Shared Appreciation Agreements

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I. Introduction.

Throughout the history of American Agriculture one can always find a number of farmers experiencing financial turmoil. Certain periods find this number increasing, sometimes to crisis proportions. The most recent of these farm crises occurred in the mid to late 1980's.[1] Farmers most affected by this crisis were borrowers indebted to the Farmer's Home Administration (FmHA), now known as the Farm Service Agency (FSA),[2] because this government lender generally serves as the lender of last resort to farmers.[3] Thus, many of these farmers were in a marginal financial position even before the farm crisis.

As a response to this agricultural credit crisis, Congress passed the Agricultural Credit Act of 1987.[4] A major provision of the Act addressed the rules relating to FmHA loan servicing.[5] Congress instructed the agency to consider different types of debt servicing devices and, if certain tests were met, to restructure the loan rather than foreclose on the delinquent borrower.[6] The restructuring of loans is meant to serve two major purposes: 1) to avoid losses to the government on these loans, and 2) to ensure that farmers involved with the farmer loan programs are able to continue farming.[7]

For a debtor to be eligible for restructuring, the delinquency must have been caused by circumstances beyond the control of the borrower, the borrower must have acted in good faith in connection with the loan, the borrower must present a plan that shows he or she will be able to meet necessary family living expenses and service debts, and "the loan if restructured, must result in a net recovery to the Federal Government, during the term of the loan as restructured, that would be more than or equal to the net recovery to the Federal Government from an involuntary liquidation or foreclosure on the property securing the loan."[8]

To determine the "net recovery value to the Government" from restructuring, the agency looks to the present value of the payments the borrower would make under the proposed plan.[9] To determine the value of "net recovery from involuntary liquidation", the agency looks to the current market value of the collateral and subtracts certain costs such as the amount required to pay prior liens on the property, costs associated with taking the property into possession, and costs associated with the disposal of the property.[10] The regulations require the agency to consider the restructuring options in a certain order, "beginning with an analysis of whether a deferral, rescheduling, reamortization, consolidation, or change of interest rates will allow a farmer to service the debt, and ending with a program under which the government will write off or write down unsecured debt to the point of the greater of net recovery value of the collateral or net present value of a restructured loan."[11] A write-down reduces the amount that the borrower is obligated to pay the agency.[12]

The Act dictates that as a condition of restructuring, a borrower "may be required to enter into a shared appreciation arrangement that requires the repayment of amounts written off or set aside."[13] This repayment amount is based on the difference between the appraised values of the real security property at the time of the restructuring and the value at the time of recapture.[14] Given the dire financial situation in which numerous FmHA farmer/borrowers found themselves, many of them entered into these agreements with the government in the late eighties. Because the maximum term of these agreements is ten years, a great number of these agreements will expire and the shared appreciation amount will become due in the next few years. This article focuses on these shared appreciation agreements (SAA).[15]

Significantly, farm land prices have steeply increased in the last ten years.[16] For instance, from 1990 to 1997, the price of farm real estate in the Corn Belt has increased sixty-eight percent.[17] The average price of farm real estate in Iowa in 1988 was $947;[18] by 1997 that number had almost doubled to $1837.[19] Because the agency "shares" in the increased land value, the borrower will owe more to the agency as the amount of appreciation increases.

The article first looks at the legislative history, statutory provisions, and regulations dealing with SAA's. It will then explore some possible challenges to certain regulations. Finally, the article examines two areas that have special impact on the SAA's: appraisals and income tax consequences. The appraisal discussion considers challenges to the appraisal scheme both on constitutional and regulatory levels. The tax portion of the article will explain some of the tax consequences in the shared appreciation context and provide an example.

II. Legislative History.

The provision for SAA's was introduced on the Senate floor as an amendment to the Agricultural Credit Act of 1987.[20] The Senate Committee on Agriculture, Nutrition, and Forestry reported that it was their intent "that the Secretary shall administer the SAA provisions so as to maximize the potential recovery of debt which has been written-off or set-aside."[21] The Committee went on to instruct the Secretary "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."[22] The only Senate debate on the provision focused on a fear that Bankruptcy Chapter 12 provisions would undermine the SAA's. Some senators feared that farmers would choose to go into Chapter 12 bankruptcy rather than go through FmHA restructuring because certain provisions of the Chapter 12 bankruptcy were more favorable than those offered by the SAA's.[23] The maximum period under which the borrower was in Chapter 12 lasted only five years as opposed to the ten year duration in the SAA.[24] Given pressure from the Regan administration, however, the Senate agreed to the ten-year term in the SA agreements.[25]

The House refused to include in its bill language providing for recapture under a SAA despite serious objections on the part of the administration.[26] Eventually, however, agreed to the Senate provision in Conference.[27] Thus, the provision for SAA's became part of the Act.

II. The Workings of Shared Appreciation Agreements.

A. The Statute.

Congress provided for the use of SAA's in the Agricultural Credit Act of 1987.[28]

Seven U.S.C. section 2001 provides:

> (e) Shared appreciation arrangements
>
> (1) In general
>
> As 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.
>
> (2) Terms
>
> Shared 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.
>
> (3) Percentage of recapture
>
> The amount of the appreciation to be recaptured by the Secretary 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.
>
> (4) Time of recapture
>
> 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.
>
> (5) Transfer of title
>
> Transfer of title to the spouse of a borrower on the death of such borrower shall not be treated as a conveyance for the purpose of paragraph (4).[29]

B. The Regulations.

The agency announced final rules regulating SAA's on February 10, 1998[30] that replaced interim rules that had been in force since 1992.[31] The regulations provide rules for when the agency will require SAA's, when shared appreciation is due, how the borrower may repay the

new debt created at the expiration of an SAA, and how the agency will service the SAA's. The 1998 regulation is similar in most respects to its predecessors; however, some important differences are noted in the following discussion.

1. Creation of a SAA.

As a condition of receiving a debt write-down, the regulations demand that if the debt is secured by real estate, the borrower must agree to a SAA.[32] The agreement is entered into between the agency and the borrower,[33] and allows the agency to recapture "all or part of the amount written down by taking a share in any positive appreciation in the value of the real property securing the SAA."[34] To secure their position during the shared appreciation period, the agency maintains real estate liens that secured the original debt by attaching the new, restructured notes to the original liens.[35]

2. When shared appreciation is due.

The regulation provides that the appreciation is due upon expiration of the agreement, or earlier if any of the following events occur:

> (1) The sale or conveyance of any or all of the real estate security, including gift, contract for sale, purchase agreement, or foreclosure. Transfer to the spouse of the borrower in case of the death of the borrower will not be treated as a conveyance; until the spouse further conveys the property;
>
> (2) Repayment of the loans; or the loans are otherwise satisfied;
>
> (3) The borrower or surviving spouse ceases farming operations or no longer receives farm income, including lease income;
>
> (4) The notes are accelerated.[36]

The 1998 regulations added the requirement that the appreciated amount would be due upon acceleration of the notes. The notes referred to in this regulation are the notes that the borrowers signed as a condition of restructuring, not the notes created by the borrowers to pay the shared appreciation amount.[37]

3. Amount of shared appreciation.

The appreciation of the property is defined as the difference between the market value of the real estate at the time the SAA was entered into and the market value of the real estate at the time when the shared appreciation is due.[38] If the real estate's value did not increase during the appreciation period, no amount will be due under the agreement.[39] The amount due under the SAA may not be greater than the amount of the debt written-down.[40]

The regulations echo the statute in requiring that the amount of shared appreciation due will equal seventy-five percent of the total appreciation if the expiration of the agreement is triggered within four years of the creation of the agreement and fifty percent of the appreciation thereafter.[41]

4. Payment of shared appreciation amount.

When the borrower pays the shared appreciation amount and any remaining agency debt is paid in full, the agency will release the borrower from liability.[42] For borrowers who are unable to pay the SA amount, the new regulation clarifies that the agency will allow borrowers to amortize certain shared appreciation amounts into new loans known as SA loans.[43] Amortization, however, is not available for borrowers whose SA amount is due because of acceleration, payment of the full debt, or the borrower ceases farming.[44]

Borrowers who owe a shared appreciation amount because the shared appreciation term has expired or because they sold or conveyed the real estate that served as security but will remain farming, may still be eligible to amortize the shared appreciation amount.[45] To be eligible, these borrowers must meet certain requirements, such as the borrower must have a feasible plan that would include the payments, be unable to pay the shared appreciation amount, and be unable to obtain credit elsewhere.[46] The regulation bases the loan term on the borrower's repayment ability, with a maximum limit of twenty-five years.[47] The interest rate will be the nonprogram real property rate.[48]

This new SA loan is available only to borrowers who continue with the agency on farmer program loans;[49] however, the SA loan will be a nonprogram loan.[50] Nonprogram loans are loans made available to borrowers who do not meet the statute's or agency's eligibility requirements for program loans.[51] The fact that the regulations makes these SA borrowers ineligible for farm program loans is significant because a nonprogram loan has terms more stringent than those of regular farm program loans.[52] Further, nonprogram borrowers who become delinquent are not eligible for primary and preservation loan servicing rights such as reamortization, rescheduling, deferral, or debt writedown.[53] Nevertheless, the regulations do offer a couple special considerations to these SA loans if the borrower becomes financially distressed.[54] As the following discussion reveals, however, these options might seem hollow to a financially-strapped farmer.

The only options that the regulations provide are that the borrower may be able to reamortize the SA loan, and he or she may be able to obtain a new interest rate. The SA loan may extend repayment of the SA loan, but the period that the loan has been in effect plus the new repayment period after reamortization may not extend beyond twenty-five years.[55] Borrowers who are financially distressed also have a limited choice to lower the interest rate on the SA loan.[56] He or she may choose between the "current nonprogram rate at the date of reamortization or the interest rate on the original amortized note, whichever is less."[57] Given that the original rate will also be a nonprogram rate,[58] the borrower will not find either of the choices favorable because either of the nonprogram interest rates will be higher than an interest rate charged on a farmer program loan.[59]

IV. Possible Challenges to the Regulation.

A. Requirement that shared appreciation is due upon acceleration of notes is beyond the agency's statutory authority.

The new regulation added the requirement that shared appreciation will be due when "[t]he notes are accelerated."[60] This regulation refers to the acceleration of the notes representing the restructured debt.[61] The note representing the restructured debt is still a farm program loan,

therefore, a delinquent borrower is entitled to most primary and preservation loan service rights. The borrower first has the primary loan rights including a deferral, rescheduling, reamortization, consolidation, and change of interest rates.[62] Note that these restructured loans may not be eligible for debt write-down.[63]

If the borrower is not eligible for any of these primary loan servicing rights, the borrower is then eligible for preservation loan servicing rights of leasing or buying back the property.[64] If the borrower is unable to take advantage of the preservation rights, the restructured loan will then be accelerated.[65] When these restructured loans are accelerated, the new SAA regulation requires that the SA amount becomes due.

The Discussion on the Final Rule in 1998 explained that the interim regulations did not allow the acceleration requirement.[66] Rather, the former regulation was written "so as to allow collection only after transfer of title."[67] The agency decided to add the new requirement because the former regulation had been interpreted to require that the property must have been foreclosed upon before the agency could deem the shared appreciation due.[68] This required the agency to file a civil action after foreclosure to collect the shared appreciation.[69] The agency reasoned that this civil action "decreased collections on SAA's and increased litigation costs."

The effect of the new acceleration requirement is that the SA amount is due much sooner. As mentioned above, before the new requirement the agency waited until after foreclosure before it deemed the SA due. The completion of a foreclosure action occurs a significant period of time after acceleration. The agency does not even file for foreclosure until after the loan has been accelerated. The time of the petition until the completion of a foreclosure, when the sheriff's deed is recorded, can take anywhere from four to twenty-two months.[70] Before the new regulation, borrowers had this time between acceleration of the restructured notes and foreclosure before the shared appreciation amount became due. This time could be critical to the borrower. It could give the borrower time to assess his or her financial situation and attempt to figure out how to pay the shared appreciation amount. Nevertheless, as discussed above, the agency reasoned that it could deem the SA amount due when it accelerated the restructured loans.[71]

Despite the agency's reasoning, one must ask whether such a requirement is within the agency's statutory authority. The statute plainly states when recapture may take place under a SAA:

> 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.[72]

An acceleration of the restructured note does not fall under any of these provisions. As discussed below, a court will not uphold a regulation that is "in excess of statutory jurisdiction, authority, or limitations, or short of statutory right."[73] Because the requirement that the SA amount become due upon acceleration of the restructured loan does not appear in the statute, the regulation appears to be outside the agency's authority.

To reach this conclusion, a court will ask: "whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress."[74] With the express listing of instances that trigger recapture, Congress clearly expressed their intent.[75] The Congress did not express any intent that the agency could add to the list, which is exactly what the agency did when they added acceleration of the restructured notes as a trigger to recapture. Because this new requirement is against the intent of Congress, a court should find that the agency acted outside its statutory authority when it implemented the regulation.

B. The agency's decision to amortize the shared appreciation loans on a nonprogram basis as an impermissible construction of the statute.

In 1992 the agency received a comment on the proposed rule which suggested that "the amount due on SAA's should be consolidated with program loans and rescheduled rather than set up as a nonprogram loan."[76] The agency refused to implement this suggestion in the interim rule, noting that "[t]he law does not require the Agency to finance the shared appreciation."[77] The agency went on to explain that "[i]t was an administrative decision to finance the shared appreciation. However, the Agency has the discretion and believes it reasonable to make the shared appreciation which is due a nonprogram loan."[78] The agency carried this policy of the interim rule into the final rule of 1998.[79] One must ask whether refusing to allow borrowers to repay their shared appreciation amounts with a more favorable program loan is a permissible construction of the debt restructuring and loan servicing statute, 7 U.S.C. section 2001.[80] Even if the regulation is permissible, one wonders if, in light of the legislative policy, the regulation is preferable to one that would allow reamortization on a program basis.

Courts review an administrative regulation to determine whether it exceeds the agency's statutory authority or is arbitrary, capricious, or otherwise not in accordance with law.[81] Courts use the *Chevron* two-step analysis in reviewing a regulation.[82] First, the court will attempt to determine Congressional intent and require that the regulation be "fully consistent" with that intent.[83] If, however, "the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute."[84] If the regulation is "manifestly contrary to the statute," a court may declare the regulation invalid.[85]

Because section 2001 does not express an intent on how repayment of the recapture should be accomplished,[86] one must inquire whether the regulation is a permissible construction of the statute. As mentioned above, the Act expresses two purposes: 1) to avoid losses to the government on the FSA loans, and 2) to ensure that borrowers are able to continue farming.[87] As stated above, some SA borrowers may be able to amortize the SA amount when it becomes due, but only on nonprogram terms. One may argue that this provision which effectively moves a borrower out of the FSA program loans into the nonprogram loans is contrary to the statute.[88] Such an action would deprive the borrower of the protections afforded by the primary loan servicing options of deferral, rescheduling, consolidation, or change of interest.[89] Depriving a borrower of these protections would make it much more likely that the borrower would be forced to terminate his or her farm operations, a result expressly contrary to the statutory purpose.[90]

Borrowers may also argue that this regulation may not further the statutory goal of saving the Government money.[91] If all goes well and the borrower is able to make payments on the nonprogram loan with relatively higher interest rates, the government will have a greater return and, therefore, reduce its losses. If, however, the borrower becomes delinquent on his or her agency loans, the government will have the discretion to accelerate and foreclose on the nonprogram loan without affording the farmer the rights under primary and preservation loan servicing. This means that the agency will not be required to go through the process of figuring the "net recovery value to the government" from restructuring and the "net recovery value from involuntary liquidation". With a nonprogram loan, it would be possible for the government to foreclose on a loan when the net recovery from restructuring is greater than the net recovery from involuntary liquidation, a result not possible under a program loan.[92] Such a foreclosure may yield less to the government than would restructuring the loan. This result would go against both goals of the statute: it would increase losses to the government, and it would make it much more likely that the farmer could no longer continue his operation.

In response, however, the agency may argue that not allowing borrowers to finance the shared appreciation on a program loan basis is a permissible construction of the statute.[93] The borrower's argument outlined above focuses on the legislative history and policy of the statute. In *Lee v. Yeutter*,[94] borrowers who attacked the validity of a FmHA regulation made the same type of argument that the construction of the regulation was against the statutory goals.[95] Unfortunately for the borrowers, the court rejected their analysis. Just as on the subject of the repayment of the SA amount, Congress did not unambiguously express its intent on the subject of the regulation that was the focus of *Lee*.[96] Therefore, the court performed the second step of the *Chevron* analysis and asked whether the agency's regulation "is based on a permissible construction of the statute."[97] In *Lee* the court refused to reexamine the legislative history and policy of the statute in this step.[98] This refusal undercuts the borrowers' argument outlined above because it relies on the policy of the statute. Instead of looking to the policy of the statute, the court simply construed the language of the statute.[99]

Applying this analysis in the SAA context, the agency would point out that on the subject of repayment, the SAA Code provision simply requires that recapture occur, it does not require *how* the recapture occurs.[100] Because there is no requirement that the agency allow amortization of the amount, the agency would argue that it is reasonable to require that the recapture be in the form of cash payment or, if amortized, a nonprogram loan.[101] Because this construction is permissible, the agency would conclude, the court should uphold the regulation.

To uphold the regulation, the court only need find that the agency construction of the statute is permissible. As the court in *Lee* stated, "[w]hile the farmers' interpretation may or may not be superior, we cannot exercise our independent judgment and mandate what we believe to be the 'better' policy so long as the Secretary's regulation is reasonable and permissible."[102] Because a court is likely to find the agency's construction of the statute permissible, a court would probably uphold the regulation.

Nevertheless, just because an agency's construction of a regulation is permissible does not necessarily make it preferable. Because the statute does not express its intent on how the SA amount should be repaid, the agency has the discretion to allow the SA amount to be reamortized on a program loan basis. Given the policy considerations discussed above and the negative consequences to borrowers of not being eligible for farm program loans,[103] a court would find

this regulation a reasonable construction of the statute.[104] For these same reasons, the agency should change the regulation and allow borrowers who are otherwise eligible for program loans to amortize the SA amount on program loan terms.

V. Appraisals.

To figure the SA amount, the agency must subtract the market value of the real property at the beginning of the agreement from the current market value of the real property at the termination of the agreement.[105] The regulation states "[t]he current market value of the real estate property will be determined based on a current appraisal."[106] The regulation does not provide further guidance on the appraisal process on matters such as who can perform the appraisal, what must be included in the appraisal, or how a borrower can object to or appeal an appraisal.[107]

Generally, "an appraisal is an unbiased estimate of the nature, quality, value, or utility of an interest in, or aspect of, identified real estate."[108] "An appraisal is based on selective research into appropriate market areas; on the assemblage of pertinent data; on the application of appropriate analytical techniques; and on the knowledge, experience and professional judgment of the appraisers."[109] Importantly, appraisers are not advocates for their client; rather, their task is only to assign an objective value.[110] Appraisal theory uses principles of supply and demand, substitution, and externalities to attempt to attain the value of a property at its highest and best use.[111]

The term "highest and best use" has alternative definitions. Text books refer to both definitions: "The reasonable and probable use that supports the highest present value, as defined, as of the effective date of the appraisal. Alternatively, that use, from among reasonably probable and legal alternative uses, found to be physically possible, appropriately supported, financially feasible, and which results in the highest land value."[112] If an appraiser contemplates only one use for the land, for example farming, it is very possible that the land will be valued below its highest and best use because it is possible that farming would not yield the greatest economic return on that piece of land. This is especially true if the piece of land lies in the path of urban sprawl where developers are willing to pay well above what the land is worth as a farm.

A common problem in rural appraisals is that the appraisal report is not complete because it lacks adequate information and/or analysis.[113] Along with the property valuation, a report should present "the reasons why a specific estimate of value was reached."[114] Without such reasoning, those reviewing the appraisal will find it difficult to assess the report's reliability.

The regulations specifically dealing with SAA's do not provide guidance on appraisals. For such guidance, one must look to other regulations dealing with the farm loan appraisal procedures.[115] The regulations provide that certain loan transactions of the agency require an appraisal when the FSA is acting as a creditor.[116]

A. Valuation of property.

Before 1993 the agency used standards outlined in the C.F.R. for appraising farms securing agency loans.[117] In 1993, the agency moved away from its own standards and began using standards promulgated by the Uniform Standards of Professional Appraisal Practice (USPAP).[118] The agency changed its methods of appraisals in response to the Financial

Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA)[119] and an Office of Management and Budget Bulletin.[120] FIRREA required that Federal financial institutions perform appraisals under uniform standards.[121]

This change in standards could lead to inconsistent appraisals: at the beginning of the SAA, the agency may have appraised the value according to the standards in 7 C.F.R. section 1809; while at the end of the agreement the agency may value the real estate according to the USPAP standards. The specific problem for the borrower is that the initial appraisal may have been based on the land's "agricultural value", a value that may be lower than the "fair market value", while the ending appraisal only uses the fair market value. This comparing of apples and oranges encourages low initial appraisals and high final appraisals, therefore, increasing the amount of appreciation because, all things being equal, the fair market value may be greater than the agricultural value.[122] If the appreciation amount is greater, the amount owed by the borrower will also be greater. To detect potential problems with these different valuations, one must examine the different appraisal standards.

1. 7 C.F.R. section 1809 (1993).

The old section 1809 contemplates two types of values: "agricultural value"[123] and "market value".[124] The "agricultural value" demands that the appraiser value the property as if the only use for the property was an agricultural use; this value represents what a typical purchaser would pay considering the "earning ability of the farm."[125] The "market value" allows the appraiser to look at both "agricultural uses and non-agricultural assets the property may have."[126] To determine a farm's appraisal value, the agency might have looked at both the agricultural value and the market value.[127]

Writing while the regulation was still in force, a farmer's attorney explained:

> To determine market value, the FmHA uses a three-way approach, consisting of the market data approach, the capitalization approach, and the summation approach. The market data approach involves a review of recent sale prices of comparable tracts in the area. Generally, the FmHA lists and describes two or three comparable tracts. The capitalization approach involves an estimate of earnings, either by rental income or cash flow analysis, capitalized at an appropriate rate. The summation approach involves adding the value of essential buildings to the market value of the land. The appraiser usually reviews all three values and makes certain adjustments to reach a recommended market value. The appraiser must consider the strong and weak points of each approach and correlate the three values by considering the spread between the minimum and maximum figures.[128]

2. FmHA Instruction 1922-E and USPAP standards.

Since 1993 the agency appraisal standards have stemmed from two sources: FmHA Instruction 1922-E[129] and the Uniform Standards of Professional Appraisal Standards (USPAP).

The Instruction "prescribes the procedures and guidelines for conducting appraisals in connection with making and servicing [agency] insured loans on farm tracts."[130] It goes on to state that agency "designated appraisers and contract appraisers will comply with the guidelines and standards as set out in Sections I and II of the . . . USPAP."[131] Listing the basic principles of

real property valuation, the instruction describes the term "highest and best use" as "the most reasonable and probable use that supports the highest market value as of the effective date of the appraisal."[132] As with the old regulation, the new instruction applies three approaches to valuation in attaining a farm tracts value: sales comparison approach, income capitalization approach, and cost approach.[133] The concept of highest and best use is used in the cost approach; one of the steps under this approach requires the appraiser to "[e]stimate the value of the subject land as if vacant and available for use at its highest and best use."[134] The instruction expressly notes that "the highest and best use may be different than the highest and best use of the property as improved."[135] This last part of the instruction invites appraisers to consider the land's value in uses other than agriculture, such as for real estate development purposes.

3. Comparison of the two types of standards.

The most striking contrast between the two sets of appraisal standards is that the the older regulations fail to expressly include the notion of highest and best use.

The older regulations left room for the appraiser to consider community development and proximity to an urban center.[135] These pre-1993 regulations, however, focused on appraising the farm tract as its use as a farm rather than its highest and best use. For instance, the regulations listed certain fundamental assumptions of an appraisal of farm property such as the farm will be operated by a typical operator, the farm will be developed as planned, and general economic conditions will remain stable.[136] The regulation did recognize that the location of a farm and its state of development affect the appraisal, but most of the location factors listed by the regulation focus on the tract's location relative to farm use, such as the availability of competitive markets and the condition of roads.[137] The one glaring exception to this statement is that the regulations stated that "[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."[138] Nevertheless, unlike the new standards of the FmHA instruction, the pre-1993 regulations did not include as one of its fundamental principles that the tract should be valued for its highest and best use.[139]

This change in focus of appraisal standards could lead to inconsistent appraisals. Because the older regulations focused more on the land's use as a farm, it is more likely that the appraisal ignored other uses of the land. If the land had a use which would have given it a higher value, for example development as a residential subdivision, the old regulation may have ignored this "highest and best use" and assigned a value to the land as only a farm. The new instruction, on the other hand, specifically requires the appraiser to consider highest and best use and include it in his valuation.[140] Thus, an appraisal under the new instructions, in the case of possible development as a subdivision, would yield a higher value. In other words, the new instruction makes it more likely that an appraiser will consider the variable of highest and best use, which would result in an appraisal with a higher value compared to an appraisal using the old standards employing "agricultural use" as a valuation tool. This inconsistent appraisal method may result in an artificially large appreciation amount; a result the borrower would find unfavorable because the amount owed on the SAA is based on the appreciation amount.

B. Challenge to Congress' authority to modify private contracts.

Borrowers first reaction to the inconsistent appraisal methods may be to argue that such agency action is arbitrary and capricious.[141] The decision to change the appraisal standards,

however, was not made by the agency. Rather, Congress mandated the change in FIRREA.[142] Therefore, borrowers may need to challenge Congress' power to change the appraisal standards. The argument may go something like this: Within the SAA is an implied promise that the standards used for the appraisals at the beginning of the agreement will be the same ones used at the expiration of the SAA. By changing the appraisal standards, the Government breached this portion of the contract.

1. *Winstar* litigation.

Borrowers may find some fuel for this argument in *United States v. Winstar*,[143] a recent Supreme Court case that restricts the Government's power to change its contractual obligations through the legislative process. Nevertheless, the Government will probably douse this argument by distinguishing *Winstar* from the problem of inconsistent appraisals in the SAA context.

The dispute in *Winstar* stemmed from FIRREA and that act's effect on certain agreements that the Federal Home Loan Bank Board (FHLBB) and the Federal Savings and Loan Insurance Corporation (FSLIC) had with three different private financial institutions.[144] As an early response to the savings and loan crisis of the 1980's, the FSLIC encouraged healthy financial institutions, such as the plaintiffs in *Winstar*, to merge with weaker institutions.[145] Part of the merger included that the healthy institution would be able to use certain accounting methods that were advantageous to the healthy institution, namely, allowing the institutions to use goodwill in their regulatory capital and amortize this goodwill over long periods of time.[146] The use of this goodwill was contemplated in documents integrated into an agreement between the agency and the healthy institutions.[147]

Despite the deregulation of the industry, the crisis continued, compelling Congress to pass FIRREA "with the objects of preventing collapse of the industry, attacking the root causes of the crises, and restoring public confidence."[148] FIRREA changed the capital requirements of the thrift institutions in such a way that "many institutions immediately fell out of compliance with regulatory capital requirements, making them subject to seizure by thrift regulators."[149] The plaintiffs in *Winstar* claimed to have suffered extensive financial damages due to the new requirements under FIRREA. "Believing that the . . . FSLIC had promised them that the supervisory goodwill created in their merger transactions could be counted toward regulatory capital requirements, [the institutions] each filed suit against the United States in the Court of Federal Claims, seeking monetary damages on both contractual and constitutional theories."[150]

Writing for the plurality in the highly divided court,[151] Justice Souter announced "[a]lthough Congress subsequently changed the relevant law, and thereby barred the Government from specifically honoring its agreements, we hold that the terms assigning the risk of regulatory change to the Government are enforceable, and that the Government is therefore liable in damages for breach."[152] In reaching this conclusion, the Court first found that the Government was contractually obligated to honor the original capitalization requirements and that it breached the contracts.[153] The court found the obligation contractual because the agreement the parties entered into with the Government expressly integrated documents that stated the original capital requirements.[154]

The Court then rejected the Government's two main defenses, the sovereign acts doctrine and the unmistakability doctrine, that would have barred the contract's enforcement. The sovereign acts doctrine generally holds that "[w]hatever acts the government may do, be they

legislative or executive, so long as they be public and general, cannot be deemed specially to alter, modify, obstruct or violate the particular contracts into which it enters with private persons."[155] Justice Souter found that the Government could not use the sovereign acts doctrine as a defense because Congress' act of changing the capitalization requirements was not "public and general."[156] The court examined FIRREA's legislative history and found that Congress intended to abrogate its contractual responsibilities by targeting the legislation to institutions such as the plaintiff's in *Winstar*.[157] The Court concluded that the "extent to which [FIRREA] relieved the Government of its own contractual obligations precludes a finding that the statute is a 'public and general' act for purposes of the sovereign acts defense."[158]

The Court also rejected the Government's attempt to use the unmistakability doctrine as a defense. This doctrine states that "sovereign power . . . governs all contracts subject to the sovereign's jurisdiction, and will remain intact unless surrendered in unmistakable terms."[159] Justice Souter elaborated by providing a synthesis of the holdings of Supreme Court cases dealing with this doctrine: "a contract with a sovereign government will not be read to include an unstated term exempting the other contracting party from the application of a subsequent sovereign act (including an act of Congress), nor will an ambiguous term of a grant or contract be construed as a conveyance or surrender of sovereign power."[160] Noting that the Government enters into a wide spectrum of different types of contracts,[161] the court emphasized that this rule only applies when the enforcement of the contractual obligation would block the exercise of a sovereign power of the Government.[162]

Key to the Court's examination of the unmistakability doctrine is the Court's finding that "the Government agreed to do something that did not implicate its sovereign powers at all, that is, to indemnify its contracting partners against financial losses arising from regulatory change."[163] Because the contractual obligations at issue in *Winstar* did not cause the Government to surrender any of its sovereign powers, the Court held that the unmistakability doctrine did not apply in this case.[164] Beyond the defenses of the sovereign powers doctrine and the unmistakability doctrine, the Court also rejected the Government's argument that the agency acted ultra vires in obligating itself to bear the risk of a change in the capital requirements.[165]

2. The rule of *Winstar* applied to the SAA inconsistent appraisal problem.

As the plaintiffs did in *Winstar*, the borrowers suffering from the damage from the inconsistent standards in the SAA context may want to sue the Government for breach of contract. These borrowers would argue that by using different appraisal standards, the Government breached the implied promise that they would use the same standards for the two appraisals used to figure the amount due under the SAA.

The first obstacle the SAA borrowers must face is whether the promise to use the same appraisal standards was included in the contract. In *Winstar* the Court agreed with the Federal Circuit court finding that "the three plaintiff thrifts negotiated contracts with the bank regulatory agencies that allowed them to include supervisory goodwill (and capital credits) as assets for regulatory capital purposes and to amortize that supervisory goodwill over extended periods of time."[166] Although the agreement between the Government and the merging institutions in *Winstar* did not include specific language about the supervisory goodwill, the agreement contained an integration clause that included documents that specifically allowed the merging thrifts to recognize goodwill as a regulatory asset subject to amortization.[167]

In the SAA context, the inclusion of a promise that the two appraisals would use the same standards is not so clear. The SAA does not even mention appraisals, much less what standards would be used.[168] Neither does the agreement include an integration clause.[169] The borrowers may argue that the Government breached the good faith requirement of the contract in using inconsistent appraisal standards.[170] Nevertheless, even if the use of different appraisal standards breaches the covenant of good faith, that in itself may not create a cause of action.[171]

Even if the borrowers prove that a contractual obligation to use the same standards of appraisal exists, they may have a difficult time overcoming the Government's sovereign acts doctrine defense. As stated earlier, the sovereign acts doctrine states that "the United States when sued as a contractor cannot be held liable for an obstruction to the performance of a particular contract resulting from its public and general acts as a sovereign."[172] In *Winstar* the Court found that FIRREA's modification of the Government's obligation to allow the financial institutions to utilize supervisory goodwill was not public and general.[173] This was especially true given that, with the passage of FIRREA, Congress intended to affect the parties specifically in the position of the plaintiffs in that case.[174] Borrowers in the SAA context, however, may not find such solace from the sovereign acts doctrine because, as applied to them, the change in appraisal standards was probably caused by an act of Congress that was public and general in nature.

In deciding whether the Government acted in a public and general nature, a court asks whether the act that changed the contract was done by the Government acting as sovereign or acting as a contractor.[175] To determine this, the court looks at the Government's purpose when it so acted.[176] Congress' general purpose in passing FIRREA was to prevent the collapse of the savings and loan industry, attack the root causes of the crisis, and restore public confidence.[177] Another goal of FIRREA was to protect federal financial interests in real estate transactions.[178] Given that the requirement of uniform appraisal standards applies to all parties dealing with the Government in its capacity as a financial institution, a finding that the change in law was directed at SAA borrowers is unlikely.[179] At any rate, an intense investigation into the legislative history of FIRREA is required to overcome the Government's sovereign act's defence, an investigation that is beyond the scope of this article.

If the borrowers overcome the sovereign acts defense, they must still deal with the unmistakability defense. This doctrine states that a court will not read a provision into a contract with a sovereign government, including Congress, that exempts the other party from subsequent sovereign acts of the government.[180] As the plaintiffs did in *Winstar*, the SAA borrowers may avoid this defense by arguing that the unmistakability doctrine does not apply to this type of contract. The Court in *Winstar* held that the doctrine did not apply because the enforcement of the contractual obligation to allow the institutions to use the original supervisory capital requirements would not encroach on the Government's sovereign power.[181]

If the contractual obligation does not encroach on the government's sovereign powers, such as the power to tax or eminent domain, the doctrine applies and such a limit on the power must be unmistakably expressed in the contract for the obligation to be enforceable.[182] If, however, the contractual obligation, such as the promise to purchase food for the army, does not implicate the sovereign's power, then the doctrine does not apply and the contract need not include a term exempting the party from subsequent sovereign acts for the provision to be enforceable.[183] The SAA borrowers would argue that the obligation of the Government to apply consistent appraisals does not encroach on a sovereign power of the Government. The argument

should prevail because the Government's power to require uniform appraisal standards under its own financial dealings would hardly be a power peculiar to the Government, and therefore is probably not a sovereign power.[184] Therefore, the Government is not exercising a sovereign power in this instance and the unmistakability doctrine does not apply.

C. Appeal or negotiation of agency appraisal.

Notwithstanding the constitutional and statutory challenges outlined above in the *Winstar* discussion, a borrower may also challenge the agency on the appraisal itself. The FmHA instruction sent to FSA offices directs the county office to notify a SA borrower of appeal rights, including independent appraisals.[185] The instructions or regulations, however, do not express what appeal rights or type of independent appraisal is available. For an idea of what appeal rights the agency may afford borrowers unhappy with an appraisal, one must look to other provisions within the Code of Federal Regulations.

At 7 C.F.R. section 909 (i) appear two different procedures when the borrower disagrees with the agency appraisal. The borrower may either appeal the appraisal to the National Appeals Division (NAD) of the USDA or negotiate the appraisal amount.[186]

1. Appeal of an Appraisal.

If the borrower chooses to appeal the agency appraisal, he or she will choose an "independent" appraiser from a list provided by the agency of at least three appraisers.[187]

The borrower must pay the cost of this independent appraisal.[188] If possible, the borrower will then submit this independent appraisal to the County Supervisor and the Hearing Officer before the appeal hearing.[189] The appeal officer will consider this independent appraisal in the appeal.[190] The result of the appraisal appeal procedure is that the Hearing Officer will consider the appraisals of two appraisers: the first is that of the original agency appraisal, the second is that of a supposedly independent appraiser chosen by the borrower.

The independent appraiser must meet certain qualifications. For example, if the state has mandatory certification/licensing guidelines, the appraiser must be certified.[191] The appraisal of the independent appraiser must conform to standards provided in 7 C.F.R. section 1922. For the actual standards, the regulations look outside the C.F.R. to the Uniform Standards of Professional Appraisal Practice.[192]

If the agency appraisal and the independent appraisal differ by five percent or less, the borrower must select the appraisal he or she prefers.[193] This chosen appraisal cannot be appealed.[194] If the appraisals differ by more than five percent, the borrower can appeal the appraisal.

For appraisals that are appealable, the borrower may choose to appeal the FSA office determination to a county committee, or the borrower may be able to appeal straight to the USDA NAD.[195] The NAD Hearing Officer decision may be appealed to the director of NAD.[196] From this NAD decision, a borrower may seek judicial review.[197] Judicial review of NAD decisions are governed by the review provisions of the Administrative Procedure Act.[198]

In a challenge to an appraisal, the borrower should examine both the substantive assumptions made by the appraiser[199] and the procedural compliance to standards set forth by the

USPAP. One commentator observes: "If the appraisal has been made in adherence with the stated procedures, there is little chance of a successful challenge to the appraisal. Similarly, when the independent appraisal conforms more closely to the procedures than the original appraisal, the hearing officer should give greater weight to the independent appraisal."[200]

The FmHA has been involved in a number of different types of cases in which the borrower challenged the agency's acceptance of an appraisal.[201] The administrative decision on an appraisal is reviewed under the Administrative Procedure Act; therefore, the court reviews the administrative decision "to determine whether the action was arbitrary and capricious, an abuse of discretion, or otherwise not in accordance with law; contrary to constitutional right; in excess of statutory authority or limitation; or without procedures under law."[202]

In *Hildebrand v. U.S.*,[203] a case conducted before NAD appeal process was in place, the district court upheld the State Director's decision to use the agency's appraisal instead of the borrower's independent appraisal.[204] In applying for primary loan servicing, the plaintiff's farm was appraised by the agency. The plaintiffs disagreed with the appraisal and had an independent appraisal performed. The State director chose the agency appraisal. On appeal to the district court, the plaintiffs argued that the agency decision was arbitrary and capricious because evidence indicated that the agency did not believe the agency appraisal.[205] Some field notes existed that showed the agency disagreed with some points of each of the appraisals.[206] The court, however, noted that it could not substitute its decision for the agency's, and that it was not arbitrary for the agency to choose against an appraisal with which it disagreed.[207] Significantly, the court noted that the independent appraisal failed to include the income approach in its analysis, and therefore was not as procedurally sound as the agency appraisal.[208]

As with most matters under judicial review, it seems that courts will be unwilling to set aside agency decisions on appraisals.[209] A borrowers best chance at reversal will come when the agency appraisal relied on incorrect facts or failed to follow substantially the procedures outlined mandated by the USPAP standards.

2. Negotiation appraisal.

If the borrower is not satisfied with the agency appraisal he or she may choose to negotiate the appraisal instead of appealing the appraisal.[210] The regulations clearly offer this option to people applying for debt servicing; it is not clear whether this negotiation option is available for the appraisal occurring at the termination of the SAA. As mentioned earlier, the instructions indicate that the agency must notify the borrower of "[a]ppeal rights, including an independent appraisal review."[211] Neither the regulations nor the instruction expressly mention the negotiation appraisal. Nevertheless, given the reference to an independent appraisal review, the agency may allow a negotiation of appraisal in this situation.

A negotiation appraisal is a way for the agency and the borrower to come to a non-appealable valuation of the real estate. A borrower may negotiate each appraisal only one time.[212] As in the appeal of an appraisal, a negotiation appraisal allows the borrower to choose an independent appraiser.[213] With the negotiation appraisal, however, the appraiser need not be on the agency's list of qualified appraisers.[214] Nevertheless, the appraiser and appraisal report must meet the same qualifications and standards as those listed under the appeal of an appraisal.[215] If the values of the agency appraisal and the independent appraisal differ by five percent or less, the borrower must choose either value. This appraisal becomes the final, non-appealable appraisal.[216]

If the two appraisals differ by more than five percent, the borrower will select a third appraiser from a list of qualified appraisers provided by the agency.[217] Out of the three appraisals, the County Supervisor will average the two closest to each other.[218] The average value will become the final appraised value and will not be appealable.[219]

D. Summary.

Many issues may arise in the appraisal context. First, a borrower whose farm was appraised under the old section 1809 standards at the inception of the SAA may be subject to different standards of the end of the agreement. Although the recent Supreme Court *Winstar* case provides room for the borrower to argue that change in standards is a breach of contract, the borrower will first need to deal with the Government's defenses that the use of consistent standards was not in the SAA and that the Government was exercising its sovereign power when it changed the standards. On a more practical level, if a borrower believes that the appraisal, whatever the standards used, was performed in an arbitrary manner, he or she may appeal the appraisal through the USDA appeals process to the district court. Its likely, however, that a court will give wide discretion to the agency's decisions on appraisals and only those appraisal cases with the most egregious facts or those in which the appraiser failed substantially to follow the appraisal procedures will be reversed.

VI. Income Tax Consequences of Shared Appreciation Agreements.

A discharge of debt may be defined as income for tax purposes. Section 61 (a) (12) of the Internal Revenue Code includes in its definition of gross income "income from the discharge of indebtedness."[220] The rule generally applies to debt write-down,[221] and therefore applies in the shared appreciation context. This leads to the basic question: When is the debt discharge counted as income, at the beginning of the shared appreciation term or at the end?

Initially, some observers argued that income from discharge of debt in the shared appreciation context should not be reported until the end of the SAA.[222] Professor Harris stated that the SAA should "postpone the date on which part or all of the discharge of indebtedness occurs since the borrower may end up paying part or all of the amount that was written off at the time of restructuring the loan."[223]

The IRS, however, saw it differently. In response to a question from the FmHA about the tax consequences of SAA's, the IRS took the position that an "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 Code . . . ."[224] The IRS' main rationale was that the SAA was "fundamentally different" than the debt being written down, and that it was too uncertain whether and how much the borrower would have to pay under the SAA.[225] This private letter did not serve as legal authority for the IRS position, but it did indicate how the IRS would act in the shared appreciation situations.[226] It appears that no one successfully challenged this position, and, therefore the bulk of this analysis will assume that most borrowers who are party to a SAA's treated the debt written-down as income at the time of the write-down and did not attempt to postpone the reporting of the income from discharge of indebtedness.[227]

This analysis of the tax consequences of the SAA will first deal with the up-front tax consequences. It will outline the intricacies of reporting income from discharge of indebtedness at the time of the primary loan servicing. The analysis will then talk about the tax consequences upon repayment of part or all of the debt written down when the SAA terminates. Finally, the analysis will present an example that will deal with both the up-front and back-end tax consequences of a SAA.

A. Up-front tax consequences of debt write-down with a shared appreciation agreement.

As mentioned earlier, any analysis must begin with the proposition that I.R.C. section 61 demands that discharged debt may be defined as gross income.[228] Section 108, however, excludes certain amounts of discharged debts from gross income.[229]

1. 108 (e) (2) — Write-off of interest.

The Internal Revenue Code provides that "[n]o income shall be realized from the discharge of indebtedness to the extent that payment of the liability would have given rise to a deduction."[230] Therefore, if part of the debt discharged represented interest, the borrower does not have to treat that amount as income.[231]

2. 108 (a) (1) — Write-off of principal.

Section 108 (a) (1) excludes from gross income discharge of indebtedness if: 1) the debt is discharged in a title 11 bankruptcy (including "Family Farmer" Chapter 12)[232]; 2) the discharge occurs when the debtor is insolvent[233]; or 3) the indebtedness discharged is qualified farm indebtedness.[234]

The Code requires the taxpayer to use the exclusions in a certain order.[235] That is, if the bankruptcy exclusion is available, the taxpayer must first use that exclusion first. Then he or she must use the insolvency exclusion and then use the qualified farm indebtedness exclusion.[236] Moreover, the Code limits the insolvency exception to the amount of insolvency.[237] If the borrower/taxpayer owes the agency $100,000 and the worth of his or her assets is only $75,000, the borrower is insolvent in the amount of $25,000. Therefore, the borrower could only exclude $25,000 from gross income using the insolvency exception.

To use the qualified farm indebtedness exclusion, the borrower and the debt discharged must meet certain qualifications.[238] The indebtedness must have been incurred "directly in connection with the operation by the taxpayer of the trade or business of farming."[239] Also, at least fifty percent of the gross receipts of the taxpayer for the three years prior to the year of discharge must have been attributable to farming.[240]

Section 108 (b) requires that if a taxpayer utilizes any of the exclusions provided by section 108 (a) (1), the taxpayer must use certain tax attributes to absorb the amount excluded. A tax attribute is a tax advantage held by the taxpayer that he or she uses to decrease his or her taxable income in a particular year. Because the taxable income decreases, so does the tax liability. A taxpayer taking advantage of the 108 (a) (1) exclusions must generally use the tax attributes in the following order: 1) any net operating loss for the year of discharge and any carried over net operating loss;[241] 2) carryover business credit allowable under I.R.C. section 38;[242] 3) the minimum tax credit that will be available in the year immediately following the year

of discharge;[243] 4) net capital losses from the year of discharge or any carryover net capital loss;[244] 5) the basis of the property of the taxpayer;[245] and 6) passive activity loss or credit carryover under section 469(b) from the taxable year of the discharge.[246]

Finally, if the use of the exclusion and attributes used under the qualified farm debt exception does not take care of the taxpayer's income from discharge of debt, the taxpayer is left with income from the discharge of debt and must pay the tax liability created by this income. If, however, the borrower is using the bankruptcy or insolvency exceptions, he or she does not have to include the amount not absorbed by the attributes in gross income.[247]

To summarize, a debt write-down creates income from the discharge of debt. Section 108, however, provides mechanisms that can "soak up" some or all of this income. These sponges must be used in the following order:

1) Amounts of the debt that are deductible, such as debt created by interest.

2) The amount to which the borrower is insolvent.

3) Qualified farm indebtedness.

After the use of these exclusions, if the borrower is using the qualified farm indebtedness exception, and the borrower is left with income from the discharge of debt, the amount must be included in gross income.

B. Tax consequences of payment under a shared appreciation agreement.

If at the termination of a SAA the borrower must pay part of the appreciation amount, there will be a reconciliation at that time of tax consequences generated earlier on the assumption that the debt was discharged.[248] Generally, the adjustment will occur in reverse order, that is, the first dollar paid under the SAA will be treated as repayment of the last dollar of debt discharged. In its letter to FmHA, the Chief Counsel of the I.R.S. explained how the adjustment would be made upon payment under the SAA.

> The ordering of this reversal of tax consequences operates as follows: To the extent that the amount discharged gave rise to discharge of indebtedness income that was not excluded under section 108 of the Code, a payment made under an SAA . . . is first treated as a repayment of the amount discharged, and the borrower is permitted a deduction under section 162 of the Code. Then, to the extent the borrower excluded income under the qualified farm indebtedness exclusion and reduced a tax attribute or basis in property, the attribute or basis is restored. If the borrower has disposed of the property for which basis was reduced under the qualified farm indebtedness exclusion, the borrower is permitted a corresponding deduction or loss. Next, to the extent the borrower excluded income under the insolvency exclusion, but did not have to reduce basis in property because of the limitation under section 1017 (b) (2), no deduction, loss, or increase in bases or attributes is permitted. Next if the borrower excluded income under the insolvency exclusion and reduced a tax attribute or basis in property, the attribute or basis is restored. Next, to the extent the borrower excluded income under the insolvency exclusion, but did not have to reduce basis in property because of the limitation under section 1017 (b) (2), no deduction,

> loss, or increase in basis is restored. If the borrower has disposed of the property for which basis was reduced under the insolvency exclusion, the borrower is permitted a corresponding deduction or loss. Finally, if the borrower excluded an amount from income under the provisions of section 108 (e) (2) because payment of the amount would have been deductible, the borrower is permitted a deduction of the same type (such as an interest deduction under section 163) for payment.[249]

The letter stresses that a borrower should keep records of the amount and ordering of the adjustments made to the income from the discharge of debt.[250] The I.R.S. provides a specific form to record this type of transaction.[251]

C. Example of the tax consequences of a shared appreciation agreement.[252]

This example will focus on the tax consequences to a farmer who went through primary loan servicing in 1989, had debt written down, and entered into a SAA.

1. Facts.

Farmer uses the cash receipts method of accounting and has income from farming which equals at least fifty percent of his gross receipts for the three years preceding the debt discharge. Farmer owes the agency $355,000 in delinquent farmer program loans with no other outstanding liabilities, and the fair market value of his assets equals $280,000. Therefore, Farmer is insolvent to the extent of $75,000 because his debts exceed the fair market value of his assets to that extent.

In 1989, Farmer receives a debt write-down from the agency for $150,000 of which $20,000 is interest due and unpaid. If the interest would have been paid, it would have been deductible under section 163 of the Internal Revenue Code. Farmer has a basis in the farm of $50,000; he has no other available basis or tax attributes. The value of the real estate, Farmer's only security for the agency loan, is $280,000.

In 1999 the SAA term has run, the value of the land has increased one hundred percent (another $280,000) to $560,000, and Farmer pays the agency $140,000 pursuant to the SAA.[253]

2. Tax consequences at time of write-down.

In 1989 Farmer must recognize $5000 income from the debt write-down. The rest of the possible income from discharge of debt was excluded for the following reasons:

Twenty thousand dollars of the debt write-down constitutes deductible interest if it had been paid, therefore the discharge of such amount is not realized as income pursuant to 108 (e) (2) of the Code.

Because Farmer is insolvent to the extent of $75,000, section 108 (a) (1) (B) excludes $75,000 of the debt written-down from income.[254] The insolvency exception generally requires that tax attributes or basis be reduced to the extent of the amount excluded because of insolvency. No attributes exist in this example besides the basis. For the insolvency exclusion, section 1017 (b) (2) limits the reduction in basis to the point where the remaining basis will equal remaining liability. Because the basis is only $50,000 and the remaining debt is $125,000, the

basis will not be reduced under the insolvency exception because the basis is already below the amount of remaining debt.

Nevertheless, this basis can still be used under the qualified farm indebtedness provisions. Because the farmer qualifies for this exception (he incurred the debt for a farming business and he meets the fifty percent gross receipts test), he may use his remaining basis to absorb some of the income from discharge of debt. Therefore, the farmer may exclude $50,000 of the income.

These exclusions ($20,000 + 75,000 + 50,000) still do not absorb the $150,000 of income from discharge of debt. Therefore, the farmer must include in his 1989 income tax return income of $5000 from the write-down.

3. Tax consequences of payment under the shared appreciation agreement.

In 1999 Farmer makes a $140,000 payment under the SAA. This event generally reverses the tax consequences that occurred upon the initial write-down and initiation of the SAA. In this example the following would occur:

The first $5000 of repayment would be set against the $5000 that the farmer treated as income. In 1999 this amount would be treated as a repayment of the amount discharged and would be deductible under section 162 of the Code. Farmer would then restore the $50,000 in basis to the property (corresponding to the $50,000 in basis taken away under the qualified farm indebtedness exclusion). The next $75,000 paid corresponds to the amount excluded under the insolvency exception. The remaining $10,000 of repayment would recoup a portion of the interest deduction given away in 1989. Because this amount would have been deductible, Farmer may now use a deduction of the same type. In this example, Farmer may deduct $10,000 as an interest deduction under section 163.

D. Summary.

A borrower will generally have to include the income from discharge of indebtedness at the time of restructuring, even if the borrower entered into a SAA. However, the tax code allows the farmer to use certain tax attributes to “soak up” this income and requires that the borrower utilize these attributes in a certain order. When the SAA expires, the what the code reconciles the tax consequences by returning the tax attributes in the reverse order in which he or she was required to use them.

VII. Conclusion.

As a result of the farm crisis of the 1980’s, many farmers underwent debt restructuring with the farmers’ lender of last resort, the FmHA. Many of these farmers were required to enter into shared appreciation agreements that gave the government a certain interest in the amount of value that farmer’s land increased in the ten years after the inception of the agreement. The ten years has passed, with a great increase in land values, and now the government will want its share of the appreciation. Farmers in this situation need to be wary of possible problems that may arise.

Unfortunately for the financially-distressed farmer, the best terms that the agency will offer him on the SA amount are those of the relatively unfavorable non-program loans. Although

the farmer can challenge the agency's decision not to offer the more favorable program loans, the challenge will probably fail because the regulation is probably a permissible construction of the statute.

In the important area of appraisals, the farmer may seek contractual damages if the agency uses statutorily-mandated inconsistent appraisals. This attempt, however, may be thwarted because of the agency's defenses that the contract did not imply that the exact same standards would be used or that Congress was acting within its sovereign power when it changed the appraisal standards, and, therefore is excused from breach of contract. The farmer also should consider the agency's decision on the appraisal value itself to assure that the value was not reached in an arbitrary manner or that the appraiser failed substantially to follow the required procedures.

Finally as to tax consequences, the farmer should know that he or she has a right to recoup any tax attributes that he or she gave up at the time the SAA was entered into.

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1. KENNETH L. PEOPLES ET AL., ANATOMY OF AN AGRICULTURAL CREDIT CRISIS: FARM DEBT IN THE 1980S 46 (1992) ("By the mid-1980s, there were from two hundred thousand to three hundred thousand farmers who had exhausted their options to adjust to adversity, and who failed financially.") (citing USDA ECONOMIC RESEARCH SERVICE, AGRICULTURAL INCOME AND FINANCE: SITUATION AND OUTLOOK (various years); USDA ECONOMIC RESEARCH SERVICE, ECONOMIC INDICATORS OF THE FARM SECTOR (various years); USDA ECONOMIC RESEARCH SERVICE, AGRICULTURAL INCOME AND FINANCE: SITUATION AND OUTLOOK (various years); Kenneth L. Deavers, *Lagging Growth and High Poverty, Do We Care?*, CHOICES, 2d Quarter 1989, at 4-7); Joyce Lancaster, *Current Issues in FmHA Loan Servicing*, 23 U.C. DAVIS L. REV. 713, 713-14, (1990).

2. James T. Massey, *Farmers Home Administration and Farm Credit System Update*, 73 NEB. L. REV 187, 189-90 (1994) (concluding that "[t]here emerged from these two phenomena -- the financial and economic crisis brought on by the cost/price squeeze in general, coupled with the administration's policy of withdrawing federal assistance from farmers and ranchers -- a true credit crisis for farm credit borrowers.").

3. *See* 7 U.S.C. § 1922 (a) (stating the eligibility requirements for obtaining a real estate loan, including that the farmer "be unable to obtain sufficient credit elsewhere to finance their actual needs at reasonable rates and terms, taking into consideration prevailing private and cooperative rates and terms in the community in or near which teh applicant resides for loans for similar purposes and periods of time.").

4. Agricultural Credit Act of 1987, Pub. L. No. 100-233, 101 Stat. 1568 (1988) (codified as amended at scattered sections of 7 & 12 U.S.C.A. (1997)) (The Act's preamble states that the purpose of the Act is "[t]o provide credit assistance for farmers, to strengthen the Farm Credit System, to facilitate the establishment of a secondary market for agricultural loans, and for other purposes"). *See* Farmers' Legal Action Group, *Agricultural Credit Act of 1987: A Special Report,* 3 FARMERS' LEGAL ACTION REPORT, Jan./Feb. 1988 (thoroughly discussing the workings

of the Act and its effects on farmers). *See also* Massey, *supra* note 2, at 194-96 (discussing on the political environment which gave rise to the Act).

5. Agricultural Credit Act of 1987, Pub. L. No. 100-233, tit. VI, 101 Stat 1665-85 (1988) (codified as amended at scattered sections of 7 U.S.C.A. (1997)). *See* FARMERS' LEGAL ACTION GROUP, FARM SURVIVAL HANDBOOK: A GUIDE TO DEBT RESTRUCTURING AND APPEALS (1988) (describing in detail the procedure for restructuring FmHA debts under the Act).

6. Agricultural Credit Act of 1987, Pub. L. No. 100-233, § 615, 101 Stat. 1678 (1988) (codified as amended at 7 U.S.C.A. § 2001 (1997)).

7. 7 U.S.C. § 2001(a) (1994). *See* Lancaster, *supra* note 1, at 713 (stating that the agency "must consider the modification of delinquent loans to avoid losses).

8. 7 U.S.C. § 2001 (1994).

9. 7 C.F.R. § 1951.909 (g) (1997). *See* H.R. REP. NO. 295(I), 100th Cong., 1st Sess. 120 (1987), *reprinted in* 1987 U.S.C.C.A.N. 2723, 2791 (stating that the secretary should "estimate the present value of the payments which the borrower would make to the Secretary if the terms of his loan were modified . . . ."); H.R. CONF. REP. NO. 490, 100th Cong., 1st Sess., 161, 277 (1987), *reprinted in* 1987 U.S.C.C.A.N. 2956, 3072 (reporting the Conference Committee agreed method of valuing net present value and net recovery value). "Present value is a calculation concept which assigns a lower current value to dollars received in later years than to dollars received at the present time." 7 C.F.R. § 1951.909 (g) (1997).

10. 7 C.F.R. § 1951.909 (f) (1997). These other costs include taxes, depreciation, management costs, and interest costs. *Id. See* Lancaster, *supra* note 1, ("Net recovery is essentially the value the government could recover through foreclosure.")

11. Massey *supra* note 2 *,* at 195. *See* 7 CFR § 1951.909 (e) (1997); *Kinion v. United States*, 8 F.3d 639, 641-42 (describing the primary loan servicing rights of an FmHA borrower).

12. *Kinion*, 8 F.3d at 641-42 (citing 7 C.F.R. § 1951.906 (1989)).

13. 7 U.S.C. § 2001 (e) (1994). *See* H.R. CONF. REP. NO. 490, 100th Cong., 1st Sess., 161, 279 (1987), *reprinted in* 1987 U.S.C.C.A.N. 2956, 3074 (reporting that the Conference Committee adopted the Senate version of the SAA's).

14. 7 U.S.C. § 2001 (e) (2) (1994).

15. The following SAA was the form used beginning on October, 14, 1988. 53 Fed. Reg. 35746-47 (Sep. 14, 1988) (codified at 7 C.F.R. 1951, exh. D). The language of the agreement remained unchanged until 1998. *See* 7 C.F.R. 1951, exh. D (1997). The new rule, however, removed Exhibit D and did not include a replacement within the C.F.R. 63 Fed. Reg. 6629.

Shared Appreciation Agreement
[used from October 14, 1988 to March 10, 1998]

> This Agreement is entered into between (FmHA) and (Borrower's name) (called "Borrower") on (Date) and expires on (Date) (maximum term of ten (10) years).

Borrower is indebted to FmHA for loan(s) as evidenced by the note(s) described below:

Date ---------

Principal Amount ----------

Interest Rate ----------

Due Date ----------

This Agreement is attached to the note(s) described above. As of the date of this Agreement, before write-down, the unpaid principal balance on this note was $---------- and the unpaid interest balance was $----------. These note(s) were modified by the following note(s) which are attached to note(s) described above.

Date ----------

Principal Amount ----------

Interest Rate ----------

Due Date ----------

The note(s) described above are secured by the following real estate security instruments:

Grantor ----------

Date of Security Instrument ----------

Records of County/State ----------

Book or Reel ----------

Page ----------

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.

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.

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.

If the borrower violates the term of this agreement, FmHA will liquidate after the borrower has been notified of the right to appeal.

Market value of the property securing loan(s) $----------.

Net recovery value of property securing loan(s) $----------.

Amount of write-down $----------.

Amount of Account Equity $----------.

(Borrower's signature)

(Farmers Home Administration)

The following agreement replaced the above agreement. However, the new agreement cannot be found within the Federal Registry or C.F.R. The only place it may be found is in FSA offices at FmHA Instruction 1951-S, Exhibit D.

SHARED APPRECIATION AGREEMENT

[used after March 10, 1998]

Case Number: _____

1. This agreement is entered into between the Farm Service Agency (FSA) and _____ (borrower) on _____ and will expire on _____ (10 years).

2. FSA has agreed to writedown a portion of my FSA Farm Programs debt. The loans I had with FSA prior to the writedown are described below:

Fund Code	_____
Loan No.	_____
Note Date	_____
Note Amount	_____
Interest Rate	_____
Writedown Amount	_____
Full/Partial	_____

3. As of the date of this Agreement, before writedown, the unpaid principal and interest on the above described note(s) was $_____.

4. The total amount of writedown is $_____.

5. The Farm Loan Programs notes remaining after writedown are as follows:

Fund Code	_____
Loan No.	_____
Note Date	_____

Note Amount _____

Interest Rate _____

Due Date _____

6. The market value of all real property securing the notes described in Items 2 and 5, and the Shared Appreciation Agreement, as of the date of this agreement is $_____.

7. This agreement and the notes listed in Items 2 and 5, are secured by the following real estate security instruments:

Date of the
Security Instrument _____

Records of County _____

State _____

Book or Reel _____

Page _____

Grantor _____

8. In consideration of FSA writing down the above amounts and restructuring my Farm Loan programs, I agree to pay FSA a portion of the amount the real estate property described, in the instruments listed in Item 7, increases in value between the market value as of the date of this agreement and the market value at the end of the 10 year period, or sooner if one of the following occur:

(A) The notes described in Item 5 are paid in full or otherwise satisfied;

(B) I stop farming;

(C) My notes are accelerated;

(D) When any of the real estate security property listed in Item 7 is sold or conveyed prior to the expiration date of this agreement. Convey includes sale, gift, contract for sale, purchase agreement, or foreclosure. Convey does not include transfer of title to spouse upon death of the borrower. Collection of shared appreciation will take place if the surviving spouse sells or conveys the subject property, ceases farming, pays the notes described in Item 5 of the shared appreciation in full, or at the end of the term of the shared appreciation agreement, whichever comes first. I understand that if I sell a portion of the real estate property, the amount of the appreciation due will only be calculated on the portion sold. The Shared Appreciation Agreement will remain in effect until the end of the 10-year period to cover any real estate security not sold.

1.(sic) The amount due FSA will depend on when the appreciation is considered due and payable as described in Item 8 and based on one of the

payment schedules described below. The total amount of appreciation paid to FSA will not exceed the amount of writedown described in Item 4 of this agreement. The amount due will be as follows:

(A) Seventy-five (75) percent of any positive appreciation in the market value of the real property described in the security instruments in Item 7, if, within 4 years or less from the date of this agreement, any of the events in Item 8 occurs.

(B) Fifty (50) percent of any positive appreciation in the market value of the real property as described in the security instruments listed in Item 7 on the tenth anniversary of this agreement, or sooner, if after 4 years from the date of this agreement any of the events in Item 8 occurs.

1.(sic) If I am unable to pay the shared appreciation, the appreciation amount may be amortized to a shared appreciation loan under terms and conditions defined in FSA regulations.

2.(sic) If I violate the terms of this agreement, FSA can accelerate all my notes and liquidate the security property.

12. Signed: _____ _____
(Borrower) Date

_____ _____
(Borrower) Date

16. Alan Guebert, *Farmland Values Have Been on a Roll: Up 5.9 Percent in 1997, Prices Seem to be Defying Gravity*, PEORIA JOURNAL STAR, Jan. 20, 1998, at C2 ("While land values vary by region and state, their overall direction hasn't varied in a decade -- upwards."); NATIONAL AGRICULTURAL STATISTICS SERVICE, AGRICULTURAL STATISTICS 1997, IX-8, Table 9-12 (1997); UNITED STATES DEPARTMENT OF AGRICULTURE, AGRICULTURAL STATISTICS 1991 360, Table 537 (1991) (reporting that farm real estate values in the United States have risen from $632 in 1988 to $890 in 1996; *see* Richard Orr, *Bankers Expect Farmland Values to Stay on Upswing*, CHIC. TRIB, Mar. 16, 1998, at 7 (reporting that during 1997 real estate values in the seventh Federal Reserve District, which roughly covers to the Corn Belt, "experienced their steepest increase in almost 20 years.") (quoting Gary L. Benjamin, Vice President of the Federal Reserve Bank of Chicago); *Farm Real-Estate Values Rose 6% During 1997*, WALL ST. J., Mar. 18, 1998, at A8 (reporting that "[t]he average value of an acre of farmland, including buildings, hit a record $1,000 last year, continuing a climb that began in 1987, the bottom of the debt crisis that roiled the farm economy.").

17. National Agricultural Statistics Service, *Agricultural Land Values*, M2 Presswire, Mar. 23, 1998 (available on Westlaw on ALLNEWS database).

18. United States Department of Agriculture, *supra* note 16, at 360, Table 537.

19. Guebert, *supra* note 16, at C2 (reporting on a USDA estimate).

20. S. REP. NO. 230, 100th Cong., 1st Sess. 248-49 (1987), *amending* S. 1665, 100th Cong., 1st Sess. (1987).

21. S. REP. NO. 230, 100th Cong., 1st Sess. 46-47 (1987).

22. *Id.* at 46-47.

23. 133 CONG. REC. 33612-13 (Dec. 2, 1987) (statements of Senators Bumpers and Harkin).

24. The Senate debate included discussion of the recapture provisions under chapter 12. However, the concept of shared appreciation or recapture is absent in chapter 12. Letter from Susan Schneider to author, (April 7, 1998) (on file with author). Once the valuation of the secured property is set, the parties do not reevaluate the value of the property. *See generally Harmon v. U.S.*, 101 F.3d 574 (8th Cir. 1996) (holding that once the creditor was given a secured claim worth an agreed value of the property serving as security, the creditor was not entitled to any greater payment under the chapter 12 plan, even when the debtor sold the property for a much greater amount than the secured amount under bankruptcy). What the Senators may have been referring to is the disposable income requirement in chapter 12. In certain situations, the chapter 12 plan may require that the debtor's disposable income be applied to payments under the plan. 11 U.S.C. § 1225 (b) (1) (B) (1988). The maximum length of a chapter 12 plan is five years. 11 U.S.C. § 1222 (c) (1988).

25. 133 CONG. REC. 33613 (Dec. 2, 1987).

26. 133 CONG. REC. 36527 (Dec. 19, 1987) (statement of Senator Lugar explaining the negotiations within the Conference Committee).

27. H.R. CONF. REP. 490, 100th Cong., 1st Sess. 279 *reprinted in* 1987 U.S.C.C.A.N. 2956, 3074; 133 CONG. REC. 36527 (Dec. 19, 1987).

28. Agricultural Credit Act of 1987, Pub. L. No. 100-233, 101 Stat. 1680 (1988) (codified at 7 U.S.C. § 2001 (e) (1994)).

29. *Id.*

30. Enforcement and Collection of Shared Appreciation Agreements, 63 Fed. Reg. 6627 (1998) (to be codified at 7 C.F.R. §§ 1951.901, .909, and .914).

31. *See* 57 Fed. Reg. 18612 (1992). The 1992 interim regulations replaced the original SAA regulations adopted in 53 Fed. Reg. 35638, 35737-38 (1988).

32. 63 Fed. Reg. 6627, 6629 (1998) (to be codified at 7 C.F.R. § 1951.909 (j) (2)). Note that if the loan is not secured by real estate, the regulations do not require a SAA. *Id.*

33. FmHA Instruction 1951-S, Exhibit D (formerly 7 C.F.R. § 1951, subpt. S, exh. D). Although the FSA intends to use similar, if not the same, specialized forms relating to the SAA's, "since these matters involve internal operating procedures, the form will be contained in FSA's internal instructions only, with the regulation referencing only that a form will be executed." 63 Fed. Reg. 6628 (1997).

34. 63 Fed. Reg. 6627, 6629 (1998) (to be codified at 7 C.F.R. § 1951.909 (j) (2)).

35. 63 Fed. Reg. 6627, 6629 (1998) (to be codified at 7 C.F.R. § 1951.909 (j) (3)). The agency will maintain their real estate liens even if the entire real estate debt was written down and will not allow the liens to be subordinated during the shared appreciation period. *Id.* A

borrower who undergoes restructuring must also separate notes for each loan reamortized. 63 Fed. Reg. 6627, 6629 (1998) (to be codified at 7 C.F.R. § 1951.901 (j) (2)).

36. 63 Fed. Reg. 6627, 6629 (1998) (to be codified at 7 C.F.R. § 1951.914 (b)). Note that the new regulation adds the requirement that the shared appreciation amount is due upon acceleration. *Compare* 7 C.F.R. § 1951.914 (b) (1997) (not including acceleration as one of the events that triggers recapture of shared appreciation amount). The Discussions on the Final Rule explained:

> Current regulations are written so as to allow collection on an SAA only after transfer of title. The present wording has resulted in the interpretation that property must be foreclosed upon in order to effect a change in title before SAA can be enforced. This requires filing an additional civil action after foreclosure to collect proceeds that result from value appreciation of the security. This results in decreased collections on SAA's and increased litigation costs. This rule clarifies that acceleration of the loan triggers acceleration of the SAA.

63 Fed. Reg. at 6628. For a further discussion on this change, see *infra* part IV.A.

37. The Discussion on the Final Rule makes it clear that the notes referred to are not the notes created by the shared appreciation liability, rather the notes are those in existence before any amount is due under the shared appreciation agreement. 63 Fed. Reg. at 6628 ("This [acceleration] rule clarifies that acceleration of the loan triggers acceleration of the SAA.").

38. 63 Fed. Reg. 6627, 6629 (1998) (to be codified at 7 C.F.R. § 1951.914 (c) (1)).

39. *Id.*

40. 63 Fed. Reg. 6627, 6629 (1998) (to be codified at 7 C.F.R. § 1951.914 (c) (3)).

41. 63 Fed. Reg. 6627, 6629 (1998) (to be codified at 7 C.F.R. § 1951.914 (c) (3)).

42. 63 Fed. Reg. 6627, 6629 (1998) (to be codified at 7 C.F.R. § 1951.914 (c) (5)).

43. 63 Fed. Reg. 6627, 6629 (1998) (to be codified at 7 C.F.R. § 1951.914 (e)), which provides:

> (e) Shared appreciation amortization. Shared appreciation may be amortized to a nonprogram loan for borrowers who will continue with FSA on program loans. Shared appreciation will not be amortized if the amount is due because of acceleration, payment in full or satisfaction of the debt, or the borrower ceases farming. The amount due may be amortized as an SA loan under the following conditions:
>
> (1) The borrower must have a feasible plan as defined in S1951.906 including the SA loan payment.
>
> (2) The borrower must be unable to pay the shared appreciation, or obtain the funds elsewhere to pay the shared appreciation.
>
> (3) [Reserved]
>
> (4) [Reserved]
>
> (5) The loan term will be based on the borrower's repayment ability and the life of the security, not to exceed 25 years.
>
> (6) The interest rate will be the nonprogram real property rate contained in RD Instruction 440.1 (available in any FSA office.)
>
> (7) A lien will be obtained on any remaining FSA security, or if

there is no security remaining, the best lien obtainable on any other real estate or chattel property sufficient to secure the SA note, if available.

(8) The borrower will sign a promissory note for each SA loan established.

(9) If the borrower has outstanding FLP loans, and becomes delinquent or financially distressed as defined in S1951.906, the SA loan may be considered for reamortization as set forth in § 1951.909(e).

44. *Id.*

45. *Id.*

46. 63 Fed. Reg. 6627, 6629 (1998) (to be codified at 7 C.F.R. § 1951.914 (e)(1) and (2)).

47. 63 Fed. Reg. 6627, 6629 (1998) (to be codified at 7 C.F.R. § 1951.914 (e) (5)). For a discussion on the difference between program and nonprogram loans, see *infra* notes 51 to 54 and accompanying text.

48. 63 Fed. Reg. 6627, 6629 (1998) (to be codified at 7 C.F.R. § 1951.914 (e) (6)).

49. Examples of Farmer Program loans include Farm Ownership, Soil and Water, Recreation, Economic Opportunity, Operating, Emergency, Economic Emergency, Softwood Timber, and Rural Housing Loans. 7 C.F.R. § 1951.906 (1997) (providing definition of Farmer Program loans).

50. 63 Fed. Reg. 6627, 6629 (1998) (to be codified at 7 C.F.R. § 1951.914 (e)).

51. 7 C.F.R. § 1951.906 (1997) ("A [nonprogram] loan results when loan(s) are made to ineligible applicants and/or transferees in connection with loan assumptions and sale of surplus inventory properties at ineligible terms after first being offered for public sale by sealed bid or auciton").

52. 7 C.F.R. § 1951.451 (a) (1997).

An NP loan is a loan on terms more stringent than terms for a program loan and it is an extension of credit for the convenience of the Government because the applicant does not qualify for program assistance or the property to be financed is not suited for program purposes. Such loans are made or continued only when it is in the best interest of the Government.

Id.

53. 7 C.F.R. § 1951.452 (1997) (outlining policy of nonprogram loans that states nonprogram "borrowers are not eligible for program entitlements or servicing actions such as subsidy, moratorium, reamortization, rescheduling, consolidation, deferral, limited resource assistance, buyout, writedown and conservation easements."); *see* 7 C.F.R. § 1951.468 (providing for liquidation of NP loans on either a voluntary basis or through foreclosure).

54. 7 C.F.R. § 1951.906 (1998) defines "financially distressed borrower" as a borrower "who will not be able to make payments as planned for the current or next business accounting period. Borrowers will also be considered financially distressed if the borrower will not be able to project a feasible plan of operation for the next business accounting period."

55. 63 Fed. Reg. 6627, 6629 (1998) (to be codified at 7 C.F.R. § 1951.909 (e) (2) (vii) (D)). This regulation on the duration of reamortized loans provides:

> If repayment is extended, the new repayment period plus the period the loan has been in effect may not exceed the maximum number of years for that type of loan as set forth below, or the useful life of the security, whichever is less:
>
> ...
>
> (D) SA loans may not exceed 25 years from the date of the original amortized note.

56. 63 Fed. Reg. 6627, 6629 (1998) (to be codified at 7 C.F.R. § 1951.914 (e) (9)). *See* 63 Fed. Reg. 6627, 6629 (1998) (to be codified at 7 C.F.R. § 1951.909 (e) (2) (viii) (A)) (providing for a choice of interest rates).

57. 63 Fed. Reg. 6627, 6629 (1998) (to be codified at 7 C.F.R. § 1951.909 (e) (2) (viii) (A)).

58. *See* supra note 50 (explaining that the shared appreciation loan must be a nonprogram loan).

59. *See* 7 C.F.R. § 1951.451 (a) (1997) ("A [nonprogram] loan is a loan on terms more stringent than terms for a program loan").

60. 63 Fed. Reg. 6627, 6629 (1998) (to be codified at 7 C.F.R. § 1951.914 (b) (4)). An acceleration clause allows a lender to declare the entire amount of a loan due and payable. 2 BAXTER DUNAWAY, THE LAW OF DISTRESSED REAL ESTATE, § 11.03 (3) (1995).

61. *See supra* note 37 (explaining how the notes referred to in this acceleration trigger are the restructured notes, not notes created by the liability of a shared appreciation amount).

62. *See supra* note 11 and accompanying text (explaining the preservation loan rights of borrowers of program loans).

63. 7 U.S.C.A. § 2001 (m) (West Supp. 1997); 7 C.F.R. § 1951.909 (e) (4) (1997). Whether a loan is eligible for a write-down depends on whether it was originally initiated before January 6, 1988 and whether the loan arose from a restructuring, write-down, or net recovery buy-out.

> (m) Only 1 write-down or net recovery buy-out per borrower for a loan made after January 6, 1988
>
> (1) In general
>
> The Secretary may provide for any one borrower not more than 1 write-down or net recovery buy-out under this section with respect to all loans made to the borrower after January 6, 1988.
>
> (2) Special rule
>
> For purposes of paragraph (1), the Secretary shall treat any loan made on or before January 6, 1988, with respect to which a restructuring, write-down, or net recovery buy-out is provided under this section after such date, as a loan made after such date.

7 U.S.C.A. § 2001 (m) (West Supp. 1997). Because an SAA arises out of a debt write-down, the underlying restructured loan will not be eligible for another debt write-down.

64. 7 C.F.R. § 1951.902 (b) (4) (1997) (explaining the phases of the agency goes through while restructuring).

65. Id.

66. 63 Fed. Reg. 6627, 6628 (1998).

67. *Id.*

68. *Id.*

69. *Id.*

70. DUNAWAY, *supra* note 60, volume 2, app. 9A. The estimated time of foreclosure is based on the length of time "Housing and Urban Development considers to be the time permitted to conduct a foreclosure with "reasonable diligence." *Id.* (citing HUD HANDBOOK 4330.4 Rev. 1, *FHA Single Family Insurance Claims,* § 2-2C1, Appendix 6 & 7 (Sept. 1994)). The methodology of determining the length of a foreclosure is further explained:

> The time frames are measured from the initiation to the completion of the foreclosure. Initiation of foreclosure is the first public action required by law, such as filing a complaint or petition, recording a notice of default, or publication of a notice of sale. Completion of foreclosure is the date on which the sheriff's, trustee's, etc., deed or certificate of title is recorded. The deed is generally executed after the expiration of the redemption period and before eviction of the occupant. Therefore, the time frame includes redemption but not eviction.

71. *See* notes 66-69 and accompanying text (discussing the agency's rationale in the changing the rule).

72. 7 U.S.C. § 2001 (e) (4) (1994).

73. 5 U.S.C. § 706 (2) (C) (1994). *See supra* note -- to -- (describing judicial review of administrative decisions and the *Chevron* case).

74. *Chevron*, 467 U.S. at 843. The court reiterated in a footnote that "[t]he judiciary is the final authority on issues of statutory construction and must reject administrative constructions which are contrary to clear congressional intent." *Id.* 467 U.S. at 843, n.9.

75. *See* 7 U.S.C.A. § 2001 (e) (4) (West Supp. 1997) (listing instances when recaptured is triggered).

76. 57 Fed. Reg. 18612, 18620 (1992).

77. *Id.*

78. *Id.* The response to the comment continues: "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. Therefore, the Agency does not adopt this comment." *Id.*

79. 63 Fed. Reg. 6627, 6629 (1998) (to be codified at 7 C.F.R. § 1951.914 (e)) (providing for amortization of SA amount on a nonprogram basis).

80. *See* 7 U.S.C. § 2001 (1994).

81. 5 U.S.C. § 706 (2) (A) (C) (1994); *National Medical Enter.'s, Inc. v. Sullivan*, 957 F.2d 664, 667 (9th Cir. 1991).

82. *Chevron U.S.A. Inc. v Natural Resources Defense Council*, 467 U.S. 837, 842-843 (1984). *See* I KENNETH C. DAVIS & RICHARD J. PIERCE, JR., ADMINISTRATIVE LAW TREATISE §§ 3.2, 3.3 (3rd ed. 1994) (discussing *Chevron*); BERNARD SCHWARTZ, ADMINISTRATIVE LAW §§ 10.34 to 10.36 (3rd ed. 1991) (same).

83. National Labor Rel. Bd. v. United Food & Commercial Workers Union, 484 U.S. 112, 421 (1987) (citing Chevron, 467 U.S. at 842-843).

84. *Chevron*, 480 U.S. at 843.

85. *Id.* at 844.

86. *See* 7 U.S.C. § 2001 (e) (the subsection on shared appreciation arrangements lacks any direction on how the borrower should pay the SA amount).

87. 7 U.S.C. § 2001 (a) (1994). *See* H.R. CONF. REP. NO. 490, 100th Cong., 1st Sess., 161, 276 (1987), *reprinted in* 1987 U.S.C.C.A.N. 2956, 3071 (stating the purposes of restructuring provisions of the Act).

88. The requirement has the effect of moving a SAA party from program loans to nonprogram loans for the following reason: When the borrower went through restructuring, the agency wrote-down an amount of the program loan. Whether the borrower will ever have to pay back that amount will depend on the change in value of the security real estate in the ensuing ten years. The amount that used to be included in a program loan is effectively put in limbo for those ten years. At the expiration of the SAA, the agreement may demand that the borrower will have to pay back part or all of this amount. If the agency allows the borrower to amortize this amount, it may only be amortized on a nonprogram basis. Thus, this amount that was originally under a program loan, then in limbo for the duration of the SAA, is now moved into a nonprogram loan. *But see* 7 C.F.R. §§ 1951.901, 1951.909 (e) (2) (D), 1951.914 (e) (treating the amount due from a SAA as unrelated to the original program loans and providing for a different regime of amortization).

89. Note that even if the SA amount was allowed to be amortized on a program loan basis with the relatively favorable primary loan servicing rights, some of the loans may not be eligible for write-down or net recovery buyout. This is because Congress has limited borrowers who have undergone restucturing or had debt written-down to only one debt write-down per lifetime. 7 U.S.C.A. § 2001 (m) (1) (West Supp. 1997). Given that, by definition, a SAA arises from debt write-down, any borrower with a SAA will not be eligible for another debt write down or net recovery buyout. Notwithstanding the unavailability of debt write-down, a borrower would still find the other preservation rights highly advantageous.

90. *See* supra note 7 and accompanying text (stating the Act's purposes).

91. *Id.*

92. *See supra* note 8 and accompanying text (stating the test the agency must apply when considering whether to restructure a program loan).

93. *See Lee v. Yeutter*, 917 F.2d 1104, 1107 (8th Cir. 1990) (stating that a court will uphold a "regulation if it is a permissible construction of the statute).

94. *Id.*

95. The borrowers in *Lee* challenged a regulation requiring notice that did not include farmers who have been discharged in a chapter 7 bankruptcy in the term "borrowers" because the statute only required notice be sent to who had an obligation to the agency. *Lee*, 917 F.2d at 1107-08.

96. *Lee*, 917 F.2d at 1107.

97. *Chevron*, 467 U.S. at 843; *Lee*, 917 F.2d at 843.

98. *Lee*, 917 F.2d at 1107, n.7 (citing *Sullivan v. Everhart*, 494 U.S. 83, 89 (1990)).

99. *Id.*

100. 7 U.S.C.A. § 2001 (e) (West 1994).

101. 57 Fed. Reg. 18612, 18620 (1992) (stating that the law provides no requirement that the agency finance the amount due under the SAA).

102. Lee, 917 F.2d at 1108 (citing Chemical Mfrs. Assoc. v. Natural Resources Defense Council, Inc., 470 U.S. 116, 134 (1985)).

103. *See supra* notes 92 and accompanying text (discussing the negative consequences of being subject to a nonprogram loan rather than a program loan).

104. *See Lee*, 917 F.2d at 1108 (stating that a regulation is permissible if it is a reasonable construction of the statute).

105. 63 Fed. Reg. 6627, 6629 (1998) (to be codified at 7 C.F.R. § 1951.914 (c) (3)).

106. 63 Fed. Reg. 6627, 6629 (1998) (to be codified at 7 C.F.R. § 1951.914 (c) (1)).

107. *See* 7 C.F.R. § 1980.131 (1997) (providing for appraisal review within each state). The regulation states:

> The State Director or designee(s) will:
>
> (a) Provide for the framework of the real estate appraisal review and monitoring function and the documentation thereof;
>
> (b) Perform appraisal reviews in accordance with the requirements of Standard 3 of the USPAP and perform at least one appraisal review per fiscal year for either each appraiser, or each lending institution that prepares, or uses, a real estate appraisal for the guaranteed program in a given fiscal year; and
>
> (c) Provide appraisal training and guidance to assist State and field office personnel in making guaranteed approval decisions and serve as a resource to approval and underwriting officials performing administrative appraisal reviews, as needed.

Id.

108. American Institute of Real Estate Appraisers, The Appraisal of Rural Property, 12 (1983).

109. Frederick W. Wegener, *Probate and Property*, 1989 PROBATE AND PROPERTY 19 (Oct./Nov. 1989).

110. *Id.* at 20.

111. *Id.* at 13.

112. REAL ESTATE APPRAISAL TERMINOLOGY 107 (Byrl N. Boyce, ed. 1975); AIREA, *supra* note 108, at 19.

113. Wegener, *supra* note 109, at 20.

114. *Id.* Wegener presents the following checklist to indicate what should be included in a complete appraisal report:

1. Transmittal of the engagement and conclusion.
2. Appraiser's certification of facts and conclusions.
3. Identification of real estate to be appraised (legal description).
4. Statements of:
    a. the purpose of the appraisal and use,
    b. the real property interests appraised,
    c. the definition of the value being estimated,
    d. the effective date of the appraisal,
    e. the assumptions and limiting conditions, and
    f. the scope of the appraisal.
5. Description of surrounding neighborhood and uses prevailing.
6. Description of the real estate, such as acreage of land, uses, topography, soils, drainage, vegetation and buildings.
7. Report of zoning and use regulations, real estate taxes, ownership history, previous uses and income.
8. Analysis of the property's highest and best use.
9. Description of the valuation analysis procedure to be applied.
10. Report of valuation data with description of sales and rentals.
11. Determination of the fair market value of the property, using one or more appraisal approaches to value.
    a. Market approach (sales comparison approach) with analysis of sales, comparison of sales to the subject property and adjustments for differences as measured. Applicable to most appraisal assignments.
    b. Income approach with analysis of typical gross income, expenses and capitalization to value. Applicable to properties typically producing an annual income.
    c. Cost approach with analysis of land value and improvement value based on the cost of replacement minus estimated depreciation. Applicable to properties with newer improvements.

115. 7 C.F.R. § 1922 (1997) (providing rules for the appraisal of farms and leasehold interests).

116. 7 C.F.R. § 1941.25 (1997) (requiring for appraisals when FSA is lending institution on an operating loan). Generally, the regulation requires an appraisal when real estate is taken as primary security. *Id.* If an appraisal was performed within the last year, the regulations do not require another appraisal, "unless significant changes in the market value of real estate have occurred in the area" within the last year. *Id.*

117. 7 C.F.R. § 1809 (1993).

118. Appraisal of Farms and Leasehold Interests, 58 Fed. Reg. 44,748 (1993); *see* Appraisal Standards Board of the Appraisal Foundation, Uniform Standards of Professional Appraisal Practice (1994 ed.) [hereinafter USPAP].

119. Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) Pub. L. No. 101-73, 103 Stat. 183 (codified as amended in scattered sections of 12 and 18 U.S.C.).

120. Office of Management and Budget (OMB) Circular No. A-129, *Policies for Federal Credit Programs and Non-Tax Receivables*, 14 (Nov. 11, 1993). The circular demands that "[a]gencies shall require that all appraisals be consistent with the 'Uniform Standards of Professional Appraisal Practice,' promulgated by the Appraisal Standards Board of the Appraisal Foundation. Agencies shall prescribe additional appraisal standards as appropriate." *Id.*

121. 12 U.S.C. § 3331, 3339 (1994). *See* OMB Circular A-129, *supra* note 120, at 14. In an abstract explaining the rule change, the Federal Register reports:

> The Office of Management and Budget required all federal credit agencies to adopt similar appraisal requirements and to conduct appraisal reviews in accordance with the Uniform Standards of Professional Appraisal Practice (USPAP). FmHA must act to update its Farmer Program appraisal regulations to address the new appraisal environment. FmHA's present farm industry standards. Failure to act on this will leave the FmHA vulnerable to losses through weak appraisal requirements currently in place. The savings potential may be very significant over time.
>
> 59 Fed. Reg. 20064, 20066 (1994). Although the OMB Circular uses practically the same language of requiring uniform appraisals as 12 U.S.C.A. § 3331, the Circular does not refer to that code section as authority for the Circular. OMB Circular A-129, 1 ("This Circular is issued under the authority of the Budget and Accounting Act of 1921, as amended; the Budget and Accounting Act of 1950, as amended; the Debt Collection Act of 1982, as amended; Section 2653 of Public Law 98-369; the Federal Credit Reform Act of 1990; the Federal Debt Collection Procedures Act of 1990; the Chief Financial Officers Act of 1990; Executive Order 8248; the Cash Management Improvement Act Amendments of 1992; and pre-existing common law authority to charge interest on debts and to offset debts administratively.").

122. *See infra* notes 136-41 and accompanying text (explaining the difference between agricultural value and market value).

123. 7 C.F.R. § 1809.2 (a) (1993). The regulation provided:

> The agricultural value of a farm is the 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, This value is based upon agricultural assets only and assumes an informed typical purchaser.
>
> (1) The amount the purchaser would be justified in paying for a farm for farming purposes depends in a large measure on the earning ability of the farm. In determining the ability of a farm, the appraiser will assume that:

(i) The farm will be operated by a typical operator for the area.

(ii) The cropping system used is typical for the farm under consideration and will maintain the anticipated productivity. In determining the proper cropping system, the appraiser will take into account acreage allotments for the basic crops.

(iii) Crop yields used for the farm under consideration are representative of yields generally being obtained in the area.

(iv) Approved commodity prices and farm expenses are employed in estimating net income.

(v) The property will be improved as shown in Form FHA 424-1, "Development Plan."

(vi) The share of farm operating expenses, the cost of necessary farm repairs and replacements customarily paid by the landowner will be deducted from the landowner's share of income in determining net rental farm income.

(2) The appraiser will also consider the value of the farm as a home and will take this into account along with the amount that could safely be invested in the farm, based on the capitalization of the net rental farm income in arriving at its agricultural value.

Id.

124. 7 C.F.R. § 1809.2 (b) (1993) ("The market value is the 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. It is assumed that the property would sell for this amount with a reasonable sales effort and that the purchaser would be a willing but not anxious buyer, and the seller would be a willing but not forced seller.").

125. 7 C.F.R. § 1809.2 (a) (1993).

126. *Id.*

127. LANCASTER, *supra* note 2, at 720(discussing FmHA appraisals).

128. *Id.* (footnotes omitted) (citing 7 C.F.R. §§ 1809.2, 1809.4 (1993)).

129. This publication is generally available only in FSA offices. It is not published in the C.F.R. or Federal Registry.

130. FmHA Instruction 1922-E § 1922.201 (1993).

131. *Id.* The USPAP standards are general in nature with rules directly following the standards to implement same. Standard I states: "In developing a real property appraisal, an appraiser must be aware of, understand, and correctly emply those recognized methods and techniques that are necessary to produce a credible appraisal." USPAP, *supra* note 118, at 9. Standard II states: "In reporting the results of a real property appraisal an appraiser must communicate each analysis, opinion, and conclusion in a manner that is not misleading." *Id.*

Significantly, neither of the standards contemplates the case, like the SAA case, where the appraisals are relied on to find an appreciation amount.

132. FmHA Instruction 1922-E § 1922.205 (j).

133. *Id.* § 1922.206 (d).

134. *Id.* § 1922.207 (c) (1). Exhibit A to Instruction 1922-E offers directions for preparing the Appraisal Report. These directions require the appraiser to identify the farm tract's highest and best use. The direction further instructs the appraiser:

> Indicate the highest and best use of the property and describe on an exhibit to the appraisal the analysis if necessary. Highest and best use is defined as the most reasonable and probable use that supports the highest present value as of the effective date of the appraisal. The analysis must consider all alternative land uses 'as vacant': that are: Legally permissible; financially feasible; physically possible; and maximally productive."

FmHA Instruction 1922-E exh. A.

119. *Id.*

135. *See, e.g.,* 7 C.F.R. § 1809.3 (b) (2) (1993) (stating that appraisers should consider a farm's state of development and "carefully study a community to note the quality of farming, the standard of building maintenance, and similar economic patterns); *id* § 1809.4 (a) (1) (i) (explaining the market data approach and noting that in comparing sales of similar properties, the appraiser should consider "urban and rural orientation"); *id* § 1809.4 (d) (commenting on "market value" and stating that an appraiser should make adjustments for "unusual location and economic use features not otherwise recognized"); *id* § 1809.6 (c) (2) (directing the appraiser to "observe the surrounding area sufficiently to determine whether any favorable or unfavorable factors of the neighborhood have an effect on the value of the property).

136. 7 C.F.R. § 1809.3 (a) (1993).

137. *Id.* § 1809.3 (b).

138. *Id.* § 1809.3 (b) (vi).

139. *See* notes 134-35 and accompanying text (explaining how the new instruction uses the idea of "highest and best use" as one of its major tenets).

140. See id.

141. *See* notes 81-85 and accompanying text (outlining a challenge to administrative action on the basis that the agency acted in an arbitrary and capricious manner).

142. *See* 12 U.S.C.A. § 3331 (West Supp. 1997). This section provides the purpose of the appraisal chapter of FIRREA:

> The purpose of this chapter is to provide that Federal financial and public policy interests in real estate related transactions will be protected by requiring that real estate appraisals utilized in connection with federally related transactions are performed in writing, in accordance with uniform standards, by individuals whose competency has been demonstrated and whose professional conduct will be subject to effective supervision.

Twelve U.S.C.A § 3339 (West Supp. 1997) provides more specific requirements of standards:

> Each Federal financial institutions regulatory agency and the Resolution Trust Corporation shall prescribe appropriate standards for the performance of

real estate appraisals in connection with federally related transactions under the jurisdiction of each such agency or instrumentality. These rules shall require, at a minimum--

(1) that real estate appraisals be performed in accordance with generally accepted appraisal standards as evidenced by the appraisal standards promulgated by the Appraisal Standards Board of the Appraisal Foundation; and

(2) that such appraisals shall be written appraisals.

Each such agency or instrumentality may require compliance with additional standards if it makes a determination in writing that such additional standards are required in order to properly carry out its statutory responsibilities.

One might argue that this section leaves room for a particular agency to fashion certain appraisal standards to meet the goals of the statute under which the agency acts. For instance, maybe the FSA could develop regulations that require that final appraisals of SAA land use the same standards as the initial appraisals (the old standards found in 7 C.F.R. § 1809 (1983)). Nevertheless, such a regulation may run afoul of the FIRREA because 12 U.S.C. § 3339 requires at minimum that agencies complete appraisals using the USPAP. If the old 7 C.F.R. § 1809 standards do not meet this minimum standard, the agency may feel constrained to use the new standards.

143. 518 U.S. 839, 116 S.Ct. 2432 (1996)

144. 116 S.Ct. at 2440.

145. *Id.* at 2440-41. *See* Joshua I. Shwartz, *Assembling Winstar: Triumph of the Ideal of Congruence in Government Contracts Law?*, 26 PUB. CONT. L.J. 481, 483-85 (1997) (providing background surrounding *Winstar*); Jerry Stouk and David R. Lipson, *United States v. Winstar Corp.: Affirming the Application of Private Contract Law Principles to the Federal Government*, 6 FED. CIR. BAR J. 315, 316-19 (1996) (outlining the thrift crisis of the 1980's and the Government's resulting merger program).

146. *Winstar*, 116 S.Ct. 2441. *See* Stouk and Lipson *supra* note 146 explaining the main incentive for healthy institutions to acquire the failing thrifts, and stating:

One of the principal cash substitutes offered by the government was its agreement that the acquirors could account for the transactions pursuant to the "purchase method" of accounting. Under that method, the acquirors treated the excess of the purchase price (which included liabilities assumed) of the failing thrifts over the market value of the acquired assets as an intangible asset called "goodwill." Acquirors were then permitted to include that goodwill in their regulatory capital, and amortize it over long time periods, for purposes of meeting applicable minimum capital requirements.

The inclusion of goodwill in regulatory capital was necessary in order for the transactions to occur--without goodwill, the surplus liabilities acquired would in many cases have rendered the acquirors themselves insolvent *318 immediately upon the consummation of the transactions. The inclusion of goodwill in regulatory capital also allowed the acquirors to expand their operations and leverage more loans, thereby increasing profits.

> Finally, the long-term amortization of goodwill allowed the thrift acquirors sufficient time to overcome the burden of filling the "capital holes" existing on the failing thrifts' books with tangible capital generated through ongoing earnings. Goodwill accounting thus provided potential acquirors with sufficient incentives to take over failing thrifts, thereby allowing the government to continue to honor its insurance obligations to the depositors of failing thrifts without having to provide massive amounts of cash assistance-- amounts which it simply did not have.

(footnotes omitted). *See* 135 Cong. Rec. 2703 (June 16, 1989) (statement of Rep. Hyde) (stating that the agency used goodwill as "an inducement to the healthy savings and loans to merge with the sick ones.").

147. *See* text accompnying *infra* note 155 (explaining how the Court found the agencies contractually obliged to allow the institutions to use the supervisory good will).

148. 116 S.Ct. at 2446.

149. *Id.* (citing Black, Ending Our Forebearers' Forebearances: FIRREA and Supervisory Goodwill, 2 STAN. L. & POL. R. 102, 107 (1990)).

150. 116 S.Ct. at 2447.

151. "The Court's judgment is stated in a plurality opinion by Justice Souter and supported by Justice Breyer's separate concurring opinion. Justice Scalia, joined by two other members of the Court, concurred in the judgment. Chief Justice Rehnquist, joined (but only in part) by Justice Ginsburg, dissented. But even this summary statement understates the degree of fragmentation in the Court." Schwartz, *supra* note 146, at 488.

152. 116 S.Ct. at 2440.

153. 116 S.Ct. at 2448-51.

154. 116 S.Ct. at 2449.

155. 116 S.Ct. at 2463 (quoting *Horowitz v. United States*, 267 U.S. 458, 461 (1925)).

> The two characters which the government possesses as a contractor and as a sovereign cannot be thus fused; nor can the United States while sued in the one character be made liable in damages for their acts done in the other. Whatever acts the government may do, be they legislative or executive, so long as they be public and general, cannot be deemed specially to alter, modify, obstruct or violate the particular contracts into which it enters with private persons.... In this court the United States appear simply as contractors; and they are to be held liable only within the same limits that any other defendant would be in any other court. Though their sovereign acts performed for the general good may work injury to some private contractors, such parties gain nothing by having the United States as their defendants.

Horowitz, 267 U.S. at 461. *See generally* Gerard Wimberly and Kristin Amerling, *The Sovereign Acts Doctrine After Winstar*, 6 FED. CIR. BAR J. 127 (1996) (examining the doctrine in light of *Winstar*).

156. 116 S.Ct. 2465-69; *see* Schwartz, *supra* note 146, at 515-32 (discussion Justice Souter's analysis of the sovereign acts doctrine).

157. 116 S.Ct. 2467. "The statute not only had the purpose of eliminating the very accounting gimmicks that acquiring thrifts had been promised, but the specific object of abrogating enough of the acquisition contracts as to make that consequence of the legislation a focal point of the congressional debate." *Id. See id* nn. 47-49 (providing extensive legislative history indicating that Congress intended to modify the contracts with acquiring thrifts).

158. 116 S.Ct. at 2469.

159. 116 S.Ct. at 2453 (quoting Bowen v. Public Agencies Opposed to Social Security Entrapment, 477 U.S. 41, 52 (1986)).

160. 116 S.Ct. at 2456 (synthesizing *United States v. Cherokee Nation of Oklahoma*, 480 U.S. 700 (1987)*; Bowen*, 477 U.S. 41; and *Merrion v. Jicarilla Apache Tribe*, 455 U.S. 130 (1982)).

161. The application of the doctrine will therefore differ according to the different kinds of obligations the Government may assume and the consequences of enforcing them. At one end of the wide spectrum are claims for enforcement of contractual obligations that could not be recognized without effectively limiting sovereign authority, such as a claim for rebate under an agreement for a tax exemption. Granting a rebate, like enjoining enforcement, would simply block the exercise of the taxing power, *cf. Bowen*, 477 U.S., at 51, 106 S.Ct., at 2396, and the unmistakability doctrine would have to be satisfied. At the other end are contracts, say, to buy food for the army; no sovereign power is limited by the Government's promise to purchase and a claim for damages implies no such limitation. That is why no one would seriously contend that enforcement of humdrum supply contracts might be subject to the unmistakability doctrine. Between these extremes lies an enormous variety of contracts including those under which performance will require exercise (or not) of a power peculiar to the Government. So long as such a contract is reasonably construed to include a risk-shifting component that may be enforced without effectively barring the exercise of that power, the enforcement of the risk allocation raises nothing for the unmistakability doctrine to guard against, and there is no reason to apply it.

116 S.Ct. at 2457.

162. 116 S.Ct. at 2457.

163. 116 S.Ct. at 2460-61.

164. 116 S.Ct. at 2461

165. 116 S.Ct. at 2461-62.

166. 116 S.Ct. at 2448 (quoting *Winstar Corp. v. United States*, 64 F.3d 1531, 1545 (Fed. Cir. 1995)).

167. 116 S.Ct. 2449.

168. *See* SAA agreements, *supra* note 15 (quoting the entire SAA agreements). Both the old and new agreement ask for the "market value" of the real property securing the restructured notes. *Id.* The agency may argue that this indicates that the value at the initiation of the

agreement was not based on the agricultural value. Nevertheless, one may argue that the regulations in force at the time of the initial appraisal actually included the notion of agricultural value within the meaning of market value. Therefore, the possibility of an inconsistent appraisal standards that injure the borrower still exists.

169. *Id.*

170. *See Peterson v. H&R Block Tax Services, Inc.*, 971 F.Supp. 1204, 1211 (N.D. Ill. 1997) (stating Illinois law and that every contract implies the covenant of good faith which "requires the party vested with contractual discretion to exercise it reasonably, not arbitrarily, capriciously, or in a manner inconsistent with the reasonable expectations of the parties.")

171. *See Rayle Tech, Inc. v. Dekalb Swine Breeders, Inc.*, 133 F.2d 1405, 1411 (applying Illinois law and stating "[a]lthough every contract implies good faith and fair dealing between the parties to it, 'the covenant of good faith and fair dealing is not an independent source of duties assumed by parties to a contract and a breach of the covenant itself does not by itself create a cause of action.'") (quoting *Williams v. Jader Fuel Co., Inc.*, 944 f.2d 1388, 1394 (7th Cir. 1991) (interpreting Illinois law).

172. Yankee Atomic Electric Co. v. United States, 112 F.3d 1569, 1574 (Fed. Cir. 1997).

173. *See* notes 156 -59 and accompanying text (outlining how the Court in *Winstar* denied the government the sovereign acts doctrine defense).

174. *See* notes 149-50 and accompanying text (stating legislative purpose of FIRREA).

175. *Yankee*, 112 F.3d at 1575 (citing *Winstar*, 116 S.Ct. at 2465).

176. *Yankee*, 112 F.3d at 1575 ("Thus, [the sovereign acts doctrine] is not a hard and fast rule, but rather a case-specific inquiry that focuses on the scope of the legislation in an effort to determine whether, on balance, that legislation was designed to target prior governmental contracts.")

177. *Winstar*, 116 S.Ct. at 2446.

178. 12 U.S.C.A. § 3331 (West Supp. 1997) (quoted *supra* note 143)

179. *See Yankee*, 112 F3d at 1575 (examining the Government's purpose of changing the law in relation to the particular contract).

180. *Winstar*, 116 S.Ct. at 2456.

181. *See supra* notes 160-66 and accompanying text (explaining why the Court in *Winstar* refused to apply the unmistakability doctrine to the Government).

182. *Id.*

183. 116 S.Ct. at 2457.

184. 116 S.Ct. at 2457 (stating Government contracts include many types, "including those under which performance will require exercise (or not) of a power peculiar to the Government.")

185. FmHA Instruction 1951-S § 1951.914 (d) (1) (iv) (March 1998 revision).

186. 7 C.F.R. § 1951.909 (i) (3) & (4) (1997).

187. *Id.* § 1951.909 (i) (3) (i).

188. *Id.*

189. *Id.*

190. *Id.*

191. *Id.*

192. 7 C.F.R. § 1922.201 (1997) ("[FSA] 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, when completing farm tract appraisals as prescribed in this subpart.").

193. 7 C.F.R. § 1951.909 (i) (3) (v) (1997).

194. *Id.*

195. 7 C.F.R. § 11.5 (1997). *See* Christopher R. Kelley, *Recent Developments in Federal Farm Program Litigation*, 48 OKLA. L. REV. 215, 220-22 (1995). The regulation requires that some types of decisions at this stage be reviewed by the county committee before going to NAD. *See* 7 C.F.R. § 11.5. Kelley points out, however, that the statute possesses no such requirement and allows all adverse decisions to be appealed straight to NAD. Kelley, 48 OKLA. L. REV. at 220-21 (citing 7 U.S.C.A. §§ 6995, 6996).

196. 7 U.S.C.A. § 6998 (West Supp. 1997).

197. *Id.* § 6999.

198. *Id.*

199. Lancaster, *supra* note 1, at 721 ("In challenging appraisals, the borrower needs to examine each section of the appraisal to determine if assumptions made by the appraiser do not correspond with the facts.").

200. *Id.*

201. *See, e.g., Tuepker v. Farmers Home Admin.,* 708 F.2d 1329 (8th Cir. 1983) (denying borrower's petition for judicial review of agency's denial of application for emergency loan); *United States v. Garno*, 974 F.Supp. 628, 634 (E.D. Mich. 1997) (granting Government's motion for summary judgement in foreclosure case because, among other things, borrower failed to produce any evidence of impropriety regarding appraisal); *Deville v. U.S.*, 783 F.Supp 1009, 1010-11 (W.D. La. 1992) (granting Government's motion for summary judgement because the agency's appraisal determination was not arbitrary or capricious).

202. *Deville*, 783 F.Supp. at 1010 (citing *State of La., ex rel. Guste v. Verity*, 853 F.2d 322 (5th Cir. 1988). The court went on to explain "[t]o avoid the arbitrary and capricious label, the agency need only consider the factors and articulate a rational relationship between the facts found and the choice made. The agency's decision need not be ideal, so long as the agency gave at least minimal consideration to relevant facts contained in the record." *Deville*, 783 F.Supp. at 1010 (citing *State of La., ex rel. Guste v. Verity*, 853 F.2d 322 (5th Cir. 1988).

203. 905 F.Supp. 774 (E.D. Cal 1995) (affirmed in part, vacated in part on other grounds).

204. 905 F.Supp. at 791.

205. 905 F.Supp at 790.

206. 905 F.Supp. at 791.

207. *See Garno*, 974 F.Supp. at 634 (agreeing with the agency appraisal because the borrowers "failed to produce any evidence of impropriety regarding the appraisal."). *Deville*, 783 F.Supp at 1010-11 (rejecting borrower's challenges to the agency appraisal because either evidence existed to uphold the agency decision or the borrower failed to present evidence that the agency appraisal was arbitrary).

208. *Hildebrand,* 905 F.Supp. at 791.

209. *See Kinion v. United States*, 8 F.3d 639, 641 (1993) (in a FmHA restructuring case, stating "our reveiw of an agency's interpretation of its own regulations 'is a narrow one, deferential to the agency's interpretation . . . and only permitting reversal if the agency action is without rational basis.") (quoting *Missouri v. United States Dept. of Educ.*, 953 F.2d 373, 375 (8th Cir. 1992).

210. 7 C.F.R. § 1951.909 (i) (4) (1997).

211. FmHA Instruction 1951-S § 1951.914 (d) (1) (iv) (March 1998 revision).

212. 7 C.F.R. § 1951.909 (i) (4) (1997).

213. *Id.* § 1951.909 (i) (4) (i).

214. *Id.*

215. *See* text accompanying *supra* note 192 (noting the qualifications for appraisers and appraisal reports).

216. *Id.* § 1951.909 (i) (4) (i).

217. 7 C.F.R. § 1951.909 (i) (4) (ii).

218. *Id.* § 1951.909 (i) (4) (iii).

219. *Id.*

220. I.R.C. § 61 (a) (12) (West Supp. 1997).

221. James T. Massey, *Tax Consequences of Debt Restructuring -- Pay Now or Later*, FARMERS' LEGAL ACTION REPORT 1, 2 (Summer 1989) (citing Treas. Reg. § 1.61-12 (a) (as amended 1980)).

222. Phillip E. Harris, *Tax Consequences of the Agricultural Credit Act of 1987, in* DEBT RESTRUCTURING: TAX CONSEQUENCES, 10 (Farmers' Legal Action Group, ed. 1989); *see* Massey, *supra* note 2, at 4 (reiterating Professor Harris' argument).

223. *Id.*

224. Letter from IRS to Chet Bailey, Farmers Home Administration (May 22, 1989) *in* DEBT RESTRUCTURING: TAX CONSEQUENCES, 5 (Farmers' Legal Action Group, ed. 1989) [hereinafter Bailey letter].

225. *Id. Contra* Harris, *supra* note 223, at 9-10 (stating that because the SAA makes uncertain the amount to be written-off, the SAA postpones the date of discharge).

226. *See id* at 1. The letter stated: "While [this analysis] reflects the treatment that the Internal Revenue Service will give these transactions, this letter may not be relied on in any circumstances other than those specifically described below."

227. *See Lawinger v. Commissioner*, 103 T.C. 428 (1994). In *Lawlinger*, the borrower petitioned the court to a portion of her debt written down in a FmHA primary loan servicing action should be not included in gross income because it was qualified farm indebtedness as defined in I.R.C. § 108 (g) (2) (B). Nevertheless, in a footnote, the court stated that the parties basically agreed with the position of the IRS in the private letter mentioned above as to income not excepted by § 108. The court stated: "[T]he parties agree that, for purposes of secs. 61 and 108, petitioner's obligations to the . . . FmHA were discharged [at the time of the write-down], and the shared appreciation agreement does not create contingencies that would result in the discharge occurring in a subsequent year." *Id.* at 429, n.1.

228. I.R.C. § 61 (a) (12).

229. I.R.C. § 108.

230. *Id.* § 108 (e) (2).

231. Harris, *supra* note 223, at 2.

232. *Id.* § 108 (a) (1) (A). *See* Letter to Members of Congress from Michael J. Murphy, Acting Commissioner of the IRS (May 23, 1989) *in* DEBT RESTRUCTURING: TAX CONSEQUENCES, 1 (Farmers' Legal Action Group, ed. 1989) (specifically mentioning chapter 12 in an explanation of the tax consequences of the Agricultural Credit Act of 1987).

233. I.R.C. § 108 (a) (1) (B).

234. I.R.C. § 108 (a) (1) (C).

235. I.R.C. § 108 (a) (2).

236. I.R.C. § 108 (g) (3) (D).

237. I.R.C. § 108 (a) (3). Section 108 (d) (3) defines insolvent as "the excess of liabilities over the fair market value of assets."

238. I.R.C. § 108 (g); *see* Harris, *supra* note 223, at 4 (explaining the intricacies of the solvent farmer rule).

239. I.R.C. § 108 (g)

240. Professor Harris explains that the 50% of gross receipts test may be difficult for some borrowers: [F]or some borrowers in financial distress, gross receipts from farming were lower than usual in the three years preceding the debt restructuring while their off-farm income was higher as a result of taking off-farm employment to ease financial difficulties. Harris, *supra* note 223, at 4.

241. I.R.C. § 108 (b) (2) (A).

242. I.R.C. § 108 (b) (2) (B).

243. I.R.C. § 108 (b) (2) (C).

244. I.R.C. § 108 (b) (2) (D). *See Id.*§ 1212 (providing for capital loss carryovers).

245. I.R.C. § 108 (b) (2) (E). *See Id.* § 1017 (providing rules for reduction of basis due to discharge of indebtedness). Section 108 (b) (5) provides that a borrower may elect to reduce his or her depreciable basis before reducing the other tax attributes.

246. I.R.C. § 108 (b) (2) (F). Note that when a taxpayer uses the qualified farm indebtedness exclusion, the tax attributes work slightly differently. *Id.* § 108 (g) (3). Instead of counting the attribute against the excluded amount on a one to one basis, certain attributes allow for a more advantageous use where one dollar of attribute can soak up three dollars of income exclusion. This special advantage applies to the attributes of the general business credit and minimum tax credit.

247. I.R.C. § 108 (a) (1) (A) and (B)

248. Bailey letter, *supra* note --, at 7.

249. *Id.*

250. *Id.* at 7-8.

251. *Id.* at 8. The letter refers to Form 982, Reduction of Tax Attributes Due to Discharge of Indebtedness. This form is filed with the income tax return for the year of the discharge.

252. The following example is a synthesis of two other examples. Professor Lonnie Beard, Classroom Lecture in Agriculture Income Taxation, University of Arkansas Graduate Agriculture Law Program (Nov. 18, 1997) (on file with author) *and* Bailey Letter, *supra* note 225, at 8-9.

253. The $1400,000 is arrived at by figuring fifty percent of the amount that the land has appreciated from the time the agreement was entered into to the time the agreement expired. *See* 7 U.S.C. § 2001 (e) (1994). At the time the agreement was entered into, the land securing the agency loans was valued at $280,000. In the intervening ten years, the value has increased another $280,000. *See supra* notes 16-19 and accompanying text (explaining how farm real estate values have increased drastically in the last ten years and giving the example that Iowa farm real estate has increased nearly 100%). The amount due under the SAA equals fifty percent of the amount of value increased ($280,000), or $140,000.

254. The Baily Letter contemplates the borrower using both the amount of interest owed and the full amount of insolvency (including the interest owed used as a liability in the insolvency equation) to soak up the income from discharge of debt. Bailey Letter, *supra* note --, at 8-9. However, when arriving at the amount of insolvency used to soak up the income from discharge of indebtedness, it seems that the liability created by the interest owed should not be included because it already has been used in the deductible interest exclusion. In this example, Farmer's liabilities (including interest owed) are $355,000, while the value of his assets is only $280,000, leaving Farmer insolvent in the amount of $75,000. Farmer uses the amount of interest owed, $20,000, to soak up some of the income from discharge of indebtedness. At this point farmer should not be able to use the $20,000 again in the insolvency exception. If Farmer uses $75,000 as the insolvency amount, he is including the $20,000 from interest owed. Therefore, Farmer would in effect use the $20,000 to soak up interest from discharge of indebtedness two

times: once in the deductible interest exclusion and once in the insolvency exclusion. Farmer should use $55,000 as the amount of insolvency ($75,000 minus the $20,000 already used as deductible interest exclusion). Despite this inconsistency, the Baily Letter allows Farmer to use the amount of interest owed in both the deductible interest exclusion and the insolvency exclusion. This example follows the Bailey Letter and, therefore, also contains this inconsistency.