Shared Appreciation Agreements: Confusion and Mismanagement Threatens Family Farmers

by

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SHARED APPRECIATION AGREEMENTS: CONFUSION AND MISMANAGEMENT THREATENS FAMILY FARMERS

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To date, there have been almost 12,000 Shared Appreciation Agreements between American family farmers and the Farm Service Agency ("FSA").[1] Many of these agreements were entered into ten or more years ago as a result of the farm financial crisis of the 1980s. As these contracts reach the end of their term, the FSA is claiming a right to recover fifty percent of whatever appreciation has occurred in the farm land over the last ten years. Some argue that these agreements were never supposed to be enforced against farmers who stayed on the land for the term of the agreement.[2] Many farmers assert that they cannot afford to pay and FSA collection efforts will result in the forced sale of family farms throughout the country.[3]

This article analyzes the legal obligations associated with Shared Appreciation Agreements ("SAAs"), focusing on the agreements signed by family farmers who survived the 1980s farm crisis and who continue to operate family sized farms. The story of these farmers and the interpretation of the SAAs that they signed reveals a lack of foresight on the part of the government, naivety on behalf of farmers, and disturbing inequities. Not only did many farmers misunderstand the legal significance of the contracts they signed, post-contract regulatory changes have altered the government's interpretation of the contract and its policy toward enforcement.

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1. *See* Farm Loan Programs Account Servicing Policies—Servicing Shared Appreciation Agreements, 64 Fed. Reg. 61,221, 61,622 (Nov. 10, 1999) (to be codified at 7 C.F.R. pt. 1951) (prefatory comments).

2. *See Feds Say It's Payback Time-Farmers Left Bewildered: The Farm Service Agency Says Payments on 10-Year-Old Write-Offs Are Due: Farmers Dispute That Interpretation*, ORLANDO SENTINEL, Sept. 4, 1999, at B9 [hereinafter *Feds*].

3. *See Hearing Before the Subcomm. on Conservation, Credit, Rural Dev., and Research*, 107th Cong., 2001 WL 21756312 (statement of Carolyn B. Cooksie, Deputy Administrator for Farm Loan Programs, FSA, USDA). Cooksie reported that "under the current economic conditions, many farmers may not be able to pay the amount due under their agreement. . . . [E]ven with deferral of payments and development of longer-term repayment schedules, some farmers will not be able to keep the agreement and will face liquidation." *Id.* This looming problem has also been well documented in the press. *See* Ellyn Ferguson, *10-Year Agreement May Force Farmers to Sell Land*, USA Today, May 14, 1999, at 20A; Jim Patrico, *Losing the Farm, Ten-Year-Old FSA Loans are Coming Due, and Uncle Sam Wants His Money*, PROGRESSIVE FARMER, Feb. 1999, at 24, *available at* http://progressivefarmer.com/issue/0299/losingthefarm/default.asp.

This article will examine the nature of SAAs and will address three legal issues that have sparked controversy in the agricultural community. First, is there an obligation for recapture at the end of the term of the agreement for farmers who remain on their farms? Second, if there is an obligation, how should the amount of the recapture obligation be determined? Third, how should a recapture obligation be financed or otherwise collected?

In addition, this article discusses inequities resulting from agency delays in resolving problems with the agreements and changes in the law that have affected the government's interpretation of the original contract. Finally, this article will propose solutions for the agreements in existence and reforms to apply to agreements signed in the future.

I. BACKGROUND: THE PARTIES TO THE CONTRACT

The SAAs that are the subject of this article are agreements drafted by the FSA and used in conjunction with the farm loan programs administered by that agency. The parties to these agreements are the FSA as lender and a qualified family farmer as borrower.

A. *The Farm Service Agency*

The FSA is an agency within the United States Department of Agriculture ("USDA") created in 1994 as a result of a congressionally mandated reorganization of the USDA.[4] This reorganization merged the politically powerful Agricultural Stabilization and Conservation Service ("ASCS") with the sometimes maligned farmer loan programs of Farmers Home Administration ("FmHA").[5] ASCS was the agency in charge of the lucrative farm programs that have driven the American farm economy for many years.[6] FmHA on the other hand, was a "social welfare" agency charged with assisting those family farmers who needed financial assistance and were unable to obtain credit from commercial sources.[7] Under reorganization, these two

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4. *See* 7 U.S.C. § 6932 (1994).

5. *See id.* § 6932; *see also* Alan R. Malasky & William E. Penn, *USDA Reorganization—Fact or Fiction?*, 25 U. MEM. L. REV. 1161 (1995) (discussing the implications of the Espy plan for reorganization).

6. *See generally* Christopher R. Kelley & John S. Harbison, *A Guide to the ASCS Administrative Appeal Process and to the Judicial Review of ASCS Decisions*, 36 S.D. L. REV. 14 (1991) (discussing the creation and function of the ASCS).

7. In a landmark case addressing FmHA's obligations to its borrowers, a Georgia court carefully charted the history of FmHA as a lender. *See* Curry v. Block, 541 F. Supp. 506, 509-11 (S.D. Ga. 1982). The court concluded, "[i]n summary, federal intervention in agricultural credit shows a long history of farmer loans designed to aid the family farmer who cannot obtain credit from a different source. Thus, as with most programs spawned in the Depression years . . . the object of the legislation is to aid the underprivileged farmer, and is therefore a form of social welfare legislation. *Id.* at 511.

diverse functions merged, creating the new FSA.[8] The focus of this article is on the FmHA component of FSA, that is, the FSA division responsible for the agency's loan making functions.

The unique "social welfare" status of the farmer loan programs survived the administrative merger.[9] While now under the administration of the FSA, the purpose of the farm ownership loan program, which is one of the programs often associated with the use of shared appreciation agreements, continues to be

> to provide credit and management assistance to eligible farmers and ranchers to become owners-operators of family-sized farms or to continue such operations when credit is not available elsewhere. Agency . . . assistance enables family-farm operators to use their land, labor and other resources, and to improve their living and financial conditions so that they can obtain credit elsewhere.[10]

B. *The Borrowers*

The borrowers subject to the SAAs began their relationship with the FSA by obtaining a farm program loan from that agency or its predecessor, FmHA. Therefore, these borrowers meet the restrictive statutory and regulatory requirements associated with FSA (and previously FmHA) farm program lending.[11] Two requirements are particularly critical. First, the borrower must be unable to obtain credit elsewhere, and second, the borrower must be a "family farmer."[12]

Borrowers who are party to an SAA share another distinction, however. For "reasons beyond their control" they have defaulted on their loan obligation to the FSA and have obtained debt forgiveness from the agency.[13] The SAA is not part of the

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8. Initially, the newly merged agency was called Consolidated Farm Service Agency, but the name was changed administratively to Farm Service Agency for ease of reference. *See* Agency Name Change, 60 Fed. Reg. 64,297, 64,297 (Dec. 15, 1995).

9. *See generally* U.S. GEN. ACCT. OFF., EMERGENCY DISASTER FARM LOANS: GOVERNMENT'S FINANCIAL RISK COULD BE REDUCED, GAO/RCED 96-80, 2 (1996) (detailing loan practices that have remained consistent through the inception of the FSA).

10. Farm Ownership, Soil and Water and Recreation, 7 C.F.R. § 1943.2 (2001).

11. These requirements are both initial eligibility requirements and ongoing in nature, that is, the borrower must continue to be eligible for the program or the loan can be called and the borrower asked to "graduate" to a commercial lender. *See, e.g.*, United States v. Anderson, 542 F.2d 516, 516-17 (9th Cir. 1976) (holding a farmer was required to refinance a loan even though he would have to pay a higher interest rate).

12. For example, with regard to real estate loans, termed "Farm Ownership" ("FO") loans, FSA's statutory authority to make loans is limited to borrowers who meet four basic eligibility requirements: 1) U.S. citizenship; 2) farming background or experience; 3) the purchase of a "family sized farm;" and 4) the inability to obtain sufficient credit elsewhere at reasonable rates and terms. *See* 7 U.S.C. § 1922(a) (2000).

13. FSA loans that become delinquent are subject to a statutorily mandated debt restructuring review process. *See* 7 U.S.C. § 2001 (2000). In order for a borrower to be eligible to receive debt restructuring, the borrower's "delinquency must be due to circumstances beyond the control of the

original loan transaction. Rather, the SAA arises from the administrative debt restructuring process which is built into the loan servicing process for FSA loans.[14] If the borrower's debt obligation is written down under this process, the debt write down will be conditioned on the borrower's agreement to enter into an SAA.[15] In this context, the SAA is not negotiable, neither in its existence nor in its terms.[16] In order to provide the government with an opportunity to recover part of the debt, the FSA requires forgiveness by the SAA, if the debtor's property appreciates in value.[17] The borrower agrees to sign the SAA in order to obtain debt forgiveness and to avoid foreclosure.

II. THE ORIGIN OF THE FSA SHARED APPRECIATION AGREEMENT

The use of the shared appreciation agreements in USDA farm lending programs can be best understood by examining the origin of this use.

A. *Historical Background: The Farm Financial Crisis of the 1980s*

Following on the heels of an agricultural boom in the 1970s, the "agricultural depression" that marked the 1980s has been said to "rival that of the 1930s in terms of its impacts on farmers."[18] "Farmers saw their net worth decline by more than half as land values," machinery values, and crop prices all declined dramatically.[19] Economic forces outside of the agricultural economy caused a similarly dramatic rise in credit costs as interest rates soared.[20] FmHA, as the "lender of last resort," held a farm loan portfolio that was particularly vulnerable.

The period of the late 1970s and early 1980s was also marked by a large number of FmHA emergency loans given to farmers experiencing natural disasters.[21] At that time, these loans were given to eligible borrowers based on only "minimal projected cash flow margins" and with no maximum limit on the total amount of emergency loan debt that a farmer could accrue.[22] The combined factors of farm

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borrower." *See* 7 U.S.C. § 2001(b)(1) (2000).

14. *See id.* § 2001(e).

15. The execution of a shared appreciation agreement is a condition to receiving a write down of debt under the FSA administrative debt restructuring process. *See* Servicing and Collections, 7 C.F.R. § 1951.909(e)(4)(vi) (2001).

16. *See* 7 U.S.C. § 2001(e).

17. *See id.* § 2001(e).

18. S. REP. NO. 100-230, at 14 (1987).

19. *Id.* at 21.

20. *See* NEIL E. HARL, THE FARM DEBT CRISIS OF THE 1980S 13-17 (1990).

21. U.S. GEN. ACCT. Off., *supra* note 9, at 3. The number of emergency loans peaked in 1981 at 138,990. *See id.* at 4.

22. *Id.* at 2; *see generally* U.S. GEN. ACCT. OFF., FARMERS HOME ADMINISTRATION: BILLIONS OF DOLLARS IN FARM LOANS ARE AT RISK, GAO/RCED 92-86 (1992); U.S. GEN. ACCT. OFF., FARMERS

losses from the underlying disasters, unmanagable debt loads, and stresses from the farm economy proved catastrophic for many FmHA borowers. "As of the end of December 1986, nearly 70 percent of FmHA farm debt outstanding was delinquent."[23] By November 1987, it was estimated that over 90,000 FmHA borrowers were delinquent on their loans.[24]

Despite its social welfare mission, throughout the 1980s, the USDA was remarkably resistant to implementing any program of assistance for FmHA's financially distressed borrowers.[25] This resistance was most notable with regard to the USDA's failure to implement the loan deferral provisions enacted by Congress in its 1978 amendments to the Consolidated Farm and Rural Development Act.[26] The agency interpreted these provisions as permissive, allowing the agency to determine if and when to implement a deferral program. When the agency chose not to implement such a program, and chose instead to initiate foreclosure proceedings against thousands of delinquent farm borrowers, a class action lawsuit was filed in Georgia challenging the USDA.[27] This lawsuit resulted in a statewide moratorium on USDA farm loan foreclosures.[28]

The same challenge was then brought in a national class action case, *Coleman v. Block*[29], and a national moratorium on foreclosures was ordered.[30] The agency remained subject to this injunction as it appealed the court order and then argued with the plaintiffs over the terms of, and the notice requirements for, a deferral program. Congress eventually stepped into the fray with the passage of legislation that mandated an FmHA debt restructuring program.[31] This legislation mooted the *Coleman* moratorium as well as all pending appeals.[32] Nevertheless, the moratorium

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HOME ADMINISTRATION: PROBLEMS AND ISSUES FACING THE EMERGENCY LOAN PROGRAM, GAO/RCED 88-4 (1987).

23. S. REP. NO. 100-230, at 13 (1987).

24. *See id.* at 45.

25. *See id.* at 37-38. "Past FmHA delays in notifying farmers of the availability of the loan service programs have increased borrower financial problems." *Id.* at 38.

26. *See* 7 U.S.C. § 1981(a) (2000).

27. *See* Curry v. Block, 541 F. Supp. 506, 508-09 (S.D. Ga. 1982).

28. *See id.* at 522 (enjoining the FmHA from foreclosing on mortgages in Georgia until new regulation went into effect).

29. Coleman v. Block, 562 F. Supp. 1353 (D. N.D. 1983).

30. *See id.* at 1367 (recognizing class and granting preliminary injunction). The "national" class actually excluded the states of Alabama, Florida, Georgia, Kansas, Minnesota, and Mississippi because borrowers in each of these states were subject to a similar statewide class action lawsuit.

31. *See* Agricultural Credit Act of 1987, Pub. L. No. 100-233, 101 Stat. 1568 (codified in scattered sections of 7 U.S.C.) (amending the Consolidated Farm and Rural Development Act (CONACT)). Legislative history confirms this Congressional purpose. S. REP. No. 100-230, at 38 (1987). "This title of S. 1665 [the Agricultural Credit Act of 1987] is based on careful analysis of the *Coleman* opinions and is designed to address, for the future, the notice issues raised in that case." *Id.*

32. *See* Coleman v. Lyng, 864 F.2d 604, 605 (8th Cir. 1988).

remained significant in that its sudden lifting threw thousands of farmers at once into a new, and still developing, debt restructuring program.

B. *Statutory Creation: The Agricultural Credit Act of 1987*

The FmHA debt restructuring legislation that ended the *Coleman* standoff was part of the Agricultural Credit Act of 1987.[33] Although amended over the years, this Act still provides the basic guidelines for the assistance provided to USDA farm borrowers who experience financial distress. It directs the Secretary of Agriculture to modify the terms of delinquent farmer program loans to the maximum extent possible to effectuate two competing goals. The first goal is "to avoid losses to the Secretary on such loans,"[34] and the second goal is to "ensure that borrowers are able to continue farming or ranching operations."[35]

Given the documented failure of the agency to implement the deferral program,[36] the statutory requirements imposed by Congress in the FmHA debt restructuring provisions of the Agricultural Credit Act of 1987 were mandatory and detailed.[37] A specific formula is set forth for computing the net recovery value that the government would obtain upon the foreclosure and liquidation of a delinquent loan.[38] Subject to certain basic eligibility criteria,[39] the USDA is directed to

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33. *See* Agricultural Credit Act of 1987, Pub. L. No. 100-233, 101 Stat. 1568 (codified in scattered sections of 7 U.S.C.) (amending the Consolidated Farm and Rural Development Act (CONACT)).

34. 7 U.S.C. § 2001(a) (2000). This goal is somewhat tempered by the subsequent instruction stated in the statute. It provides that in meeting this goal, "priority consideration" should be "placed on writing-down the loan principal and interest . . . and debt set-aside . . . whenever these procedures would facilitate keeping the borrwower on the farm or ranch, otherwise throught the use of primary loan service programs as provided in this section." *Id.*

35. *Id.* § 2001(a).

36. Legislative history affirms Congressional concerns regarding implementation. The Senate Report on the bill noted that "[t]he Committee intends that the Secretary shall provide clear, concise, informative, and timely notices of the loan servicing program of the Farmers Home Administration. In the past, FmHA has generally placed the burden on the borrower to request loan servicing. FmHA has failed to tell borrowers about such programs at a time when they could effectively make use of them. When FmHA did provide notice to borrowers, sometimes under court order, the notices were difficult to read, complicated and confusing. Most borrowers could not have been expected to respond appropriately." *See* S. REP. NO. 100-230, at 37-38 (1987).

37. *See id.* at 45. "Under this program, the Secretary will restructure loans if the net return to the government is equal to, or greater than, the net return to the government through foreclosure and if the borrower can cash flow the restructured loan payment." *Id.*

38. *See* 7 U.S.C. § 2001(c) Restructuring determinations:

(1) Determination of net recovery:

In determining the net recovery from the involuntary liquidation of a loan under this section, the Secretary shall calculate (A) the recovery value of the collateral securing the loan, in accordance with paragraph (2); and (B) the value of the restructured loan, in accordance with paragraph (3).

(2) Recovery value: For the purpose of paragraph (1), the recovery value of the collateral securing the loan shall be based on (A)(i) the amount of the current appraised value of the interests of the borrower in

restructure a farmer's loan if the borrower can afford to pay an amount under a restructured loan that is greater than this net recovery value.[40] The agency is directed to utilize specific restructuring tools, including the use of principal and interest write down in restructuring the obligation.[41]

A dramatic decline in farmland values occurred between the boom years before the financial crisis, when many of the FmHA loans were obtained, and the crisis years of depressed values, when the borrower's loans were evaluated for restructuring.[42] Because of this, the "net recovery value" that the government would receive upon foreclosure was very low in many cases. In these cases, the government could recover more by writing off a portion of the debt and restructuring the remaining loan obligation than it could ever hope to recover by foreclosure and liquidation of the borrower's assets. Subject to certain eligibility criteria,[43] the

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the property securing the loan; plus (ii) the value of the interests of the borrower in all other assets that are (I) not essential for necessary family living expenses; (II) not essential to the operation of the farm; and (III) not exempt from judgment creditors or in a bankruptcy action under Federal or State law; less (B) the estimated administrative, legal, and other expenses associated with the liquidation and disposition of the loan and collateral, including (i) the payment of prior liens; (ii) taxes and assessments, depreciation, management costs, the yearly percentage decrease or increase in the value of the property, and lost interest income, each calculated for the average holding period for the type of property involved; (iii) resale expenses, such as repairs, commissions, and advertising; and (iv) other administrative and attorney's costs; plus (C) the value, as determined by the Secretary, of any property not included in subparagraph (A)(i) if the property is specified in any security agreement with respect to such loan and the Secretary determines that the value of such property should be included for purposes of this section. (3) Value of the restructured loan: (A) In general-For the purpose of paragraph (1), the value of the restructured loan shall be based on the present value of payments that the borrower would make to the Federal Government if the terms of such loan were modified under any combination of primary loan service programs to ensure that the borrower is able to meet such obligations and continue farming operations. (B) Present value- For the purpose of calculating the present value referred to in subparagraph (A), the Secretary shall use a discount rate of not more than the current rate on 90-day Treasury bills. (C) Cash flow margin- For the purpose of assessing under subparagraph (A) the ability of a borrower to meet debt obligations and continue farming operations, the Secretary shall assume that the borrower needs up to 110 percent of the amount indicated for payment of farm operating expenses, debt service obligations, and family living expenses. *Id.*

39. *See id.* § 2001(b). The delinquency must be "due to circumstances beyond the control of the borrower;" the borrower must have acted in "good faith" with regard to the loan; and a "preliminary plan" must be presented showing that the borrower will be able to pay "necessary family living and farm operating expenses" as well as service all debts. *Id.*

40. *See id.* § 2001(c)(5).

41. *See id.* § 2001(d).

42. *See* HARL, *supra* note 20, at 38-39 (discussing the decline in farm land values). Professor Harl notes that "[t]he sharp decline in land values was one of the most striking—and devastating—features of the farm debt crisis of the 1980s. The Iowa Land Survey, the oldest and one of the most highly respected surveys in the country, showed a sixty-three percent decline in the value of Iowa farmland from 1981 to 1986 . . . . For the United States, land values declined from an average of $823 per acre in 1982 to $547 per acre in 1987 . . . ." *Id.*

43. *See* 7 U.S.C. § 2001(b).

Agricultural Credit Act of 1987 mandated an offer of restructuring in many of these cases.[44] The USDA estimates that over $1.7 billion of farm debt was written off pursuant to this debt restructuring process.[45]

As will be evidenced, however, the understanding that this farm debt has been "written off" or "forgiven" under the debt restructuring process is somewhat inaccurate. The Agricultural Credit Act also contained a provision that authorized the use of a shared appreciation "arrangement" as a potential means of recovering some or all of the debt that was written off.[46] This provision has not been substantively amended since its initial enactment in 1987.[47] It provides that "[a]s a condition of restructuring a loan in accordance with this section, the borrower of the loan may be required to enter into a shared appreciation arrangement that requires the repayment of amounts written off or set aside."[48] As some farmers have now realized, the debt that was "written off" may end up only having been deferred. The FSA reports that over $58 million dollars of debt that was written down has now been recovered pursuant to the shared appreciation agreements.[49] In one sense, the debt forgiveness promised in the Agricultural Credit Act is only a contingent write off, with the contingency linked to the shared appreciation agreement.

The statute's use of the phrase "a borrower . . . *may* be required to enter into a shared appreciation agreement"[50] gives the Secretary of Agriculture discretion whether or not to impose a shared appreciation arrangement upon a borrower who has had debt written off or set-aside. If the Secretary does impose this requirement, however, the statute sets forth mandatory terms. It provides that "[s]hared appreciation agreements *shall* have a term not to exceed 10 years, and *shall* provide for recapture based on the difference between the appraised values of the real security property at the time of restructuring and at the time of recapture."[51]

The timing of any recapture is also specified. "Recapture shall take place at the end of the term of the agreement, or sooner--

(A) on the conveyance of the real security property;

(B) on the repayment of the loans; or

(C) if the borrower ceases farming operations."[52]

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44. *See id.* § 2001(c)(5).

45. *See* Farm Loan Programs Account Servicing Policies—Servicing Shared Appreciation Agreements, 64 Fed. Reg. 61,221, 61,222 (Nov. 10, 1999) (prefatory comments).

46. *See* 7 U.S.C. § 2001(e).

47. The only amendment that has been made is the addition of a notice provision. *See id.* § 2001(e)(6). It provides that "[b]eginning with fiscal year 2000 not later than 12 months before the end of the term of a shared appreciation arrangement, the Secretary shall notify the borrower involved of the provisions of the arrangement." *Id.*

48. *Id.* § 2001(e)(1).

49. *See* Farm Loan Programs Account Servicing Policies—Servicing Shared Appreciation Agreements, 65 Fed. Reg. 50,401, 50,402 (Aug. 18, 2000) (prefatory comments to final rule).

50. 7 U.S.C. § 2001(e)(1) (emphasis added).

51. *Id.* § 2001 (e)(1) (emphasis added).

52. *Id.* § 2001(e)(4). The statute also provides that the transfer of title to a spouse on the death

The statute provides that the amount of recapture "shall be 75 percent of the appreciation in the value of such real security property if the recapture occurs within 4 years of the restructuring, and 50 percent if the recapture occurs during the remainder of the term of the agreement."[53]

C. *The Agency's Initial Regulatory Implementation*

The FmHA published a proposed rule for the implementation of the new debt restructuring program on May 23, 1988.[54] After reviewing comments received on this proposed rule, an interim final rule was published on September 14, 1988.[55] This extensive rule (160 pages in the Federal Register), sets forth in detail how the agency intended to implement the changes brought about by the Agricultural Credit Act. Part 1951 of the new rule governed "Servicing and Collections," and subpart S therein applied to Farmer Program Account Servicing Policies.[56] Provisions governing the new shared appreciation agreements were included in this subpart.[57] The actual SAA to be used[58] and the notice that would be provided to financially distressed borrowers[59] were each published as exhibits to the regulations.

These interim regulations recognized the Secretary's statutory authority to impose shared appreciation arrangements on certain borrowers and made shared appreciation agreements mandatory in many situations. Under these regulations, if a

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of the borrower will not be treated as a conveyance for purposes of triggering the recapture. *Id.* § 2001(e)(5).

53. *Id.* § 2001(c)(3).

54. *See* Certain Provisions of the Agricultural Credit Act of 1987 and Additional Amendments of Portions of Farmer Program Regulations, 53 Fed. Reg. 18,392, 18,392 (May 23,1988).

55. *See* Certain Provisions of the Agricultural Credit Act of 1987 and Additional Amendments of Portions of Farmer Program Regulations, 53 Fed. Reg. 35,638, 35,638 (Sept. 14, 1988).

56. *See* Certain Provisions of the Agricultural Credit Act of 1987 and Additional Amendments of Portions of Farmer Program Regulations, 53 Fed. Reg. at 35,716 (to be codified at 7 C.F.R. pt. 1951, subpart. S). This central organization for all loan servicing program rules represented a change from previous FmHA regulations that had scattered loan servicing rules throughout the various loan program regulations. *See* Certain Provisions of the Agricultural Credit Act of 1987 and Additional Amendments of Portions of Farmer Program Regulations, 53 Fed. Reg. at 35,649 (prefatory comments to interim rule).

57. *See* Certain Provisions of the Agricultural Credit Act of 1987 and Additional Amendments of Portions of Farmer Program Regulations, 53 Fed. Reg. at 35,737 (to be codified at 7 C.F.R. § 1951.914).

58. *See* Certain Provisions of the Agricultural Credit Act of 1987 and Additional Amendments of Portions of Farmer Program Regulations, 53 Fed. Reg. at 35,746 (to be codified at 7 C.F.R. pt. 1951, subpt. S, exh. D).

59. *See* Certain Provisions of the Agricultural Credit Act of 1987 and Additional Amendments of Portions of Farmer Program Regulations, 53 Fed. Reg. at 35,739 (to be codified at 7 C.F.R. pt. 1951, subpt. S, exh. A, Attachment 1).

loan was secured by real estate, in order for a borrower to obtain a write down of FmHA debt, the borrower "must agree to a Shared Appreciation Agreement."[60]

The terms of the published SAA contract echo the specific statutory language.[61] The contract identifies the parties to the agreement and calls for the date that the agreement will expire, noting that it can have a maximum term of ten years. It calls for a recitation of information regarding the borrower's current indebtedness to the agency, information regarding the new obligation that the borrower will owe after restructuring, and information regarding the real estate security. The contract also provides:

> As a condition to, and in consideration of, FmHA writing down the above amounts and restructuring the loan, Borrower agrees to pay FmHA an amount according to one of the following payment schedules:
>
> 1. Seventy-five (75) percent of any positive appreciation in the market value of the property securing the loan as described in the above security instrument(s) between the date of this Agreement and either the expiration date of this Agreement or the date the Borrower pays the loan in full, ceases farming or transfers title of the security, if such event occurs four (4) years or less from the date of this Agreement.[62]
>
> 2. Fifty (50) percent of any positive appreciation in the market value of the property securing the loan above as described in the security instruments between the date of this Agreement and either the expiration date of this Agreement or the date Borrower pays the loan in full, ceases farming or transfers title of the security, if such event occurs after four (4) years but before the expiration date of this agreement.[63]
>
> The amount of recapture by FmHA will be based on the difference between the value of the security at the time of disposal or cessation by Borrower of farming and the value of the security at the time this Agreement is entered into.[64]

The contract then calls for recitation of the current "[m]arket value of the property securing the loan," the "[n]et recovery value of the property securing the loan," the "[a]mount of writedown" and the "[a]mount of the [a]ccount [e]quity."

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60. Certain Provisions of the Agricultural Credit Act of 1987 and Additional Amendments of Portions of Farmer Program Regulations, 53 Fed. Reg. at 35,727 (to be codified at 7 C.F.R. pt. 1951.909 (e)(5)(iii)(D)).

61. *See* Certain Provisions of the Agricultural Credit Act of 1987 and Additional Amendments of Portions of Farmer Program Regulations, 53 Fed. Reg. at 35,746-747.

62. Certain Provisions of the Agricultural Credit Act of 1987 and Additional Amendments of Portions of Farmer Program Regulations, 53 Fed. Reg. at 35,746.

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64. Certain Provisions of the Agricultural Credit Act of 1987 and Additional Amendments of Portions of Farmer Program Regulations, 53 Fed. Reg. at 35,746.

The published SAA contract is not well drafted.[65] It does not address several crucial issues and is arguably ambiguous about the amount of recapture that is due at the end of the term of the agreement.[66] These drafting problems, coupled with delayed and careless agency action to address the problems resulted in controversy when the SAAs came to the end of their ten year term.[67] At that time, questions arose regarding the legal effect of the SAA.

III. LEGAL OBJECTIONS TO SAA ENFORCEMENT BY THE FSA

Over a decade after their creation, SAAs remain controversial. Three legal issues have sparked particular controversy in the agricultural community. First, is there an obligation for recapture at the end of the term of the agreement for farmers who remain on their farms? Second, if there is an obligation, how should the amount of the recapture obligation be determined? Third, how should a recapture obligation be financed or otherwise collected?

The first issue, involving the basic obligation at the end of the term, has produced the most publicity.[68] At least two individual cases[69] and one case filed as a national class action have been brought directly on this issue.[70] As will be explained in this article, however, this issue may well be the weakest argument from the perspective of borrower protection. In the long run, the most persuasive legal challenges to the SAAs are those related to the determination of the amount due.

A. *The Obligation: Is There an Obligation for Recapture at the End of the Term of the Agreement for Farmers Who Remain on Their Farms?*

There is general agreement between borrowers and the FSA that certain actions trigger a recapture determination under the SAA contract. If a farmer sells the

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65. *See* Patrico, *supra* note 3, at 24, *available at* http://progressivefarmer.com/issue/0299/losingthefarm/default.asp. (quoting Stephen Carpenter, an attorney with Farmers' Legal Action Group, Inc., in referring to the contracts as "poorly written," "ambiguous," and leading to confusion among the farmers who signed them).

66. *See In re* Moncur, No. 98-03213, 1999 WL 33287727, at *2 (Bankr. D. Idaho May 27, 1999) (stating that "[u]nfortunately the SAA is not crystal clear with respect to the nature of the Debtor's obligations to FSA at the expiration of the ten-year SAA term.").

67. *See generally* Patrico, *supra* note 3, at 24 *available at* http://progressivefarmer.com/issue/0299/losingthefarm/default.asp (discussing the impacts of the SAA).

68. *See generally Feds, supra* note 2, at B9 (discussing the FSA's collection of payments).

69. *See* Israel v. USDA, 135 F. Supp. 2d 945 (W.D. Wis. 2001); *In re* Moncur, No. 98-03213, 1999 WL 33287727, at *2 (Bankr. D. Idaho May 27, 1999).

70. *See* Stahl v. Veneman, No. A3-01-85 (D. N.D. filed June 29, 2001). The plaintiffs in *Stahl* are over one hundred farmers from North Dakota, South Dakota, Idaho, Illinois, Indiana, Iowa, Kentucky, Louisiana, Michigan, Minnesota, Missouri, Montana, and Nebraska. A motion for class certification has not yet been ruled on.

farm, ceases farming, or pays the underlying loan in full, the farmland will be evaluated for appreciation and recapture can be assessed.[71]

There has been confusion, however, with respect to farmers who continued to own and farm the land until the end of the term of the agreement. Some of these farmers were astonished to hear that FSA interpreted the SAA as requiring a recapture determination at the end of the ten year contract term.[72] Some are unable to afford the appreciation recapture charged against them and may need to sell their farms in order to pay it.[73] These farmer have compelling stories.[74]

Little legal analysis was done at the time the SAAs were signed.[75] When the FSA indicated its intent to collect recapture obligations at the end of the ten year term, however, legal challenges to enforcement were made and examined by commentators and the courts. Borrowers and their attorneys considered all possible avenues of defense. Two primary arguments have emerged. The first line of attack is that the contract is either ambiguous in stating when recapture is required or simply that the agreement "expires" after ten years. Once contract ambiguity is established, the proponents of this argument seek support from congressional intent as evidenced by the legislative history of the Agricultural Credit Act of 1987. Their goal is to show that Congress intended the SAA obligation to be extinguished at the end of the term of the agreement.

The second argument is one of misrepresentation—that the farmers were misled by the agency. Some farmers testify that they were expressly told by FmHA personnel that as long as they continued farming the secured property, the shared

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71. *See Israel*, 135 F. Supp. 2d at 950 (noting that borrowers understood that SAA recapture would occur if they ceased farming, sold the property, or paid their loan in full).

72. *See, e.g., id.* at 948 (addressing the borrowers argument that the SAA "expired" at the end of the term, meaning that no shared appreciation was due at that time); Trenna R. Grabowski, *Farm Debt Write-Down Adjustment Coming Due, Did You Sign a Shared Appreciation Agreement?*, DAKOTA FARMER, Sept. 1998, at 46. "It is also believed some borrowers misunderstood the provisions. Many of them assumed that if the agreement was not triggered during the 10-year period, it would expire." *Id.*

73. *See* Brief in Support of Motion for Preliminary Injunction to Suspend Collection of Amounts Claimed Due Under Shared Appreciation Agreement at 23-29, Stahl v. Veneman, No. A3-01-85 (D. N.D. filed June 29, 2001) [hereinafter Brief in Support of Motion for Preliminary Injunction] (on file with author).

74. *See id.* In making the case of irreparable harm, the plaintiffs in *Stahl* set forth one heart rendering story after another, detailing the loss of family farms, depression, and even suicide caused by the government's efforts to collect a recapture obligation.

75. Most analysis focused on the immediate debt restructuring possibilities. However, the legal effect of the SAAs was addressed briefly in a special report issued by the Farmers Legal Action Group, Inc. ("FLAG"). *See* Lynn A. Hayes, *Farmers Home Administration: What the New Law Provides*, FARMER'S LEGAL ACTION REPORT: THE AGRICULTURAL CREDIT ACT OF 1987 Jan./Feb. 1988 at 9. FLAG is a nonprofit corporation that provides legal assistance, education, and training to financially distressed farmers, their attorneys and advocates. According to this publication, SAAs allow for recapture "at the end of the term of the agreement, which is likely to be ten years. Or FmHA will recapture the allowed amount earlier if: a) the land is conveyed; b) the loan is repaid in full; or c) the borrower stops farming operations." *Id.*

appreciation agreement would not be triggered against them, and that after ten years, the agreement would expire by its own terms. These farmers insist that they were told that the only events that would trigger recapture under the SAA were if they stopped farming, paid the debt or sold the farmland within ten years of the agreement.[76] Further confusion resulted from the Internal Revenue Service's treatment of the forgiven debt as taxable income in the year of the write off.

While both of these arguments present a gallant attempt to right a perceived injustice, as will be evidenced, each has serious legal flaws.

1. *Ambiguous Contract Terms*

The section of the SAA contract regarding "payment schedules" states that an obligation will be owed as of "either the expiration date of this Agreement or the date the Borrower pays the loan in full, ceases farming or transfers title of the security." While this language would seem to strongly support the imposition of the recapture obligation at the end of the SAA term, some have argued that it can be interpreted to mean that either on the date that the triggering event occurs, or on the date that the contract expires, if the farmer has either paid the loan, ceased farming or transferred title, recapture is triggered. Under this analysis, the agency can claim its recapture at either the point of time that the trigger event occurs or at the end of the agreement, so long as one of the three triggering events have occurred before the agreement expires.[77]

Consistent with this analysis, the contract paragraph that describes the amount of recapture that will be due omits any reference to the expiration of the agreement. This paragraph provides that the "amount of recapture" is to be based on the difference between the value of the property at the inception of the agreement and the value of the property at the time the borrower either disposes of the property or ceases farming.[78] It does not address the amount of recapture if the debt is paid in full or if the agreement reaches the end of its term.[79] This omission has been used to argue that there is no recapture due at the end of the term.[80] However, there is an inconsistency

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76. *See id*; *see also Feds, supra* note 2, at B9.

77. *See, e.g.*, Brief in Support of Motion for Preliminary Injunction, *supra* note 73, at 35-38; *see also Israel*, 135 F. Supp. 2d at 950-51.

78. The relevant provision in the SAA contract provides: "[t]he amount of recapture by FmHA will be based on the difference between the value of the security at the time of disposal or cessation by Borrower of farming and the value of the security at the time this Agreement is entered into." Certain Provisions of the Agricultural Credit Act of 1987 and Additional Amendments of Provisions of Farmer Program Regulations, 53 Fed. Reg. 35,638, 35,746 (Sept. 14, 1988) (codified at 7 C.F.R. pt. 1951, subpt. S, exh. D 1989), *repealed by* Enforcement and Collection of Shared Appreciation Agreements, 63 Fed. Reg. 6627, 6629 (Feb. 10, 1998).

79. *See* Certain Provisions of the Agricultural Credit Act of 1987 and Additional Amendments of Provisions of Farmer Program Regulations, 53 Fed. Reg. at 35,638.

80. *See* Brief in Support of Motion for Preliminary Injunction, *supra* note 73, at 35-38; *see also Israel*, 135 F. Supp. 2d at 950-51.

to the argument. It is not disputed that the SAA is triggered if the borrower pays the loan in full. This triggering event is similarly omitted from the paragraph that describes the amount of recapture that will be due.[81]

While the contract is poorly drafted, the interpretation of the contract in this manner is strained. More importantly, it is inconsistent with the statute. An otherwise sympathetic court addressed this problem in the *Stahl* case, brought on behalf of over one hundred farmers throughout the country.[82] That court correctly began with "the premise that the meaning of the SAA's depends on the statutes authorizing them, making this a case of statutory construction." [83]

The relevant statutory language provides that "[r]ecapture shall take place at the end of the term of the agreement or sooner—(A) on the conveyance of the real security property; (B) on the repayment of the loans; or (C) if the borrower ceases farming operations."[84]

Even under this statutory language, however, some farmers and their attorneys have argued that the end of the term of the agreement is simply the last point in time for the agency to consider whether the triggering events have occurred. At best, however, this argument gives rise to a determination that the statute is ambiguous. In this event, the agency's interpretation, as set forth in its duly promulgated regulations, would be afforded *Chevron* deference.[85] The regulations state that:

> Recapture of any appreciation will take place at the end of the term of the Agreement, or sooner if the following occurs: (1) On the conveyance of the real security property by the borrower . . . (2) On the repayment of the loan; (3) If the borrower . . . ceases farming operations; or (4) Five months prior to the end of the Shared Appreciation Agreement.[86]

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81. *See* Certain Provisions of the Agricultural Credit Act of 1987 and Additional Amendments of Provisions of Farmer Program Regulations, 53 Fed. Reg. at 35,746 (codified at 7 C.F.R. pt. 1951, subpt. S, exh. D. (1989)), *repealed by* Enforcement and Collection of Shared Appreciation Agreements, 63 Fed. Reg. 6627, 6629 (Feb. 10, 1998).

82. *See* Stahl v. Veneman, No. A3-01-85 2001 U.S. Dist. LEXIS 12925, Memorandum and Order at *3 (D.N.D. Aug. 22, 2001).

83. *Id.* (citing Maricopa-Stanfield Irrigation and Drainage Dist. v. United States, 158 F.3d 428, 435 (9th Cir. 1998)).

84. 7 U.S.C. § 2001(e)(4) (1994).

85. For example, when construing the SAA statute, the *Stahl* court applied the *Chevron* standard, first considering whether congressional intent was clear from the plain language of the statute, then considering the agency's interpretation in light of that intent. *See* Stahl v. Veneman, No. A3-01-85 U.S. Dist. LEXIS 12925, Memorandum and Order at *4 (D.N.D. Aug. 22, 2001) (citing Ragsdale v. Wolverine Worldwide, Inc., 218 F.3d 933, 937 (8th Cir. 2000)).

86. Certain Provisions of the Agricultural Credit Act of 1987 and Additional Amendments of Portions of Farmer Program Regulations, 53 Fed. Reg. at 35,738. The fourth item, "[f]ive months prior to the end of the Shared Appreciation Agreement" appears to be included to allow the FmHA County Supervisor an opportunity to notify the borrower of the impending recapture. This regulation goes to on specify the notice that should go out to borrowers when any of the four events occurs. The current regulation has been modified somewhat, in part to clarify the agency's interpretation of the SAA and to

The regulations further confirm the agency's interpretation that recapture is due at the end of the term of the agreement by specifying the procedures to be followed in that situation.[87]

Despite these challenges, proponents of the ambiguous contract and statute argument have continued to press their case. Legislative intent has been a driving force behind their conclusion that the agency is now misinterpreting the SAA requirements. The argument that Congress intended that the SAA obligation would only be triggered upon the sale of the farm, payment of the debt, or the cessation of farming is best articulated by the attorneys in the *Stahl* case.[88]

A centerpiece of the plaintiffs' argument in *Stahl* is that Congress intended that the administrative debt restructuring afforded to debtors under the 1987 Act should be "equal to or better than what the farmer would get under chapter 12 [bankruptcy]."[89] The plaintiffs conclude that only if the SAA "expires" without obligation at the end of the term is administrative debt restructuring as advantageous to the debtor as filing for relief under Chapter 12.[90]

Putting aside the numerous problems with relying upon legislative history,[91] the plaintiffs' argument has serious flaws. First, conceptually, comparing administrative debt restructuring to Chapter 12 bankruptcy is problematic. What is more financially advantageous will largely depend on the individual situation presented.

Second, a review of the discussion in the legislative history reveals that the senators may have failed to completely understand the impact of bankruptcy options.[92] It is therefore problematic to use these statements as subsequent support for the farmers' preferred interpretation.

Third, the plaintiffs' analysis of the advantages of Chapter 12 bankruptcy as a restructuring option is exaggerated. The plaintiffs argue that a "borrower would have been better off taking a Chapter 12 bankruptcy in 1989 or the early 1990's" because

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confirm the existence of an obligation at the end of the SAA term. *See* Servicing and Collections, 7 C.F.R. § 1951.914 (2001).

87. *See* 7 C.F.R. § 1951.914(b).

88. *See* Brief in Support of Motion for Preliminary Injunction, *supra* note 73 at 43-44.

89. 133 CONG. REC. S16945 (daily ed. Dec. 2, 1987) (statement of Sen. Harkin).

90. *See* Brief in Support of Motion for Preliminary Injunction, *supra* note 73 at 43-44.

91. *See generally* Thomas W. Merrill, *Textualism and the Future of the* Chevron *Doctrine*, 72 WASH. U. L.Q. 351 (1994) (explaining the complex nature of textualism and the difficulties that arise with sole reliance on original intent interpretation).

92. The senators appeared to believe that Chapter 12 incorporated a shared appreciation provision that provided for recapture in either three or five years. 133 CONG. REC. S16959 (daily ed. Dec. 2, 1987). However, there is no shared appreciation provision in Chapter 12. Secured claims are established early on based on appraised values and incorporated into the payments made under the debtor's plan. This plan is three to five years in length. Secured creditors with unsecured claims may receive more based on the disposable income test, but this test is based on farm income, not on appreciation of assets. *See* 11 U.S.C. § 1225 (2001).

"the portion of the FmHA debt that equaled the loan writedown would have been considered unsecured debt and therefore whatever could not have been paid from disposable income would have been discharged at the end of the three-to-five year plan." [93] This analysis fails to account for the fee due to the bankruptcy trustee,[94] and the attorneys fees involved in filing bankruptcy. It also dismisses the onerous disposable income requirement in Chapter 12 as if it were insignificant.[95] Moreover, the plaintiffs' analysis misses an important advantage presented by administrative debt restructuring. Administrative agency write-downs were based on the net recovery value of the assets, whereas in bankruptcy, fair market value is generally the base valuation used.[96] Therefore, the write down of debt available to debtors seeking relief under Chapter 12 is likely to have been significantly less.

Even more importantly, however, while the plaintiffs focus on the Chapter 12 discussion on the floor of the Senate, they fail to address language in the Senate Report accompanying the bill. This language mimics the statute and expressly provides that "[r]ecapture shall take place at the end of the term of the agreement, or (A) sooner on the conveyance of the real security property; (B) on the repayment of the loans; (C) or if the borrower ceases farming operations."[97] While this report also speaks to concerns about bankruptcy, it provides that "the Secretary is instructed to negotiate with the borrower to determine the term (number of years) of the shared appreciation agreement and, in such negotiations, to attempt to avoid forcing the borrower into filing for bankruptcy."[98] Thus, the Senators' proposed solution to the bankruptcy problem was not to eliminate recapture at the end of the term, but to direct the Secretary to negotiate a shorter term.

The plaintiffs' argument is further strained by the fact that Congress has amended the SAA statutory provision on two occasions since its inception, and each time it has not only failed to contest the agency's interpretation, it has made changes that arguably indicate its agreement with that interpretation.

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93. Brief in Support of Motion For Preliminary Injunction, *supra* note 73, at 44.

94. Chapter 12 bankruptcy trustees generally receive ten percent of payments made under the plan, with this sum coming directly from the Chapter 12 debtor. *See* 28 U.S.C. § 586(e) (1994).

95. The disposable income requirement is a very expensive aspect of Chapter 12 bankruptcy. *See* 11 U.S.C. § 1225(b) (2000). Courts have interpreted it as requiring a complete accounting of income and expenses during the term of the Chapter 12 plan. Any income that exceeds reasonable expenses for maintaining the basic farm operation have been found to constitute disposable income payable to unsecured creditors. *See* Broken Bow Ranch, Inc. v. Farmers Home Admin., 33 F.3d 1005, 1009-10 (8th Cir. 1994) (requiring farmers to pay $81,862.00 as a disposable income payment at the end of the plan term); *see also* Hammrich v. Lovald, 98 F.3d 388, 390-91 (8th Cir. 1996) (requiring farmers to pay $95,885.86 as a disposable income payment).

96. *See* RANDY ROGERS & LAWRENCE P. KING, COLLIER FARM BANKRUPTCY GUIDE 2-180, n. 65 (1999); *see also* Associates Commercial Corp. v. Rash, 520 U.S. 953, 965 (1997) (holding that replacement value rather than liquidation value is the appropriate valuation for purposes of similar provisions in Chapter 13 restructuring).

97. S. REP. NO. 100-230, at 125 (1987).

98. S. REP. NO. 100-230, at 249 (1987).

In 1998, Congress added a notice requirement to the shared appreciation provision.[99] This addition provides that "[b]eginning with fiscal year 2000, not later than 12 months before the end of the term of a shared appreciation arrangement, the Secretary shall notify the borrower involved of the provisions of the arrangement."[100]

While the language in this provision does not directly confirm the agency's position that the obligation would become due at the end of the term of the agreement, nevertheless, it suggests that the issue was considered by Congress. Despite such consideration, no action to "correct" the agency's "misunderstanding" of its intent was taken.

Congress stepped into the debate more directly with another statutory change in 2000. At that time, it added a provision that assured very favorable interest rates for farmers who wished to finance the SAA recapture obligation.[101] This provision also requires that the favorable interest rate be applied to those farmers who had previously refinanced the obligation with the agency.[102] This provision implicitly affirms the agency's interpretation, as it clearly acknowledges the agency's collection efforts.

While the argument that there is no obligation due at the end of the term of the SAA has received much publicity, the legal analysis underlying this position is weak. Court decisions to date confirm this, as three courts have rejected the argument in individual cases.[103] In addition, in *Stahl,* the case filed as a class action, the court was unpersuaded by the argument and denied the plaintiffs' motion for a preliminary

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99. *See* 7 U.S.C. § 2001(e)(6) (2000).

100. *Id.* § 2001(e)(6).

101. *See* Agriculture, Rural Development, Food & Drug Administration and Related Agencies—Appropriations, Pub. L. No. 106-387, 114 Stat. 1549 (2000) (codified as amended at 7 U.S.C. § 2001(e)(7)). The new provision states as follows:

(7) Financing of recapture payment

(A) In general

The Secretary may amortize a recapture payment owed to the Secretary under this subsection.

(B) Term

The term of an amortization under this paragraph may not exceed 25 years.

(C) Interest rate

(i) In general

The interest rate applicable to an amortization under this paragraph may not exceed the rate applicable to a loan to reacquire homestead property less 100 basis points.

(ii) Existing amortizations and loans

The interest rate applicable to an amortization or loan made by the Secretary before October 28, 2001 to finance a recapture payment owed to the Secretary under this subsection may not exceed the rate applicable to a loan to reacquire homestead property less 100 basis points.

102. *See id.*

103. *See* Israel v. USDA, 135 F. Supp. 2d 945, 951 (W.D. Wis. 2001) (citation omitted); *In re* Moncur, No. 98-03213, 1999 WL 33287727, at *3 (Bankr. D. Idaho May 27, 1999) (recognizing that the regulations require the borrower to pay shared appreciation at the end of the ten-year SAA term); Sentinel Fed. Credit Union v. United States (*In re* Tunnisen), 216 B.R. 834, 837-38 (Bankr. D.S.D. Mar. 4, 1996) (explaining that the FSA's release of mortgages will be the result of debtors full performance under the SAA).

injunction.[104] The court stated that although it "remains open" to the plaintiffs' argument, this provision only means the USDA cannot collect beyond the ten year term.[105] The court was, at least for now, "in general agreement" with the government's position.[106]

2. *Misrepresentation*

Some farmers have claimed that when they executed the shared appreciation agreements, they were expressly told by FmHA personnel that as long as they continued farming the secured property, the shared appreciation agreement would not be triggered against them, and that after ten years, the agreement would expire by its own terms. These farmers insist that they were told the only events that would trigger recapture under the shared appreciation agreement were if they stopped farming, paid the debt, or sold the farmland within ten years of the agreement.[107] Reports of this misrepresentation have been repeated by farmers throughout the country, indicating a pervasive and widespread misunderstanding.[108]

The circumstances under which the agreements were signed provides some justification for the confusion. The debt restructuring program was new, and despite attempts to make it easy to understand, the outcome of each restructuring consideration depended upon a complex computer based analysis of the farmer's financial situation overlaid with the consideration of a laundry list of debt restructuring tools available to the agency.[109] Termed DALR$, this computer analysis determined whether the farmer's loan could be successfully restructured or whether it should be foreclosed.[110] Farmers who "passed" the DALR$ analysis on the basis of a

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104. *See* Stahl v. Veneman, No. A3-01-85 U.S. Dist. LEXIS 12925, Memorandum and Order at *3-4 (D.N.D. Aug. 22, 2001).

105. *Id.* at *6.

106. *Id.*

107. *See, e.g.*, Joe Walker, *Kentucky Farmers Confused Over Nature of Loans From Federal Government*, PADUCAH SUN, Oct. 16, 2000, *available at* 2000 WL 28273068 (reporting that a Kentucky farmer was told by an FSA officer to sign the SAA "and you won't ever have to worry about it . . . you keep the farm 10 years and that'll be the end of it").

108. *See* Grabowski, *supra* note 72, at 46 (reporting that some farmers "misunderstood the provisions" of the SAA); Alan Guebert, *Bureaucrats Turn USDA Program Into a Fiasco*, PEORIA J. STAR, June 27, 2000, *available at* 2000 WL 20642160 (reporting that "[s]everal borrowers contend they signed the SAAs because they believed—in fact, were told by many FmHA officials—that the appreciation side deal between Uncle Sam and borrowers expired after 10 years. Expired, to these borrowers, means dead; they owe FmHA no part of the appreciated value."); *see also* Brief in Support of Motion for Preliminary Injunction, *supra* note 73, at 4, 35.

109. *See* Servicing and Collections, 7 C.F.R. § 1951.909(a) (1989).

110. *See id.* § 1951, subpt. S., exh. J. DALR$ is a "computerized decision support tool" that performs a "series of mathematical calculations based upon predetermined criteria" and upon the farmer's financial data, as entered by FmHA or FSA County personnel. *Id.* The program analyzes each combination of primary loan servicing options "until a feasible plan is reached or it is determined a feasible plan is not possible with full utilization of primary service programs." *Id.*

debt "write down" were required to sign an SAA as a condition to receiving the write down.[111] Given that the alternative was foreclosure, farmers likely had little concern about understanding or even reading, what they were asked to sign. Further, the debt that was "written down" was consistently referred to and treated as if it were forgiven. The term "write down" was used consistently in the FmHA regulations and notices.[112]

Further confusion relates to the tax treatment of the restructuring event. Section 61(a)(12) of the Internal Revenue Code provides that income from the discharge of indebtedness is included in the definition of gross income for taxation purposes.[113] Thus, if FmHA wrote off debt without further recourse or liability, the amount of debt written off would clearly be considered income under § 61. The existence of the SAA and the possibility of recapture complicates the issue somewhat.

Soon after the debt restructuring program was implemented, the Internal Revenue Service directed the FmHA that the full amount of the debt written down would be considered "income from the discharge of indebtedness" despite the existence of the SAA.[114] Noting that "it is impossible to estimate whether and when any amount will be paid under the SAA," the IRS determined that "a[n] FmHA borrower realizes discharge of indebtedness income in the year of the write-down to the extent of the write-down amount even when a SAA is part of the restructuring arrangement, subject to the provisions of section 108 of the [tax] Code . . . ."[115] Consistent with this direction, the FmHA sent 1099-G notices to the farmers who received debt write downs.[116] Farmers were required to schedule this as income on their tax forms, generally either reducing tax attributes or paying income tax on the amount of debt forgiven.[117] This further reinforced farmers' misunderstanding regarding their obligations under the SAA.[118]

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111. *See id.* § 1951.909(e)(5)(iii)(D).

112. *See, e.g., id.* § 1951.909(e)(5).

113. *See* 26 U.S.C. § 61(a)(12) (1994).

114. Letter from Peter K. Scott, Acting Chief Counsel, Department of the Treasury, Internal Revenue Service, to Chet Bailey, Farmer Program Division, FmHA 2-4 (May 22, 1989) (on file with author).

115. *Id.* at 5. Section 108 excludes discharged indebtedness from income under certain circumstances, one of which is if the indebtedness is "qualified farm indebtedness." 26 U.S.C. § 108(a)(1)(C) (1994). Under §108(b), a farmer who uses this exception must reduce certain tax attributes and basis in property to the extent of the excluded income. *See id.* § 108(b).

116. *See, e.g.*, Lawinger v. Commissioner, 103 T.C. 428, 432 (1994).

117. *See id.*

118. Having either paid taxes on the debt write down or reduced tax attributes under a § 108 exception, farmers have argued that treatment of the debt as forgiven for tax purposes is evidence that there should not be any SAA liability assessed against them at the end of the term of the SAA. There are two flaws with this argument. First, the Internal Revenue Service anticipated that there may be an SAA recovery when it provided its analysis of the tax consequences of the write down to the FmHA. In written analysis provided to FmHA, the Acting Chief Counsel to the IRS explained that in the event that a borrower makes a payment to the FmHA under an SAA, the borrower would generally be "permitted an adjustment that reverses the tax treatment" accorded to the write down. Letter from Peter K. Scott, *supra* note 114, at 6. Second, the tax argument fails to account for the identical treatment afforded the other

It has been argued that the farmers' claims of misrepresentation should give rise to a legal claim of equitable estoppel. Generally, however, equitable estoppel will not lie against the government. In a similar situation, in *Fed. Crop Ins. Corp. v. Merrill*,[119] the Supreme Court held that a federal crop insurance agent could not bind the government when he provided erroneous information regarding crop insurance coverage.[120] Despite the fact that the farmer relied to his detriment on the erroneous advice, the court rejected his claim of estoppel, stating that "anyone entering into an arrangement with the Government takes the risk of having accurately ascertained that he who purports to act for the Government stays within the bounds of his authority."[121] Because the agent did not have the authority to deviate from the legally authorized federal crop insurance coverage available, his representations could not bind the government.[122]

In *Israel v. USDA*,[123] the federal district court in Wisconsin applied *Merrill* to an SAA borrower's equitable estoppel argument and rejected the borrower's claim.[124] In addition, the court also discussed a "narrow category of cases" in which a claim of estoppel has been allowed against the government.[125] In these cases, the plaintiff has shown the traditional elements of estoppel plus "affirmative misconduct on the part of the government."[126] The court stated that with regard to the SAA, "[a]t most . . . [the agency official] misunderstood the terms of the agreement and conveyed his mistaken understanding to the plaintiffs. . . . "[127] The court held that while erroneous information may have been given negligently, it did not constitute affirmative misconduct.[128]

A review of the early general administration of the SAA program by the FmHA reveals support for *Israel's* finding of negligence as opposed to affirmative misconduct. The USDA Office of Inspector General ("OIG") released an Audit Report in September of 1992 that describes numerous instances of FmHA mismanagement.[129] For example, the report observed that "FmHA has no record of

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triggering events. If treating the debt forgiveness income as income from the discharge of indebtedness precludes any subsequent liability, then this preclusion should also apply to the other triggering events: sale of the property, payment of the debt in full, or ceasing to farm. Thus, in order to be successful, this argument would have to undercut the validity of an SAA obligation under any circumstances.

119. Federal Crop Ins. Corp. v. Merrill, 332 U.S. 380 (1947).

120. *See id.* at 385.

121. *Id.* at 384.

122. *See id.*

123. Israel v. USDA, 135 F. Supp. 2d 945 (W.D. Wis. 2001).

124. *See id.* at 953.

125. *See id.*

126. *Id.* (citing Kennedy v. United States, 965 F.2d 413, 417 (7th Cir. 1992); LaBonte v. United States, 233 F.3d 1049, 1050 (7th Cir. 2000)).

127. *See Israel*, 135 F. Supp. 2d at 953.

128. *See id.*

129. *See* OFFICE OF INSPECTOR GENERAL, USDA, FARMERS HOME ADMINISTRATION NET

how many agreements have been executed."[130] The national office did not instruct the local offices on the proper completion of the SAA.[131] No oversight reviews were conducted.[132] The auditors found instances of agreements that had been signed unnecessarily,[133] real estate that was sold with out a claim of recapture,[134] and data elements on the agreements that were computed erroneously.[135] Foretelling problems in the future, the report stated:

> We observed inconsistencies between the agreements and other documents or the law during our review of 52 of 117 agreements. These went unnoticed because there was no oversight review of the preparation of the agreements. As a result, there could be potential legal problems when FmHA tries to enforce these recapture provisions as specified in the law.[136]

These FmHA management problems reveal an agency troubled by its own ineptitude, but not one that was consciously providing misinformation to its clientele.

Even if affirmative misconduct could be shown, there is a fundamental flaw in the borrower's estoppel argument. Reliance upon the oral representations of the agency officials is only reasonable if other correct notice is not provided. Even assuming that the contract is ambiguous as to the borrower's obligation at the end of the term, the farmer received clear written notice that a recapture obligation could be claimed at the end of the term. The official notice of restructuring sent to each delinquent borrower and published first in the Federal Register and subsequently in the Code of Federal Regulations provides, in straightforward terms, the following advice.

> You must sign a shared appreciation agreement. The agreement asks you to:
>
> - Repay a part of the sum written down.
>
> - The amount depends on how much your real estate collateral increases in value.
>
> - The shared appreciation agreement will not last longer than 10 years.

RECOVERY BUYOUT RECAPTURE AND SHARED APPRECIATION AGREEMENTS, AUDIT REPORT NO. 04099-185-Te (Sept. 1992) [hereinafter OFFICE OF INSPECTOR GENERAL].

130. *Id.* at 4.
131. *See id.* at 2.
132. *See id.* at 2, 10.
133. *See id.* at 9.
134. *See id.* at 8.
135. *See id.* at 2-3.
136. *Id.* at 10.

> During this 10 years, FmHA will ask you to repay part of the debt it wrote down if you do one of the following things:
>
> (1) Sell or convey the real estate.
>
> (2) Stop farming.
>
> (3) Pay off the entire debt.
>
> If you do not do one of these things during the ten years, FmHA will ask you to repay part of the debt written down at the end of the ten years.[137]

FmHA farm borrowers received this notice when they became delinquent on their FSA loans and were offered the opportunity to apply for debt restructuring. Admittedly, the SAA provisions were part of a packet of information that was "long and technical."[138] However, receipt of this notice, regardless of whether it was read and understood, undercuts a legal claim of reasonable reliance upon the oral representations contrary to the notice.

Despite the compelling stories of farmers who misunderstood the legal significance of the SAAs that they signed, despite the poorly drafted SAA contract, despite the agency's negligence in administering the program, the arguments that the SAA does not trigger a recapture obligation at the end of its term are weak. It is unfortunate that the pursuit of these arguments may have clouded the better legal claims. These better claims, untested in the courts as of this writing, present a far greater likelihood of success.

B. *The Recapture Amount: If There is an Obligation, How Should the Amount of the Recapture Obligation Be Determined?*

Assuming that borrowers are indeed obligated at the end of the term of the agreement, the determination of the amount of recapture is, nevertheless, problematic. For farmers that reach the end of the SAA term,[139] the contract fails to clearly define

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137. Servicing and Collections, 7 C.F.R. pt. 1951, subpt. S, exh. A, Attachment 1 (1989).

138. *See* Stahl v. Veneman, No. A3-01-85 U.S. Dist. LEXIS 12925, Memorandum and Order at *9 (D.N.D. Aug. 22, 2001).

139. There is an additional provision that applies when one of the triggering events has occurred prior to the end of the term of the agreement. This provision does not add any specificity, however. It states only that "the amount of recapture by FmHA will be based on the difference between the value of the security at the time of disposal or cessation by Borrower of farming and the value of the security at the time this Agreement was entered into." Certain Provisions of the Agricultural Credit Act of 1987 and Additional Amendments of Portions of Farmer Program Regulation, 53 Fed. Reg. 35,638, 35,746 (Sept. 14, 1998) (codified at 7 C.F.R. pt. 1951, subpt. S exh. D. (1989)), *repealed by* Enforcement

the process by which the amount of recapture will be computed. The contract refers to a percentage of the "positive appreciation in the market value of the property securing the loan."[140] This implies that the recapture obligation will be based on a comparison of the value at the contract inception and the value at the end of the contract. Accordingly, the sample contract form provides a blank for the insertion of the specific "Market Value of the property securing the loan(s)."[141] This, presumably, is the baseline value, the value as of the date of the agreement. The contract does not, however, provide guidance as to how value should be determined at the end of the agreement.[142]

This omission would not be problematic if the agency focused its contract interpretation on a fair reading of the term "appreciation." True appreciation in value can only be determined if the same process and the same variables are considered at the end of the agreement as were considered when value was determined at the inception of the agreement. The agency, however, has not chosen that interpretation. Two serious problems with the agency's approach to valuation are observed.[143] First,

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Collection of Shared Appreciation Agreements, 63 Fed. Reg. 6627,6629 (Feb. 10, 1998).

140. Certain Provisions of the Agricultural Credit Act of 1987 and Additional Amendments of Portions of Farmer Program Regulation, 53 Fed. Reg. at 35,746.

141. Certain Provisions of the Agricultural Credit Act of 1987 and Additional Amendments of Portions of Farmer Program Regulation, 53 Fed. Reg. at 35,746.

142. When drafting the initial regulations and the SAA contract, the agency also neglected to include any provision that would cap the amount of recapture at the amount of debt forgiven. Nevertheless, the agency has consistently interpreted recapture as being limited to the amount of debt forgiveness. This maximum limit is now set forth in the regulations. *See* Servicing and Collections, 7 C.F.R. § 1951.914(c)(3) (2001).

143. The problems discussed herein are substantive problems that have systemic application associated with all SAAs. There are also procedural problems that may present issues in individual cases, but that are beyond the scope of this article. These problems concern the procedures used in determining the value of the property when recapture is triggered. Borrowers were promised one process at the time that the first SAAs were signed, but over the course of the SAA term, the process was significantly modified. The original procedures, as published in the interim regulations, provided that the borrower would be asked to choose an FmHA approved appraiser from a list provided by the agency and that appraiser would be asked to assess the current market value of the property. *See* Servicing and Collections, 7 C.F.R. § 1951.914(b)(4)(ii)(1989). The agency and the borrower would split the cost of the appraisal. *See id.* § 1951.914(b)(4)(ii). In 1998, the regulation that established this procedure was eliminated from the regulations. *See* 7 C.F.R. § 1951.914 (1999). The regulations are now silent as to the notice that the agency is to provide to the borrower. It is apparent, however, that the agency now chooses the appraiser and sets the appraised value without borrower input. This increases the importance of the borrower's subsequent appeal rights. These rights are set forth in the general loan servicing regulations. *See* 7 C.F.R. § 1951.909 (2000). The borrower has a right to obtain a new, independent appraisal from an appraiser on the agency's approved list or one that meets the Farmers Home Administration's qualifications. *See id.* § 1951.909(i)(4). The appraisal is at the borrower's own expense. If the difference between the agency's appraisal and the independent appraisal is not more than five percent, the borrower must choose the appraisal to be used. *See id.* If the difference between the two appraisals is greater than five percent, the regulations provide a procedure for "negotiating" the appraisal. *See id.* The FSA, however, has taken the position that this negotiation process does not apply to an SAA appraisal.

although property values at the inception of the SAA contract were arguably based primarily on the agricultural use value of the property, the FSA now uses "highest and best use" to determine value at the end of the SAA. This is, in effect, comparing apples to oranges, with the result being inaccurately high recapture obligations.[144]

Second, the agency fails to give appropriate consideration for an increase in value that is the result of capital improvements made by the farmer to the property during the SAA term. These farmers may end up paying twice for their improvements, once with the initial expense and later, with the recapture obligation.

1. *Agricultural Use Value Compared to "Highest and Best Use" Value*

The contract's failure to specify a valuation method presents a critical question regarding the type of real estate valuation to be employed in the recapture process. Will the value of the secured property be appraised according to its farm production value, i.e., what it is worth in continued agricultural production, or will it be valued at the highest price that could be obtained, including the value if it were taken out of production, i.e., its "highest and best use" value? In many areas, particularly those surrounding large urban areas, the difference in these values is staggering.

Regardless of which valuation approach is used, key to the concept of appreciation from one time period to another is the use of the same approach. For example, if highest and best use value is used to determine valuation at the SAA contract inception, the same approach should be used to determine value at the end of the contract term. Similarly, if agricultural value is the valuation used at inception, agricultural value should be used to determine what true appreciation has occurred. If agricultural value is compared to highest and best use value, there is no certainty that appreciation is measured. The difference in values could simply be a measure of the different approaches.

A review of the valuation techniques used by the FSA (and its predecessor, FmHA) documents this problem. As the agency regulations demonstrate, the original

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Therefore, the borrower only has the option of appealing the appraisal to the National Appeals Division (NAD). The Director of NAD has concluded that when reviewing appraisals, NAD hearing officers' review is limited to determining whether the agency appraisal is in compliance with official appraisal standards. *See* USDA National Appeals Directive, Norman Cooper, Director, NAD-98-01 (Dec. 16, 1997) (granting greater authority), rescinded Apr. 19, 1999. The borrower's appraisal can be used as evidence to support a finding that the agency appraisal is not in compliance, but cannot be substituted as establishing the accepted valuation. Thus, the most that the borrower can hope to obtain from the NAD hearing is a remand to the agency for a new appraisal.

144. *Cf.* Hall v. Glickman, No. 3:99-CV-171BN, slip op. at 25 (D. Miss. July 19, 2000) (reviewing FSA appraisals of property containing timber in the context of SAA recapture). This court held that the initial agency appraisal had to be consistent in approach regarding timber valuation with the final appraisal. Unless it was, the court stated that the agency would not be "comparing apples to apples." *Id.*

market value set forth as the base value on the SAA contract was based primarily on the agricultural value of the land.[145] Current FSA regulations, however, have been amended to provide that farm real estate is now valued according to its highest and best use.[146] This is, therefore, the value that is used to determine the amount of "appreciation" for purposes of SAA recapture.

a. *The Approach Used For the Initial SAA Property Valuation*

The SAA calls for the insertion of an amount designated as the "Market Value of the property securing the loan(s)."[147] This is the baseline valuation amount upon which appreciation can subsequently be computed. Any inquiry into the validity of the appreciation computation should begin with an analysis of how the agency computed this first valuation.

As noted previously, only farmers who participated in the administrative debt restructuring process and were found to be eligible for debt write down were required to sign the SAA.[148] Valuation of the farmer's assets was the cornerstone of this debt restructuring process.[149] From this value, both the availability of debt restructuring and the base amount for shared appreciation computation were determined. The appraised value of the real estate, plus other assets, minus pre-determined agency recovery costs determined net recovery value. Net recovery value was then used as a baseline to determine whether restructuring was possible.[150] If the restructuring was possible, and if it included a writedown of debt, the base value of the real estate also provided the amount that would be incorporated into the SAA as the "[m]arket value of the property securing the loan(s)."[151]

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145. *See* Appraisals, 7 C.F.R. § 1809 (1989).

146. *See* Servicing and Collections, 7 C.F.R. § 1951.914(c)(1) (2001).

147. Certain Provisions of the Agricultural Credit Act of 1987 and Additional Amendments of Portions of Farmer Program Regulations, 53 Fed. Reg. 35,638, 35,746 (Sept. 14, 1988) (codified at 7 C.F.R. pt. 1951, subpt. S, exh. D) *repealed by* Enforcement and Collection of Shared Appreciation Agreements, 63 Fed. Reg. 6627, 6629 (Feb. 10, 1998).

148. *See* S. REP. NO. 100-230, at 45 (1987).

149. *See id.* The debtor was required to present a restructuring plan that would provide the agency more than it would receive on liquidation. The agency thus compared the amount that the debtor could afford to pay against the amount that his or her farm assets would bring in a collection action. The restructuring plan was accepted only if it promised the agency more than the value of the property, less the cost that it would take for the agency to liquidate the property. Thus, for every debt restructuring application, the agency appraised the property to determine its value, then subtracted the agency's estimated recovery costs to arrive at a lower figure termed "net recovery value."

150. *See* 7 U.S.C. § 2001(c) (2000). The formula for calculation for the net recovery value is available at *supra* note 39.

151. Certain Provisions of the Agricultural Credit Act of 1987 and Additional Amendments of Portions of Farmer Program Regulations, 53 Fed. Reg. at 35,746. A number of FmHA loan officers erroneously used the value of all assets instead of only the real estate assets in filling out the SAA. OFFICE OF INSPECTOR GENERAL, *supra* note 129. This results in lower SAA recapture obligations, when the erroneously high number is subtracted from the value of the property at the expiration of the SAA.

The primary loan servicing regulations promulgated in September of 1988 established the guidelines for the debt restructuring process.[152] With regard to valuation determinations, these regulations expressly directed the agency to determine the current market value of the borrower's real estate using the method set forth in the agency's general farm appraisal regulations.[153] Consistent with this direction, the appraisal regulations, found in Part 1809 of title 7 provided that "[a]ll farms, except small farms appraised for RH [Rural Housing] loans, will be appraised for their market value under this subpart."[154]

Three distinct aspects of the appraisal regulations support the argument that market value, as used as a baseline for SAA appreciation, reflects farmland value, not highest and best use value.

i. *The Three Way Approach*

The appraisal regulations proscribe a three way approach to determining market value for farms.[155] The three approaches consider market sales data, capitalization data, and a summation of all resources and facilities. Ultimately, relying on this combination, the appraiser is to arrive at a "market value for the full range of [FmHA financed] farm properties."[156]

In explaining the different approaches, the regulations, identify the "capitalization approach" as the most important.[157] This approach estimates the earnings from the farm, capitalized at an appropriate rate to determine the earnings value.[158] The regulation explains alternative ways to obtain capitalization value, considering either rental values or cash flow and production reports.[159] The

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Although the agency challenged this result, at least one district court required FSA to live by its error. *See* Viers v. Glickman, No. 4-99-CV-90431, slip op. at 7 (S.D. Iowa July 10, 2000); *see also* Viers v. Glickman, No. 4-99-CV-90431, 2000 WL 33363197 (S.D. Iowa Nov. 28, 2000) (denying farmer-plaintiff's request for attorneys fees).

152. *See* Certain Provisions of the Agricultural Credit Act of 1987 and Additional Amendments of Portions of Farmer Program Regulations, 53 Fed. Reg. at 35,638 (codified in scattered sections of 7 C.F.R.).

153. *See* Certain Provisions of the Agricultural Credit Act of 1987 and Additional Amendments of Portions of Farmer Program Regulations, 53 Fed. Reg. at 35,720 (to be codified at 7 C.F.R. § 1951.902(b)(3) (1989)). The regulation states that "[t]he County Supervisor will determine the current market value of the collateral in accordance with Subpart A of Part 1809 of this chapter. . . ." *Id.*

154. Appraisals, 7 C.F.R. pt. 1809.1, subpt. A (1989).

155. *See id.* § 1809.4.

156. *Id.* § 1809.4.

157. *See id.* § 1809.4(b).

158. *See id.* § 1809.4(b).

159. *See id.* § 1809.4(b). The "rental income method" translates farm rental earnings into a capitalization rate. Rental terms are based on equitable farm tenancy terms in the area or a comparable area. *Id.* § 1809(b)(1). The "earnings method" is a detailed cash flow analysis of the farm operator and/or comparable farm properties. *Id.* at § 1809(b)(2).

importance of the capitalization value in determining the market value of the farm was emphasized in the prefatory comments to the debt restructuring regulations. These comments indicate agreement with respondents that "the price of suitable farmland should reflect the annual production value. FmHA uses the capitalization value to determine this. Therefore we have revised this section [7 C.F.R. § 1809.4] to clarify the procedure for this."[160]

In addition to the capitalization value, the three way approach also considers market data regarding the farm property.[161] This is based upon the recent sale prices of comparable properties. The regulation identifies the factors used to evaluate comparable property. These factors reflect agricultural uses. They are "[l]ocation, soil, and topography, water resources, dwelling, other essential buildings, allotments, proportion of cropland to total land, farm layout and arrangement, general appearance, accessibility to services and facilities, state of cultivation, woodland, pasture, urban or rural orientation, and alternative uses."[162]

The Summation approach is the final consideration. This approach is obtained by "adding the value of essential buildings to the market value of the land."[163] This approach is to be used "for checking purposes in making the appraisal."[164] The age, attractiveness, and functional utility of the buildings is to be considered.[165] Although there is a reference to "potential residential value for off-farm employment," it appears to be tied to an assumption that the farm will continue in production while giving farm residents the opportunity to seek additional income.[166]

The regulations direct the appraiser to consider the results of the three approaches in arriving at the final "recommended market value" figure.[167] The regulations note that the market data approach, "as a general rule" is the most reliable indicator of value.[168] However, the appraiser is to examine the spread between the three values and "determine which approach appears to be the most reliable answer to the appraisal problem."[169]

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160. Certain Provisions of the Agricultural Credit Act of 1987 and Additional Amendments of Portions of Farmer Program Regulations, 53 Fed. Reg. 35,638, 35,640 (Sept. 14, 1988) (prefatory comments to interim final rule).

161. *See* 7 C.F.R. § 1809.4(a).

162. *Id.* § 1809.4(a)(1)(i).

163. *Id.* § 1809.4(c).

164. *Id.* § 1809.4(c).

165. *See id.* § 1809.4(c)(2).

166. *Id.* § 1809.4(c)(2)(v). "Location of farm buildings for possible farm reorganization including potential service as a headquarters unit, accessibility to markets and potential residential value for off-farm employment will give added value to farm buildings." *Id.*

167. *Id.* § 1809.4(d).

168. *See id.* § 1809.4(d).

169. *Id.* § 1809.4(d).

ii. *Definition of Values*

The regulations acknowledge that "[t]here are different kinds of values used in farm appraisals which may be considered in arriving at the Recommended Market Value for farm properties."[170] Two such values are identified in the definitions section of the regulations.[171]

Agricultural value is defined as an "amount a typical purchaser would, under usual conditions, be willing to pay and be justified in paying for the farm, as improved, for customary agricultural uses, including farm-home advantages, with the expectation of receiving typical net earnings from the farm."[172] This value is based upon agricultural assets only and "depends in a large measure on [the] earning ability of the farm. . . ."[173]

Market value is also defined as a value that can be considered in arriving at the final Recommended Market Value.[174] It is defined as an "amount a typical purchaser would be willing to pay and justified in paying for the property considering agricultural uses and nonagricultural assets the property may have."[175] The regulations note that a market value determination is to "be made for the acquisition of individual tracts of security servicing" for certain specific loan programs.[176] The programs listed are Rural Renewal Loans, Emergency Loans, Resource Conservation and Development Loans, Community Services Loans and Grants, Cooperative Association Loans, Timber Development Loans in the Appalachian Region, and security servicing actions under Part 1965.[177] Farmer Program Loans, which are serviced under Part 1951, are not included in the listing. The existence of this specific listing and the exclusion of farmer program loan servicing from the list supports the argument that agricultural value rather than for market value was used for the debt restructuring appraisals that underlie the SAA baseline value.

iii. *The Valuation Principles*

The third aspect of the regulations at Part 1809 that support the conclusion that farmland valuation was used are the "[b]asic farm valuation principles" contained therein.[178] These are "the [most] important principles and factors affecting value that should be considered in making farm appraisals. . . ."[179] Four fundamental

170. *Id.* § 1809.2.
171. *See id.* § 1809.2.
172. *Id.* § 1809.2(a).
173. *Id.* § 1809.2(a).
174. *See id.* § 1809.4(d).
175. *Id.* § 1809.2(b).
176. *Id.* § 1809.2(b).
177. *See id.* § 1809.2(b).
178. *Id.* § 1809.3.
179. *Id.* § 1809.3.

assumptions are set forth.[180] These are: "(1) The farm will be operated by a typical operator. (2) The farm will be developed as planned. (3) The crop yields are based on current practices and present farm technological methods in general use, [and] (4) General economic conditions will remain stable."[181] Each of these assumptions presupposes a value based on continued agricultural use.

The regulations discuss the importance of location, but most considerations relate to its impact on the farming operation. For example, the regulations provide that "distance to market and trading centers," the "kind and condition of roads to market" and the "opportunity for off-farm employment" may be important in evaluating the location.[182] The only indication of any inflation in value due to non-farm value factors is one statement that provides, "[w]hen location causes the property to have more value than justified on the basis of customary agricultural use, the appraiser should determine and include an estimate of what the better features will be worth to a typical buyer."[183] Unfortunately, the regulations are not clear as to what impact this estimate should have, nor do they provide where it should be used.

Similarly, the regulations discuss the state of development, but the discussion does not reflect the typical urban development pressures. Rather, the regulations note that "[a]ppraisers should carefully study a community to note the quality of farming, the standard of building maintenance, and similar economic patterns."[184]

Earning power of the farm is an important valuation consideration.[185] The regulations explain that the net earnings of the farm are derived from a variety of factors including the kind of crops grown, acreage, yields, soil types, market prices and costs.[186] The regulations further provide that "[i]ncome as a factor in valuation must be based upon a typical operation. . . . A typical operator would be the most likely operator the farm would be expected to attract who would conduct a farming operation suited to the property."[187] The availability of off farm employment is acknowledged as a positive factor, but only as a means of supplementing farm income.[188]

iv. *Appraisals Consistent With the Purpose of the Valuation*

Part 1809's focus on agricultural production value is supported by the fact that many of the appraisals conducted thereunder were primarily done as part of the

180. *See id.* § 1809.3.
181. *Id.* § 1809.3(a)(1)-(4).
182. *Id.* § 1809.3(b)(1)(i), (iii).
183. *Id.* § 1809.3(b)(1)(vi).
184. *Id.* § 1809.3(b)(2).
185. *See id.* § 1809.3(d).
186. *See id.* § 1809.3(d).
187. *Id.* § 1809.3(d).
188. *See id.* § 1809.3(f).

evaluation of applications for farm loans.[189] The agency would understandably be concerned about whether the production value of the property would sustain the cash flow needs of the farming operation and support the repayment of the loan. As FmHA/FSA farm program loans can only be maintained by a farmer with a continuing farming operation, and cessation of farming is a cause for loan acceleration, accurate farm production value was the primary information needed by loan officers.

At first glance it might appear that appraisals for purposes of debt restructuring would have a different concern. Net recovery value, which is the valuation of what the government could recover if it sold the property, would seem to place a different focus on the appraisal. The Agricultural Credit Act of 1987, however, required that any property that was suitable for farming and that was taken into government inventory, for example, property that was liquidated, was to be sold as farmland.[190] This requirement was implemented through a priority system for inventory sales that strongly favored FmHA qualified borrowers and prior owners.[191] Thus, the use of farmland valuation under Part 1809 for debt restructuring consideration purposes, provided an accurate measure of what the agency would recover if it were to obtain the property through foreclosure.

In conclusion, Part 1809 provided the guidelines for the appraisals that formed the baseline for SAA recapture determinations.[192] These guidelines can be interpreted as either mandating an agricultural value, or at a minimum, as requiring a valuation that is influenced by the production value of the farm. Under either interpretation, this is a very different standard than that used by the FSA currently.

b. *The Approach Used For the Final SAA Property Valuation*

Regulatory changes over the course of the term of the SAAs have dramatically altered the FSA's approach to appraisals. In 1993, the agency removed the regulations at Part 1809 and published new appraisal rules at Part 1922.[193] The new regulations emphasize compliance with the Uniform Standards of Professional Appraisal Practice ("USPAP") as required under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA").[194] The new appraisal rules

189. *See id.* § 1809.6(a) (providing that the appraisal should be conducted after the borrower has been found to be eligible for the FmHA loan).

190. *See* Agricultural Credit Act of 1987, Pub. L. No. 100-233, 101 Stat. 1568, 1669 (to be codified at 7 U.S.C. 1985(c)) (amending the Consolidated Farm and Rural Development Act (CONACT)). For a good discussion of the priority sale requirements, *see* Hayes, *supra* note 75 at 16.

191. *See* Agricultural Credit Act of 1987, Pub. L. No. 100-233, 101 Stat. 1568, 1669 (to be codified at 7 U.S.C. 1985(c)) (amending the Consolidated Farm and Rural Development Act (CONACT)).

192. *See* Appraisal of Farms and Leasehold Interests, 58 Fed. Reg. 44,748, 44,749-750 (Aug. 25, 1993) (to be codified at 7 C.F.R. pt. 1922).

193. *See* Appraisal of Farms and Leasehold Interests, 58 Fed. Reg. at 44,748-749 (prefatory comments).

194. *See* Appraisal of Farms and Leasehold Interests, 58 Fed. Reg. at 44,748-749.

omit all of the substantive guidelines set forth in the former Part 1809. The new Part 1922 contains only one general section and one section on easements. The general section provides in relevant Part as follows:

> This subpart prescribes the procedures and guidelines for conducting appraisals in connection with making and servicing Farmers Home Administration (FmHA) insured loans on farm tracts . . . Farm tracts will be appraised for market value. FmHA designated appraisers and contract appraisers will comply with the guidelines and standards as set out in Sections I and II of the Uniform Standards of Professional Appraisal Practice (USPAP), when completing farm tract appraisals as prescribed by this subpart . . . .[195]

Some of the Part 1809 provisions that were eliminated from the regulations were published as instructions. Although the three approaches to value remain in the instructions, all of the significant references that favor the importance of farmland production value, were deleted.[196]

In November 1999, the FSA eliminated the appraisal regulations at Part 1922 and published new regulations at Part 761.[197] The new regulations provide only that real estate appraisals, technical appraisal reviews of real estate appraisals, and their respective forms must comply with the standards contained in USPAP, as well as applicable Agency regulations and procedures for the specific Farm Loan Program activity involved.[198]

On August 18, 2000, the FSA published new regulations affecting the SAAs, regulations that remain in effect today.[199] These regulations provide in relevant part that "[t]he value of the real estate security at the time of maturity of the Shared Appreciation agreement (current market value) shall be the appraised value of the security at the highest and best use . . . ."[200]

c. *The Requirements of USPAP*

The FSA appears to believe that the changes in the appraisal process are mandated under the USPAP.[201] As federal law requires federal agencies to apply the

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195. *See* Appraisal of Farms and Leasehold Interests, 58 Fed. Reg. at 44,748-749.

196. *See* FmHA Instructions Part 1922 - APPRAISAL (Aug. 8, 1993) (Procedural Notice 211).

197. *See* Streamlining of Regulations for Real Estate and Chattel Appraisals, 64 Fed. Reg. 62,566, 62,566 (Nov. 17, 1999) (to be codified at 7 C.F.R. § 761.7).

198. *See* Streamlining of Regulations for Real Estate and Chattel Appraisals, 64 Fed. Reg. at 62,567.

199. *See* Farm Loan Programs Account Servicing Policies—Servicing Shared Appreciation Agreements, 65 Fed. Reg. 50, 401, 50,401 (Aug. 18, 2000) (to be codified at 7 C.F.R. 1951.909, 1951.914).

200. Farm Loan Programs Account Servicing Policies—Servicing Shared Appreciation Agreements, 65 Fed. Reg. at 50,404. The public was not afforded an opportunity to comment on this change in that the "highest and best use" language was not contained in the proposed rule that preceded the publication of this final rule. Servicing and Collections, 7 C.F.R. § 1951.914(c)(1) (1989).

201. The Deputy Administrator for Farm Loan Programs, Carolyn Cooksie, expressly stated in

USPAP standards to its appraisal activities, consideration of these standards is appropriate.[202] As will be shown, however, conducting appraisals to determine the farmland production value of land for purposes of SAA recapture assessment is fully consistent with the USPAP standards.

A review of the USPAP standards reveals little specific direction and no constraint on FSA agricultural value appraisals. Many of the USPAP provisions reflect basic codes of conduct necessary to assure the integrity of the appraisal.[203] For example, Standard 1 provides that "in developing a real property appraisal, an appraiser must identify the problem to be solved and the scope of the work necessary to solve the problem, and correctly complete research and analysis necessary to produce a credible appraisal."[204]

With regard to different valuations, the USPAP references market value in a number of contexts, but it is clear that this is not the only permissible value to be used in appraisals. Standards Rule 1-2(c) provides that the appraiser must "identify the purpose of the assignment, including the type and definition of the value to be developed; and if the value opinion to be developed is market value, ascertain [various financing options]."[205]

There are a number of the USPAP provisions that would allow for an appraiser to consider the agricultural value of the property, particularly in the context of a final SAA valuation. Standard 1-2(b) calls for an identification of the intended use of the opinion.[206] Standard 1-2(e) calls for an identification of the "characteristics

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a letter to Lynn Hayes, Staff Attorney, Farmers Legal Action Group, Inc., that "The Office of Management and Budget requires that all Federal agency appraisals conform to Uniform Standards of Professional Appraisal Practice (USPAP), which mandate assessment at the "highest and best use" of the property. Thus, the capitalization value cannot be used to lower any amount due under an SAA." Ms. Cooksie also claims in this letter that "[a]t no time did the Farm Service Agency (FSA) or its predecessor agency appraise real estate at its capitalization/agricultural value for loan servicing purposes." Letter from Carolyn B. Cooksie, Deputy Administrator, Farm Loan Programs, FSA, to Lynn A. Hayes, Staff Attorney, Farmers' Legal Action Group, Inc. (Apr. 16, 1999) (on file with author) (conflicting with the agency comments regarding the regulations, *supra* note 157 and the accompanying text).

202. *See* Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA"), Pub. L. No. 101-73, 103 stat. 183 (1989). Section 1110 FIRREA (codified at 12 U.S.C. § 3339) requires federal agencies to adopt regulations that establish minimum standards for appraisals used in connection with federally related transactions within the agency's jurisdiction. These regulations must require that all appraisals used in connection with federally related transactions be performed in accordance with generally accepted appraisal practices as evidenced by the appraisal standards promulgated by the Appraisal Standards Board of the Appraisal Foundation. The Appraisal Standards Board of the Appraisal Foundation has promulgated appraisal standards for real-estate related transactions in its Uniform Standards of Professional Appraisal Practice (the "USPAP").

203. *See* APPRAISAL STANDARDS BOARD, UNIFORM STANDARDS OF PROFESSIONAL APPRAISAL PRACTICE, 13 (2000).

204. *Id.* at 13.

205. *Id.* at 14.

206. *See id.*

of the property that are relevant to the purpose and intended use of the appraisal."[207] Appraisals conducted by the FSA for the purposes of SAA recapture would be in compliance with USPAP if they identified use of the appraisal as for SAA recapture; stated that the use of the property was agricultural; and, stated that the use of the property reflected in the appraisal was agricultural production.

Only when the purpose of the appraisal assignment is to establish market value does USPAP require the highest and best use value.[208] The USPAP comment that explains this requirement states that "[t]he report must contain the appraiser's opinion as to the highest and best use of the real estate, unless an opinion as to highest and best use is unnecessary - e.g., as in insurance valuation or 'value in use' appraisals."[209] Presumably, appraising a farm for its farmland value would be a value in use appraisal.

Finally, the USPAP provides that other laws can take precedence over the standards. The Supplemental Standards Rule provides that specific guidelines for appraisals prepared for "specific purposes or property types may be issued by public agencies."[210] Moreover, the Jurisdictional Exception Rule allows for the severability of any provision that would be contrary to the law of any jurisdiction.[211] Clearly, the USPAP standards were not intended to, nor do they in any way, limit the authority of the FSA to value property according to its agricultural use in assessing appreciation recapture. The USPAP provides no shield behind which the agency can hide to justify its departure from the standards it originally used to determine the initial SAA value.

d. *Assessing an Accurate Measure of Appreciation*

Regardless of the characterization of farmland value or highest and best use value, the fundamental argument presented is that appreciation can only be accurately determined if the same appraisal standards are used to arrive at the beginning value as are used to arrive at the end value. For early SAAs, this calls for the agency to use the same standards as set forth in Part 1809 for the valuation of property as of the expiration of the agreement.[212] The use of any other standard, and particularly the use of the highest and best use standard, cannot be found to provide an accurate measure of appreciation.[213]

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207. *Id.*
208. *See id.* at 16 (Standards Rule 1.3(b)).
209. *Id.* at 22. (Official Comment to Standards Rule 2-2(a)(x)).
210. *Id.* at 9.
211. *See id.* at 8.
212. *See* Appraisals, 7 C.F.R. § 1809.6 (1989).
213. Under the regulations, the farmer is subject to the same treatment in instances where the property is sold and in instances where the farmer seeks to retain the property. From a policy standpoint, this is problematic. If a farmer voluntarily sells property at a value reflecting development pressures and a large gain is realized, it would seem appropriate for this gain to be shared with the government lender that allowed the farmer to retain the property by restructuring the debt. Alternatively, given the purpose

2. *The Impact of Capital Improvements on Valuation: Recapture of Capitalized Assets*

The FSA's approach to the appraisal of property at the end of the SAA term results in a second significant problem for farm borrowers. The SAA does not discuss the impact of capital improvements made by the borrower during the term of the SAA. Accordingly, the FSA initially took the position that there would be no deduction whatsoever for improvements to the real estate. Some farmers owned bare land that was subject to an SAA and built a home or farm building on it during the ten year term of the agreement. Others installed irrigation equipment, raising the value far above what appreciation may have otherwise occurred.[214] According to the FSA's initial regulations, the full value of the improved property would be included in the recapture determination.[215] The farmer would, in effect, pay twice for the improvement; once when he or she borrowed funds to build the structure or install the irrigation and once when the SAA was triggered.

The farmers subject to the SAA were given no advice, notice, or suggestion that improvements would increase the ultimate SAA liability. In a traditional lending relationship or any other arms length transaction, this might be understandable. Given the social welfare purposes of the FSA loan program and its paternalistic approach toward borrowers, however, such an omission is indefensible. FSA borrowers are generally required to submit detailed annual farm and home plans to the agency, describing with specificity their plans for the farming operation.[216] They are required to ask permission to change their farming operation[217] or to use the proceeds of collateral for expenditures, including routine farm expenses.[218] They are frequently required to attend agency approved classes or borrower training sessions.[219] In some

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underlying the very existence of the farm loan programs, if the farmer seeks to continue in farming and the real estate is used in the farming operation and not conveyed, farm production value should be used in assessing any obligation under the shared appreciation agreement. Imposing the burden of an appreciation debt that is based on development value is contrary to the very intent of the restructuring program from which the shared appreciation agreement stems.

214. *See, e.g.*, Patrico, *supra* note 3, at 24, *available at* http://progressivefarmer.com/issue/0299/losingthefarm/default.asp (reporting on Michigan farm family that built a new two bedroom house to replace one that was "falling apart," doing most of the labor themselves).

215. *See* Certain Provisions of the Agricultural Credit Act of 1987 and Additional Amendments of Portions of Farmer Program Regulations, 53 Fed. Reg. 35,638, 35,746 (Sept. 14, 1988) (codified at 7 C.F.R. pt. 1951, subpt. S, exh. D (1989)) *repealed by* Enforcement and Collection of Shared Appreciation Agreements, 63 Fed. Reg. 6627, 6629 (Feb. 10, 1998).

216. *See* Construction and Repair, 7 C.F.R § 1924.56 (2001).

217. *See* Farm Ownership, Soil and Water and Recreation, 7 C.F.R. § 1943.3 (2001).

218. *See* Personal Property, 7 C.F.R. § 1962.17 (2001); *Id.* § 1962.18.

219. *See* 7 C.F.R. § 1924.74; *see also* 7 C.F.R. 1943.12. These training sessions are designed to assist the borrower in making good decisions regarding the farm. As one of the regulations states, "[t]he goal of this training is for borrowers to develop and improve the financial and production

cases, they may have an agency supervised bank account.[220] Thus, in most cases, it can be presumed that the agency either provided advice regarding the improvement, or at a minimum, had full knowledge of it. In many cases, it is likely that the agency even financed the improvement. Under these circumstances, FSA's claim to additional recapture based on the improvement seems patently unfair.[221]

Aside from this equitable argument, there are persuasive arguments that capital improvements to the real estate should never have been considered for purposes of computing appreciation under an SAA. Arguably, the inclusion of capital improvements is inconsistent with the underlying concept of real estate "appreciation," and it is inconsistent with the intent of Congress in enacting the SAA provision.

Appreciation represents an increase in the value of the subject property because of a change in market conditions over time.[222] A capital improvement can be distinguished from appreciation in that the improvement represents a positive change in the property due to the infusion of capital. The underlying value of the real estate, based solely on market conditions, could actually depreciate while capital improvements could increase the overall value of the property. Black's Law Dictionary recognized this distinction when it defined "appreciation in value" as an increase in value that excludes "that added value of the property made by extensions and permanent improvements."[223]

Case law has recognized the distinction between capital improvements and appreciation. Echoing the definitional language, the Supreme Court of New York stated that "we must bear in mind the distinction between this 'appreciation' in value and that added value of the property made by extensions and permanent improvements. Extensions and permanent improvements do add to the value of the property, but that added value is not 'appreciation.'"[224] Similarly, state courts called

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management skills necessary to successfully operate a farm, build equity in the farm business, and become financially successful to graduate from Agency programs to commercial sources of credit." *Id.* § 1924.74(a)(1).

220. *See* 7 C.F.R. § 1924.74.

221. It is sadly ironic that FmHA's failure to provide proper guidance and notice to borrowers was one of the driving forces behind the congressional imposition of a mandatory debt restructuring program on the agency in 1987. *See supra* note 36 and the accompanying text. The adage "you can't teach an old dog new tricks" comes to mind.

222. *See* Letter from Christopher R. Kelley, Of Counsel, Vann Law Firm, to Director, Farm Loan Programs (Jan. 7, 2000) (on file with author) (commenting on SAA proposed rules regarding capital improvements, Farm Loan Programs Account Servicing Policies—Servicing Shared Appreciation Agreements, 64 Fed. Reg. 61,221 (proposed Nov. 10, 1999) (to be codified at 7 C.F.R. pt. 1951.914)).

223. *See* BLACK'S LAW DICTIONARY 130 (4th rev. ed. 1968). *See also* most recent definition of appreciation, "[a]n increase in an asset's value, usually because of inflation." BLACK'S LAW DICTIONARY 97 (7th ed. 1999).

224. *See* People *ex rel.* Adirondack Power and Light Corp. v. Public Service Comm'n, 193 N.Y.S. 186, 189 (App. Div. 1922).

to decide the appropriate division of property under a marital dissolution action frequently examine improvements made to separate property and distinguish these improvements from normal appreciation.[225]

Few, if any, would argue about the underlying purpose of the SAA. Market appreciation, and not capital improvement, was clearly the focus of Congress in enacting the SAA requirement. At the time that the SAA requirement was passed, members of Congress, as well as USDA proponents of the SAA provision, were well aware of both the cyclical nature of farmland values and the depressed values of farmland as a result of the farm crisis of the 1980s.[226] References from the Congressional Record reporting on the Senate discussion of the SAA provision consistently indicate concern with land value and market appreciation. Senator Bumpers spoke of "the appreciated value" of the farm property over time;[227] Senator Lugar referred to the SAA coming into play if the "land appreciates in value" and the government's right to share in an "increase in the land value."[228] The inclusion of borrower financed improvements to the real estate valuation for purpose of recapture is inconsistent with the congressional intent directed toward normal appreciation.[229]

The practical implications of recapturing the value of capital improvements also argues against such an interpretation. If capital improvements are to be included, the SAA serves as a powerful incentive for borrowers to make no improvements to the real estate. Given the ten year term of the agreement, such an interpretation would reward the farmer who made no improvements to the farm for the entire term and penalize the farmer who invested his or her own capital to improve and modernize the operation. This is contrary to the central goal of the FSA loan programs to assist the farmer in building a successful farming operation and eventually graduating to commercial credit.[230]

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225. *See* Maedje v. Maedje, 868 P.2d 580, 582 (Mont. 1994) (finding that "it is highly probable that neither Kim nor Rick's improvements to property may have significantly contributed to the increase in value during the course of the marriage. Rather, it appears that the increase was primarily attributable to appreciation."); Burns v. Burns, 466 N.W.2d 421, 422 (Minn. Ct. App. 1991) (finding that $5,000 increase in value due to "improvements" to the homestead, the other $5,000 attributable to "market appreciation".); Michelson v. Michelson, 551 P.2d 638, 644 (N.M. 1976) (finding that "[f]ifty (50) percent of this value is attributable to the community expenditures of time, effort and money and the other fifty (50) percent is attributable to the normal appreciation of property"). This argument, as well as additional case citations supporting it, was presented to the Deputy Administrator for the FSA Farm Loan Programs in March 1999. *See* Letter from Lynn Hayes, Staff Attorney, Farmer's Legal Action Group, Inc., to Carolyn Cooksie, Deputy Administrator, Farm Loan Programs, FSA (Mar. 29, 1999) (on file with author). Ms Cooksie rejected the argument, stating that "the Agency was unable to agree with your reasoning or to implement your suggestions." Letter from Carolyn Cooksie, *supra* note 201.

226. *See* S. REP. NO. 100-230, at 13-14 (1987).

227. *See* 133 CONG. REC. 33,612 (Dec. 2, 1987) (statement of Sen. Bumpers).

228. *Id.* (statement of Sen. Lugar).

229. *See* Appraisals, 7 C.F.R. § 1809.3 (1989).

230. *See, e.g.,* Farm Ownership, Soil and Water and Recreation, 7 C.F.R. § 1943.2 (stating that the goal of the FSA Farm Ownership Loan program is to enable "family-farm operators to use their land, labor and other resources, and to improve their living and financial conditions so that they can obtain

USDA Secretary Glickman acknowledged the problems associated with the agency's interpretation of appreciation as including all improvements in a press release in March of 1999.[231] In this press release, he promised farmers with SAA obligations that the policy would be changed. Nevertheless, the agency continued to assess recapture obligations based on appreciation values that included capital improvements.

In November 1999, the agency issued a proposed rule that suggested a deduction for a very limited category of capital improvements.[232] Improvement deductions were allowed only for a "dwelling, barn, grain storage bin, or silo."[233] The proposed rule sparked a number of critical comments that argued that the deduction was too little, too late.[234]

The final rule was not issued until August 18, 2000, almost seventeen months after Secretary Glickman acknowledged the capital improvements problem.[235] Under the new rule, the borrower is asked to identify any capital improvement made to the property. The appraisal must then specifically identify the contributory value of the improvement. The kinds of capital improvements that can be deducted, however, remain limited. The value that the improvement contributes to the current market value of the property will be deducted only if the improvement is either a new residence (or an expansion of the square footage of the prior residence)[236] or if it is an improvement to the real estate with a useful life of over one year that was capitalized and not taken as an operating expense on the borrower's federal tax records.[237]

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credit elsewhere.").

231. *See* News Release, USDA, Glickman Announces Measures to Reduce Financial Burden on Farm Loan Borrowers, Release No. 0111.99 (Mar. 18, 1999), *available at* http://www.fsa.usda.gov/pas/newsroom/releases/1999/03/0111.htm.

232. *See* Farm Loan Programs Account Servicing Policies—Servicing Shared Appreciation Agreements, 64 Fed. Reg. 61,221, 61,223 (proposed Nov. 10, 1999) (to be codified at 7 C.F.R. 1951.914).

233. Farm Loan Programs Account Servicing Policies—Servicing Shared Appreciation Agreements, 64 Fed. Reg. at 61,223.

234. Thirty-nine out of the forty-four comments submitted on the issue of capital improvements called for an expansion of the capital improvement deduction. *See* Farm Loan Programs Account Servicing Policies—Servicing Shared Appreciation Agreements, 65 Fed. Reg. 50, 401, 50,403 (Aug. 18, 2000) (to be codified at 7 C.F.R. 1951.909, 1951.914); *see, e.g.*, Comments submitted by Karen R. Krub, Staff Attorney, Farmers' Legal Action Group, Inc., on behalf of the National Family Farm Coalition (January 10, 2000) (on file with author) (arguing that "the scope and applicability of the proposed change must be expanded if the deduction is to be more than [an] empty promise for thousands of farmers").

235. *See* Farm Loan Programs Account Servicing Policies—Servicing Shared Appreciation Agreements, 65 Fed. Reg. at 50, 404; *see also* News Release, *supra* note 231 *available at* http://www.fsa.usda.gov/pas/newsroom/releases/1999/03/0111.htm.

236. *See* Farm Loan Programs Account Servicing Policies—Servicing Shared Appreciation Agreements, 65 Fed. Reg. at 50,405.

237. *See* Farm Loan Programs Account Servicing Policies—Servicing Shared Appreciation Agreements, 65 Fed. Reg. at 50,405.

This definition of the allowable capital improvements deduction is limited in the following respects. With regard to home improvements, it only provides a deduction for building a new house or expanding the square footage of the existing home.[238] Therefore, it does not allow a deduction for other home related capital expenditures, such as installing heat or plumbing, wiring for electricity, adding a garage, or other remodeling improvements.

With regard to the alternative category of improvements, these are limited to those that have been capitalized for federal income tax purposes. Federal tax law, however, allows taxpayers to deduct up to $24,000 of their depreciable business asset expenditures as a section 179 deduction each year.[239] Using this deduction allows the taxpayer to receive the immediate tax advantage of a deduction instead of depreciating the asset over time. If a farmer took advantage of this provision and deducted the cost of a capital improvement, he or she unknowingly lost the SAA deduction for that improvement.

The capital improvements deduction is also limited, however, in time of application. According to the regulations, it only applies to shared appreciation agreements that are triggered after the effective date of the regulation, August 18, 2000, and to recapture obligations that were suspended pursuant to an agency Suspension Agreement.[240] The result is a dramatically different treatment of borrowers depending upon circumstances beyond their control. Borrowers whose agreements were triggered prior to the effective date of the regulation are excluded unless they participated in the Suspension Program.[241] Some borrowers may have been ineligible for suspension because their SAA term ended too soon; others may have chosen not to enroll in the program.[242] The Agency estimates that there are over

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238. The prefatory comments to the rule state that the residence deduction will only be allowed for "the contributory value of the borrower's primary residence to the security if it was built on the security property during the term of the Shared Appreciation Agreement and the contributory value of any improvements made to the residence which actually added living area square footage." Farm Loan Programs Account Servicing Policies—Servicing Shared Appreciation Agreements, 65 Fed. Reg. at 50,403. This interpretation was subsequently codified in a correction to the final rule. *See* Farm Loan Programs Account Servicing Policies—Servicing Shared Appreciation Agreements, 65 Fed. Reg. 81,325 (Dec. 26, 2000). The rule now states that "only the value added to the real property by the new or expanded portion of the original dwelling (if it added value) will be deducted from the current market value." Farm Loan Programs Account Servicing Policies—Servicing Shared Appreciation Agreements, 65 Fed. Reg. at 81,326.

239. *See* 26 U.S.C. § 179(b)(1) (2001) (showing that the limitation for this deduction has been increasing over recent years under the specific terms of the statute).

240. *See* Farm Loan Programs Account Servicing Policies—Servicing Shared Appreciation Agreements, 65 Fed. Reg. at 50,405; *see also* Suspension of Collection of Recapture Amount for Borrowers With Certain Shared Appreciation Agreements, 64 Fed. Reg. 19,863, 19,864 (Apr. 23, 1999).

241. *See* Farm Loan Programs Account Servicing Policies—Serving Shared Appreciation Agreements, 65 Fed. Reg. at 50,405 (to be codified at 7 C.F.R. pt 1951); *see infra*, notes 253-258 and accompanying text.

242. As will be noted *infra*, note 229 and the accompanying text, the Suspension Program required farmers to agree to the agency's calculation of their recapture obligation. Farmers who disputed

5,000 borrowers that will not be afforded the new deduction and 1,500 who will.[243] The prefatory comments to the regulations address this inequity and justify it as relieving the Agency of the "substantial administrative burden" of re-evaluating those farmers' obligations.[244] This justification is particularly disturbing in that it is the agency's initial failure to address the capital improvements issue that caused the problem. Moreover, this justification does not comport with the fact that after Secretary Glickman acknowledged the problem, it took the agency almost a year and a half to issue final regulations addressing it.

C. *Paying the Recapture Debt: What Financing Options Should be Available?*

The third area of difficulty in the interpretation of SAAs is the final step in the analysis: resolving the recapture obligation once it has been acknowledged and determined. Assuming that the obligation exists, and putting aside the issues surrounding validity of the amount claimed to be due, how is the borrower expected to pay? As will be presented, the answer to this question has changed significantly over the term of the SAAs.

The original regulations, in effect when the majority of the SAAs were signed, provided simply that:

> If the borrower cannot obtain satisfactory financing to pay the recapture, the amount to be recaptured will be added on the principal of the note and the note will be reamortized over the remaining life of the loan(s) at the applicable rate of interest. If the borrower is financially capable of paying the recapture, as determined by the FmHA County Committee and the payment is not made by the borrower within 180 days from the date due, the borrower's account will be treated as delinquent . . . .[245]

In 1992, the Agency changed the borrowers' rights when a shared appreciation agreement is triggered for recapture.[246] For borrowers whose recapture is triggered by the end of the term of the agreement, the new regulations no longer provided that the appreciation can be added to the principal of the original loan and reamortized at the farmer loan rate.[247] Instead, the revised regulations provided that borrowers who cannot afford to pay the recapture amount and who cannot find other

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the amount owed were understandably hesitant to enroll in the Program.

243. *See* Farm Loan Programs Account Servicing Policies—Servicing Shared Appreciation Agreements, 65 Fed. Reg. at 50,403.

244. Farm Loan Programs Account Servicing Policies—Servicing Shared Appreciation Agreements, 65 Fed. Reg. at 50,403.

245. Servicing and Collections, 7 C.F.R. § 1951.914(c)(1) (1989).

246. *See* Farmer Program Account Servicing Policies and Availability of Loan Servicing Programs for Delinquent Farm Borrowers for Section 1816 and Other Related Sections for the "1990 FACT ACT" 57 Fed. Reg. 18,612, 18,649 (Apr. 30, 1992) (to be codified at 7 C.F.R. § 1951.914).

247. *See* 7 C.F.R. § 1951.914(c)(1).

financing to pay it off, can only be offered financing through a new non-program loan at ineligible interest rates.[248] This change is significant because farmer program loans, like the original loan supporting the shared appreciation agreement, are set at greatly subsidized rates that are significantly below the non-program rate.[249] The agency justified the change in its prefatory comments by stating that

> [t]he law does not require the Agency to finance the shared appreciation. It was an administrative decision to finance the shared appreciation. However, the Agency has the discretion and believes it is reasonable to make the shared appreciation which is due a nonprogram loan. The nonprogram loan will not count against the statutory limits of the program loan and this will not interfere with a borrower's ability to obtain additional FmHA financing. Also, the nonprogram loan will be easier to keep track of.[250]

The comments do not address the fact that many borrowers who signed their shared appreciation agreements may have relied upon the agency's promise that the debt could be added to the original loan.

In 1998, just as many SAAs were coming due, the FSA again revised its treatment of the SAA recapture obligation.[251] A new final rule was issued that provided more specific requirements for the issuance of a non-program loan to finance an SAA recapture obligation. Among the new provisions, the rule provided that the borrower must present a feasible plan for the farming operation including the SAA recapture debt, in order to be eligible for such financing.[252]

A little over a year later, in April 1999, facing adverse publicity in the farm press and renewed questions regarding the validity of the SAA end of term obligation, the agency announced a new Suspension Program.[253] The stated purpose of this program was to "allow . . . borrowers to suspend their obligation to pay the recapture amount to give them time to recover from the current situation of depressed commodity prices."[254]

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248. *See* Farmer Program Account Servicing Policies and Availability of Loan Servicing Programs for Delinquent Farm Borrowers for Section 1816 and Other Related Sections for the "1990 FACT ACT" 57 Fed. Reg. at 18,649.

249. For example, in August 2000, the non-program interest rate was 10.25%; the program rate for farm ownership loans was 7.25%. *See* Farm Loan Programs Account Servicing Policies—Servicing Shared Appreciation Agreements, 65 Fed. Reg. at 50,402.

250. Farmer Program Account Servicing Policies and Availability of Loan Servicing Programs for Delinquent Farm Borrowers for Section 1816 and Other Related Sections for the "1990 FACT ACT" 57 Fed. Reg. at 18,620 (prefatory comments to interim final rule).

251. *See* Enforcement and Collection of Shared Appreciation Agreements, 63 Fed. Reg. 6627, 6629 (Feb. 10, 1998) (to be codified at 7 C.F.R. § 1951.914).

252. *See* Enforcement and Collection of Shared Appreciation Agreements, 63 Fed. Reg. at 6629.

253. *See* Suspension of Collection of Recapture Amount for Borrowers With Certain Shared Appreciation Agreements, 64 Fed. Reg. 19,863, 19,865 (Apr. 22, 1999) (to be codified at 7 C.F.R. § 1951.914).

254. Suspension of Collection of Recapture Amount for Borrowers With Certain Shared Appreciation Agreements, 64 Fed. Reg. at 19,864.

The Suspension Program was not open to all borrowers with SAAs. The program was available only to farmers who had not already financed or paid off the SAA recapture obligation, whose SAA recapture obligation had not already been accelerated, and whose ten year SAA term ended on or before December 31, 2000.[255]

In order to participate in the program, borrowers were required to certify that they were not able to repay the recapture amount.[256] Most problematic, they were also required to admit that they owed the amount that FSA claimed was due under the SAA.[257] This raised a serious problem for farmers who wished to challenge either the existence of the obligation or the amount computed to be due. Nevertheless, borrowers had a short time to decide whether to participate. The regulation stated that they had the later of thirty days from receiving notice of their recapture obligation or May 24, 1999, to sign up.[258]

The original suspension term was one year.[259] The suspended obligation accrued interest at the applicable rate of interest of federal borrowing.[260] The regulations provided that it could be extended "not more than twice."[261] Although the entire obligation would be suspended for the first year based only on the borrower's certification that the borrower was "not able to pay the recapture amount," with regard to extensions, the test was more stringent.[262] Based on the borrower's Farm and Home Plan, the amount suspended would be limited to the "amount the borrower is still

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255. *See* Suspension of Collection of Recapture Amount for Borrowers With Certain Shared Appreciation Agreements, 64 Fed. Reg. at 19,865. The regulation also limits eligibility to farmers who have "complied with the other terms of the agreement" and who have not conveyed any of the secured property. *Id.*

256. *See* Suspension of Collection of Recapture Amount for Borrowers With Certain Shared Appreciation Agreements, 64 Fed. Reg. at 19,865.

257. *See Borrower Notification of Opportunity to Request a Temporary Suspension of Shared Appreciation Agreement Recapture Payment and Borrower Request For Suspension of Shared Appreciation Payment*, FSA Form Letter 1951-S-2, FSA Procedural Notice No. 64 (June 1, 1999). This form letter contained a blank for the insertion of the amount of recapture debt. This amount was to be filled in by the FSA officer. In order to participate in the program, the borrower signed a statement at the end of this notice that provided "I wish to have FSA consider suspending the obligation to pay the Shared Appreciation Agreement recapture amount for which I am now responsible." *Id.*

258. *See* Suspension of Collection of Recapture Amount for Borrowers With Certain Shared Appreciation Agreements, 64 Fed. Reg at 19,865.

259. *See* Suspension of Collection of Recapture Amount for Borrowers With Certain Shared Appreciation Agreements, 64 Fed. Reg.at 19,865

260. *See* Suspension of Collection of Recapture Amount for Borrowers With Certain Shared Appreciation Agreements, 64 Fed. Reg.at 19,865

261. Suspension of Collection of Recapture Amount for Borrowers With Certain Shared Appreciation Agreements, 64 Fed. Reg.at 19,865

262. The certification requirements concerned agricultural lawyers and advocates who questioned the government's ability to subsequently challenge the borrower's certification under civil and criminal false claim provisions. Lynn A. Hayes, *New Option for SAA Borrowers*, FARMERS' LEGAL ACTION REP. (Second issue 1999) at 1-2.

unable to pay, or obtain credit to pay, from any other source (including nonprogram loans from the Agency . . .)."[263]

When the agency issued the August 2000 regulations that amended the treatment of capital improvements to real estate covered by an SAA, they also acted to reduce the interest rate that would be offered to borrowers who financed their SAA recapture obligations.[264] Again, however, this regulation only helped borrowers prospectively. The reduced interest rate was only to apply to future SAA recapture loans "because the previous rates are fixed by the existing promissory notes."[265]

Congress finally weighed in on the SAA issue in November of 2000 and provided financing assistance for all borrowers with SAA recapture obligations who obtained FSA loans to pay the obligation.[266] Under a new statutory provision, these borrowers would be entitled to an interest rate of one percentage point less than the rate applicable to a loan to reacquire homestead property. Moreover, unlike the agency, who tended to offer new benefits only to farmers prospectively, this provision includes the requirement that the interest reduction be applied to all SAA recapture loans, including those previously made by the Secretary.[267]

IV. PROBLEMS WITH REGULATORY CHANGES DURING THE TERM OF THE AGREEMENTS

The overall administration of the SAA program reveals a failure on the part of FSA to consider from the outset how the SAA program was going to work. Not just details, but substantive issues that should have been addressed at the time of initial implementation and contract formation were decided years later, then amended, and amended again throughout the term of the contracts. Some of these changes were generous amendments offered to soften the impact of the recapture obligation. Others, however were detrimental to farmers' interests. The following table lists the various changes in the regulations and the underlying statute that substantively and procedurally affected the rights of borrowers who signed an SAA contract as part of their debt restructuring package at the end of the financial crisis of the 1980s.

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263. Suspension of Collection of Recapture Amount for Borrowers With Certain Shared Appreciation Agreements, 64 Fed. Reg. at 19,865 (to be codified at 7 C.F.R. pt. 1951).

264. *See* Farm Loan Programs Account Servicing Policies—Servicing Shared Appreciation Agreements, 65 Fed. Reg. 50,401, 50,404 (Aug. 18, 2000) (to be codified at 7 C.F.R. pt. 1951).

265. Farm Loan Programs Account Servicing Policies—Servicing Shared Appreciation Agreements, 65 Fed. Reg. at 50,402.

266. *See* Agriculture, Rural Development, Food & Drug Administration and Related Agencies—Appropriations, Pub. L. No. 106-387, 114 Stat. 1549, 1549A-58 (2000) (codified at 7 U.S.C. § 2001(e)(7)).

267. *See* Agriculture, Rural Development, Food & Drug Administration and Related Agencies—Appropriations, Pub. L. No. 106-387, 114 Stat. 1549, 1549A-58 (2000) (codified at 7 U.S.C. § 2001(e)(7)).

SUBSTANTIVE CHANGES AFFECTING SAAS	
Certain Provisions of the Agricultural Credit Act of 1987 and Additional Amendments of Portions of Farmer Program Regulations, 53 Fed. Reg. 35,638 (Sept. 14, 1988) (to be codified at 7 C.F.R. § 1951.914).	Interim final rule: Original regulations requiring SAAs and establishing the terms of the agreements.
Farmer Program Account Servicing Policies and Availability of Loan Servicing Programs for Delinquent Farm Borrowers for Section 1816 and Other Related Sections for the "1990 FACT ACT" 57 Fed. Reg. 18,612, 18,649 (Apr. 30, 1992) (to be codified at 7 C.F.R. § 1951.914).	Interim final rule: Amended the financing of recapture obligations Eliminated the borrower's right to have recapture obligation added to existing loan and provided for financing only at non-program rates.
Appraisal of Farms and Leasehold Interests, 58 Fed. Reg. 44,748, 44,750 (Aug. 25, 1993) (to be codified at 7 C.F.R. § 1922)	Interim final rule: Eliminated 7 C.F.R. pt. 1809 regarding appraisals and replaced it with 7 C.F.R. pt. 1922; dramatically altered focus on agricultural value in appraisal of farmland.
Enforcement and Collection of Shared Appreciation Agreements, 63 Fed. Reg. 6627 (Feb. 10, 1998) (to be codified at 7 C.F.R. § 1951.914).	Final rule: Added specific language that confirms that recapture is "due at the end of the term;" Added "The notes are accelerated" as a trigger for recapture; Provided explicitly that the total amount of debt written down is a cap on the amount of the recapture obligation; Provided more specific terms for non-program loans to finance recapture and included a requirement that the borrower must present a "feasible plan" in order to be eligible for such financing.; Removed all references to appraisal procedures.
Omnibus Consolidated and Emergency Supplemental Appropriations Act of 1999, Pub. L. 105-277, § 101(a), 112 Stat. 2681, 2681-40 (1998) (codified at 7 U.S.C. § 2001(e)(6)).	Added a notice requirement to the shared appreciation provision ("[b]eginning with fiscal year 2000, not later than 12 months before the end of the term of a shared appreciation arrangement, the Secretary shall notify the borrower involved of the provisions of the arrangement.").
Suspension of Collection of Recapture Amount for Borrowers With Certain Shared Appreciation Agreements, 64 Fed. Reg. 19,863, 19,865 (Apr. 23, 1999) (to be codified at 7 C.F.R. § 1951.914).	Interim rule: Created a new Suspension Program whereby certain borrowers with SAAs that ended prior to December 31, 2000 could have their recapture obligation suspended for up to three years, accruing interest at the Federal borrowing rate.

SUBSTANTIVE CHANGES AFFECTING SAAs cont'd	
Streamlining of Regulations for Real Estate and Chattel Appraisals, 64 Fed. Reg. 62,566 (Nov. 17, 1999) (to be codified at 7 C.F.R. § 761.7).	Final rule: Eliminated regulations that controlled appraisal procedures for FSA debt servicing (7 C.F.R. pt. 1922); Instituted new appraisal rule applicable to all FSA farm program loan making and servicing.
Farm Loan Programs Account Servicing Policies—Servicing Shared Appreciation Agreements, 65 Fed. Reg. 50,401 (Aug. 18, 2000) (to be codified at 7 C.F.R. § 1951.914).	Final rule: Provided for a limited deduction for certain capital improvements when computing appreciation for purposes of recapture; Reduced interest rate available for FSA financing of recapture obligations; Mandated use of "highest and best use" valuation in SAA recapture appraisals.
Agriculture, Rural Development, Food & Drug Administration and Related Agencies - Appropriations, Pub. L. 106-387, 114 Stat. 1549, 1549A-58 (2000) (codified at 7 U.S.C. § 2001(e)(7)).	Reduced interest rate charged on recapture obligations financed by the FSA; Applied both to new financing arrangements and required reduction of rate on existing recapture obligations.

It must be acknowledged that the most recent of these changes have been beneficial to farmers with unresolved SAA recapture obligations. These are the changes that occurred beginning with congressional action in 1998. There can be little doubt that political pressure provoked the regulatory concessions that the agency then made to borrowers. Similarly, it can be presumed that similar pressures urged Congress' efforts to assist borrowers by lowering the interest rate charged on recapture obligations financed by the agency. Any advocate of family farmers can be grateful that these changes were instituted.

The earlier changes, however, clearly diminished borrower rights[268] and generally resulted in higher recapture obligations.[269] Borrowers ended up with obligations markedly different than those they assumed when they entered into the SAA contract.

In this regard, the remedial changes made recently might have never been needed had the SAA program been properly implemented from the beginning. This implementation should have been consistent with congressional intent and the underlying purposes of the FSA loan programs. Had borrowers been properly advised

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268. *See, e.g.*, Farmer Program Account Servicing Policies and Availability of Loan Servicing Programs for Delinquent Farm Borrowers for Section 1816 and Other Related Sections for the "1990 FACT ACT" 57 Fed. Reg. 18,612, 18,649 (Apr. 30, 1992) (to be codified at 7 C.F.R. pt. 1951.914) (eliminating the borrower's right to have recapture obligation added to existing loan and provided for financing at non-program rate).

269. *See, e.g.*, Appraisal of Farms and Leasehold Interests, 58 Fed. Reg. 44,748, 44,748 (Aug. 25, 1993) (to be codified at 7 C.F.R. pt. 1922) (dramatically altered focus on agricultural value in appraisal of farmland).

and counseled during the term of the agreement, they might have been able to prepare for the looming obligation. Had the agency not altered its policy regarding appraisals, recapture obligations may have been significantly less. Similarly, if the agency had allowed a deduction for all capital improvements as part of its initial interpretation of the SAA, no regulatory amendment would have been required.

With regard to some borrowers, even the pro-borrower changes are very troubling. These borrowers, the least publicized group of SAA borrowers, are the borrowers who received their notice of an SAA recapture obligation early on and in good faith, often with great personal sacrifice, paid what the agency told them they owed. Farm hotline attorneys tell of such borrowers who cashed in retirement accounts, sold all or part of their farm, or borrowed money from family member to earnestly pay a debt that the government told them that they owed.[270] These borrowers were not given the opportunity to suspend payment of the obligation; they were not allowed any deduction for capital improvements; they were not offered a low interest loan. Some may have been foreclosed upon. Others sold all or part of their farm. Some were denied financing as they were unable to meet the feasibility requirement for an FSA loan to pay the recapture obligation. Tragically, these farmers may have met the feasibility requirement had the new interest rate figure been analyzed with their cash flows or had capital improvements been deducted. But all of these concessions came after many borrowers paid their obligation or otherwise resolved their agency indebtedness. Their cases are now closed. While their situation does not present a legal claim, and some may even be pleased that the program was changed to assist their fellow borrowers, nevertheless, there is a fundamental inequity presented. The longer the farmers put off paying their SAA obligation, the better the repayment deal that was offered. Similarly, the longer the agency put off making concessions to farmers who argued about the fairness of the SAA program, the more FSA recovered as it continued to process other cases. Surely, this is not the way that our farm programs, our social welfare agencies, or our family farms should function.

V. HOW THE SAA PROGRAM SHOULD BE ADMINISTERED

From both a substantive and procedural standpoint, the administration of the SAA program to date has been troubling. While there is little that can be done to erase the mistakes of the past, much could be done to correct them with regard to existing SAAs and even more that could be done to improve the program for future participants. This final section of the article proposes both corrections and future improvements.

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270. Telephone Interview with Karen Krub, Staff Attorney, Farmers' Legal Action Group, Inc. (Jan. 15, 2000).

A. *The Basic Obligation*

From the beginning, borrowers were inadequately advised of their rights. The SAA contract was poorly drafted, and even local FSA officials apparently were ill-advised regarding its effect. Nevertheless, as has been shown, the obligation to pay recapture was intended to trigger at the end of the term of the agreement. This author does not suggest forgiveness of this obligation. Reassessment of the amount of their recapture obligation should be made, however, based on the suggestions set forth *infra* with regard to appraisal valuations.

For future contracting, the SAA contract should be carefully reviewed and revised as necessary to clearly indicate the obligations imposed upon the borrower who signs it. Some improvements have already been implemented.[271] The contract, however, should reflect the agency's thoughtful analysis of how the program was designed to work, from application to enforcement. All provisions should be clearly determined and articulated prior to contract execution. Regulations, drafted with proper notice and comment should be carefully promulgated. Contract language should be clear and understandable. Only unforeseen and dramatic events should cause deviation from implementation according to plan.

Beyond the actual contract language, given the special "social welfare" relationship between FmHA/FSA and farm loan program borrowers, additional efforts must be made to accurately convey the legal significance of the SAA obligation to the borrower.[272] This information should be conveyed at the time that the agreement is signed and throughout the term of the agreement. Adequate notice is particularly important as the agreement nears its conclusion. Congress recognized the importance of this type of notice when it added a notice requirement to the shared appreciation provision.[273] Under this requirement, the agency must notify the borrower "not later than 12 months before the end of the term of a shared appreciation arrangement."[274] The regulations now provide for a shorter SAA term, hopefully, making continued communication throughout the term more likely.[275]

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271. *See* Servicing and Collections, 7 C.F.R. § 1951.914(b) (2001) (although the contract is no longer published in the regulations, these provisions clarify some of the SAA requirements).

272. This is not to say that borrowers are without blame for the problems that they encountered. Gone are the days when any farm borrower, even a family farmer should sign contracts unaware of the legal consequences of the obligations therein.

273. *See* Ombibus Consolidated Farm and Rural Development Act, Pub. L. No. 105-277, § 353(e), 112 Stat. 2681, 2681-40 (1998) (codified at 7 U.S.C. § 2001 (e)(6)).

274. Ombibus Consolidated Farm and Rural Development Act, Pub. L. No. 105-277, § 353(e), 112 Stat. 2681, 2681-40 (1998) (codified at 7 U.S.C. § 2001 (e)(6)).

275. *See* 7 C.F.R. § 1951.914(b) (stating SAA contracts will now have five year terms).

B. *Appraisal Issues*

Problems regarding the FSA's interpretation of value for purposes of the computation of the SAA recapture should be addressed. These problems concern the appraisal approach and the valuation of capital improvements.

1. *Suggestions Regarding Agricultural Valuation*

A review of the regulations in effect at the time that the early SAAs were executed required appraisals to assess the agricultural value of the farm real estate. Current regulations mandate a highest and best use valuation.[276] In many cases, the recapture obligations that are based on the difference between these two values reflect the difference between the appraisal methods rather than true appreciation. The only way to assure an accurate measure of appreciation is to establish one standard that is applied consistently to both the initial valuation and the valuation at the trigger point of the contract.

For borrowers who signed their SAAs prior to the agency's move to highest and best use valuation, the only fair result would be to appraise their property for recapture purposes using the prior standards. The valuation of the property at the end of their ten year term should be based on the same requirements that controlled the initial valuation. In many cases, this will require that the agency conduct a new appraisal.[277]

Even borrowers whose recapture obligation has already been established should be given a right to request a new appraisal. In some cases, the borrower may be satisfied with the prior appraisal, but in others, the borrower may believe that the appraisal for agricultural value will be substantially less. If the appraisal shows a significant difference, the associated recapture obligation should be reduced.

This proposed solution raises the issue of the farmer who may resolve the recapture obligation with the agency and then subsequently sell the farm for development purposes at a highest and best use value. This windfall raises obvious concerns about abuse of the government's generosity. Because the current contract does not provide for a remedy, arguably one should not be imposed after the fact. Changing the contract interpretation to require highest and best use valuation may prevent this windfall, but it will also drive many farmers off the farm, forcing them to surrender land that has been valued for development purposes. These farmers may well have intended to continue farming the land and to pass it on to the next generation of farmers.

A compromise solution may be to require an agricultural restrictive convenant in some circumstances. While it should not be imposed as a new contract term, it

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276. *See id.* § 1951.914(c).

277. *See id.* § 1951.914(c). A new appraisal is already required in many of these cases because of the new treatment of capital improvements. Many of these appraisals have yet to be done.

could be linked to financing. Borrowers who receive FSA financing for the recapture obligation, could be required to promise to keep the subject land in agricultural production for a set period of time in the future or face additional recapture.

For future SAAs, the highest and best use valuation does not present the same problems. As long as this is the value that is assessed at contract inception, it can be the value upon which recapture is ultimately based.

2. *Suggestions Regarding Capital Improvements*

The concept of appreciation should never have included capital improvements made to the property during the term of the agreement. It is inconsistent with the concept of normal appreciation, violative of congressional intent, and it serves to punish those farmers who are farming in a progressive manner. The definition of the capital improvements contained in the current regulations should be expanded to include all improvements that increase the value of the property beyond that of normal appreciation. Farmers should be allowed to present evidence of such improvement, and the appraiser should be instructed to reflect that appropriate deduction from the value of the property.

The current allowance for capital improvement deduction only applies to borrowers whose recapture amount has not been finally established as of August 18, 2000, or to borrowers who participated in the suspension program.[278] The FSA decided not to apply this deduction to any other borrowers because of the administrative burden presented.[279] This is not a sufficient reason to treat one class of borrowers differently than another, particularly when it was the agency's own delay that was at fault. The agency should establish appeal rights that would allow borrowers to come forward with claims of capital improvements to their property. If sufficient evidence was provided, the borrower's recapture obligation should be reduced accordingly.

Future SAA contracts should clarify the treatment of capital improvements. A specific provision for deducting the cost of these improvements from the valuation should be included in both the contract and the regulations. Borrowers should not be discouraged from improving their farmland or the farming operations. As FSA's interests is secured by a mortgage on the improved property, the capital improvements serve to strengthen FSA's position as mortgage holder. FSA should not, however, be entitled to additional recapture as a result.

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278. *See id.* § 1951.914.

279. *See* Farm Loan Programs Account Servicing Policies—Servicing Shared Appreciation Agreements, 65 Fed. Reg. 50,401, 50,403 (Aug. 18, 2000) (to be codified at 7 C.F.R. pt. 1951).

3. *Suggestions Regarding Financing Options*

The aforementioned changes will correct many of the errors associated with the unreasonably large recapture obligations assessed against farmers. It will not, however, make all recapture obligations affordable. As noted previously, farmland values were at a low point when the SAAs were signed, and in many areas, there has been significant appreciation. Farmers with a tight cash flow and a poor debt to asset ratio will simply not be able to afford commercial financing to pay the obligation. Therefore, an FSA financing option is imperative.

Even with this option, some borrowers will still not be able to afford the additional debt, even at subsidized interest rates. Many of these farmers are elderly and are struggling to meet their present obligations.[280] As cash flow feasibility is a test for FSA financing, many of these farmers may not qualify for loans. These borrowers should be afforded treatment that recognizes the problems associated with the early SAAs. A new debt settlement program, with homestead retention rights may be a possibility. Debt forgiveness in exchange for an agricultural preservation restrictive covenant may also be a workable alternative.

For future SAAs, financing should continue to be an option, but hopefully, with good communication and instruction from the agency throughout the SAA, the borrower can set aside funds to pay the SAA recapture obligation prior to its conclusion.

VI. CONCLUSION

The FSA debt restructuring process is conceptually a solid and reasonable approach to resolving farm financial distress experienced by FSA borrowers. The SAA component of that program is also a reasonable approach. The government has every right to ask to recover some of the debt that it has written off if land values rise during the term of the agreement. As the saying goes, however, "the devil is in the detail." And the details regarding the SAA program were literally made up as the contracts went along. Some of these details amounted to substantive changes in the bargain that the farmer made with the agency when the SAA was first instituted.

With regard to the farmers who first signed the SAAs, agency changes in SAA contract interpretation and changes to the governing regulations must be evaluated and amended in a manner that preserves the integrity of the SAA program in existence at the time that the agreement was signed.

For new borrowers who enter into an SAA with the government, hopefully, the lessons of the last ten years will not be lost. Hopefully, future SAA participants

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280. *See, e.g*, Brief in Support of Motion for Preliminary Injunction, *Stahl, supra* note 73 (stating that the majority of the plantiffs are over sixty-five, and the named plaintiff, Clarice Stahl is a 70 year old widow who still ranches in eastern Montana).

will be afforded clear, consistent, and equitable treatment under their contracts. The borrowers who emerged from the financial crisis of the 1980s were not.*

* After this article was written, but just prior to publication, the Seventh Circuit Court of Appeals affirmed the District Court decision in Israel v. U.S.D.A., 282 F.3d 521 (7th Cir. 2002), holding that the expiration of the SAA was a triggering event for recapture. The South Dakota District Court reached the same decision in the recently published case of Bukaske v. U.S.D.A., No. CIV. 00-1011, 2002 WL 480393 (D.S.D. Mar. 27, 2002).