions are present: (a) The present value of the loan restructured to enable the borrower to meet the loan obligations exceeds the liquidation value of the loan (taking into consideration the lender's estimate of the borrower's repayment capacity and the liquidation value of any interests in property securing the loan less reasonable and necessary costs and expenses, including attorneys' fees, court costs, collateral asset depreciation, and other commonly incurred costs, that would be incurred by the lender to obtain payment on the loan or title to the interests, to preserve the value of any interests that may depreciate, and to dispose of the interests in the course of a liquidation); and (b) the borrower has acted responsibly in the management of his business affairs, has pledged or agreed to pledge all available assets of more than nominal value to the extent required to increase the value of the collateral for the loan to the amount required under the Act and has acted in good faith with the lender.
>
> After a qualified lender has reviewed *a high risk loan* to determine whether steps (including restructuring) may be taken to reasonably ensure that it will not become a nonaccrual loan and considered any proposals offered by the borrower to so ensure that it does not become nonaccrual, the lender would be required to take any steps (including restructuring) that the lender deems necessary to so ensure that the loan does not become nonaccrual, if the borrower has acted responsibly in the management of his business affairs and has acted in good faith with the lender.

Id. at 2748.

11. *Are there any other matters regarding the treatment of distressed loans by lenders?*

Yes. The lender must develop a policy for the treatment of such loans. The policy must be approved by the FCA. The borrower should ask for a copy of the policy. The policy developed may not modify, amend, or deviate from any of the criteria specified by the 1987 Act. *Id.* at 2749.

12. *What is the status of loans which are already in the process of foreclosure?*

Lenders are prohibited from foreclosing *or continuing foreclosure pro-*

ceedings effective immediately. The lender must consider such loans for restructuring or preventive action in accordance with the new law. *Id.* at 2749 (emphasis added).

13. *Are there situations in which the lender may foreclose or take other action relative to a contractual provision without giving consideration to restructuring or preventive action?*

Yes. If a lender has reasonable grounds to believe that loan collateral will be destroyed, dissipated, consumed, concealed, or permanently removed from the state in which it is located, the lender may act without consideration of restructuring or preventive action. Also, if the lender and the borrower are already negotiating restructuring or preventive action, the lender may forgo the notice and evaluation requirements. *Id.* at 2749-50.

14. *Are there any penalties for restructuring?*

Yes. If an FLB or PCA forgives any of the principal of an outstanding loan, it may cancel the borrower's stock up to an amount equal to the percentage the principal forgiven bears to the total outstanding principal of the loan. *Id.* at 2750.

15. *What should a borrower do if the lender is not complying with the new restructuring or preventive action procedures?*

Notify the FCA. The FCA has enforcement powers over FCS lenders *and their personnel* in such matters. The FCA may enforce compliance with the Act or invoke penalties for violations of the new procedures. *Id.* at 2750 (emphasis added).

16. *Are there penalties if a borrower defaults on a restructured loan?*

Yes. The legislative history of the 1987 Act states that: "In all instances . . . [the] language in . . . [the] agreements enables . . . [the lenders] to restore the *full amount of debt* prior to restructuring . . . ." The agreements should be reviewed to ascertain whether the phrase "full amount of debt" includes interest and other charges, because the 1987 Act does not specify what is included. *Id.* at 2734 (emphasis added).

C. *Miscellaneous*

17. *What is the extent of the FCSIC's power to enforce collection of its premiums?*

The FCSIC may bring an action in court to enforce payment of the premium. In such an action, the FCSIC may impose personal liability on

every director who participated in or assented to failure to pay the premiums. Pub. L. 100-233, 1988 U.S. CODE CONG. & ADMIN. NEWS (100 Stat.) 2723, 2771.

18. *For what damages would the directors in Question 17 be liable?*

All, including consequential. *Id.* at 2771.

19. *Must the FCSIC always give assistance to an FCS member in need?*

No. If the cost of such assistance would be greater than the cost of liquidating the FCS member (including paying insured obligations issued on behalf of the bank), the FCSIC may decline assistance and liquidate the member. *Id.* at 2774.

20. *If the FCSIC provides assistance to an FCS member, what are the rights of owners of obligations issued by the bank, and of its other creditors?*

The rights of owners of obligations issued by the bank, and those of other creditors, are superior to those of the FCSIC. *Id.* at 2774.

21. *What else can a borrower or his representative do?*

The FCA can be expected to promulgate rules to implement the 1987 Act. They will be published in the *Federal Register*. Look in the index of the *Federal Register* under the heading: "Farm Credit Administration."