Litigation Involving The Farm Credit System

And

The Rights of Member-Borrowers of Federal Land Bank Associations (FLBAs) and Production Credit Associations (PCAs)

by

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Note: This outline is current to September 15, 1988. It was completed contemporaneously with the adoption by the Farm Credit Administration Board of final rules governing the borrower's rights provisions of the Agricultural Credit Act of 1987. Consequently, a reading of this outline should be supplemented with a careful reading of those rules and the prefatory comments accompanying them. Because of additional impending changes to the regulations governing the Farm Credit System and rapidly developing case law arising from the Agricultural Credit Act of 1987, the reader is urged to be alert to continuing developments.

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Topic

The Farm Credit System

The statutory authority for the Farm Credit System is found at 12 U.S.C.A. §§ 2001-2279 (West 1980 & Supp. 1988). The regulations appear at 12 C.F.R. Parts 600-605 and 611-624 (1988). The Agricultural Credit Act of 1987, Pub. L. No. 100-233, 101 Stat. 1568-1717 (1988) (codified in scattered sections of 12 U.S.C.), will require the revision of the regulations. The proposed and final regulations will appear in the Federal Register in the coming months. Certain proposed regulations, including the regulations relating to the borrowers' rights provisions of the 1987 Act, appear at 53 Fed. Reg. 16934-16970 (1988). The final borrowers' rights regulations appear at 53 Fed. Reg. 35427-458 (1988). In this outline, references to the most recent proposed or final regulations will include both the Federal Register citation and the proposed codification citation.

In addition to changes in the regulations, the Agricultural Credit Act of 1987 was recently amended by the Agricultural Credit Technical Corrections Act of 1988. The text of the Act, signed by the President on August 17, 1988, is found in H.R. 3980, 100th Cong., 2d Sess., 134 Cong. Rec. S 10798-819 (daily ed. Aug. 3, 1988).

As noted elsewhere in this outline, the contents of this outline were prepared under a September 15, 1988, deadline. The law governing the Farm Credit System is changing rapidly. In addition to urging readers to be alert for continuing developments, the authors request the reader's understanding of the difficulties inherent in describing a subject that is

essentially a "moving target" and also request the reader's tolerance for any shortcomings in this outline that result from that inherent difficulty.

I. THE PURPOSE OF THE FARM CREDIT SYSTEM

"The objective of the Farm Credit System is to satisfy the peculiar credit needs of American farmers and ranchers while encouraging those farmers and ranchers to participate through management, control, and ownership of the system." Daley v. Farm Credit Administration, 454 F.Supp. 953, 954 (D. Minn. 1978).

The Congressional expression of the policy and objectives of the Farm Credit System is as follows:

> (a) It is declared to be the policy of the Congress, recognizing that a prosperous, productive agriculture is essential to a free nation and recognizing the growing need for credit in rural areas, that the farmer-owned cooperative Farm Credit System be designed to accomplish the objective of improving the income and well-being of American farmers and ranchers by furnishing sound, adequate, and constructive credit and closely related services to them, their cooperatives, and to selected farm-related businesses necessary for efficient farm operations.
>
> (b) It is the objective of this chapter to continue to encourage farmer- and rancher-borrowers participation in the management, control, and ownership of a permanent system of credit for agriculture which will be responsive to the credit needs of all types of agricultural producers having a basis for credit, and to modernize and improve the authorizations and means for furnishing such credit and credit for housing in rural areas made available through the institutions constituting the Farm Credit System as herein provided.

> (c) It is declared to be the policy of Congress that the credit needs of farmers, ranchers, and their cooperatives are best served if the institutions of the Farm Credit System provide equitable and competitive interest rates to eligible borrowers, taking into consideration the creditworthiness and access to alternative sources of credit for borrowers, the cost of funds, including any costs of defeasance under section 4.8(b), the operating costs of the institution, including the costs of any loan loss amortization under section 5.19(b), the cost of servicing loans, the need to retain earnings to protect borrowers' stock, and the volume of net new borrowing. Further, it is declared to be the policy of Congress that Farm Credit System institutions take action in accordance with the Farm Credit Act Amendments of 1986 in such manner that borrowers from the institutions derive the greatest benefit practicable from that Act: Provided, That in no case is any borrower to be charged a rate of interest that is below competitive market rates for similar loans made by private lenders to borrowers of equivalent creditworthiness and access to alternative credit.

12 U.S.C.A. § 2001 (West 1980 & Supp. 1988). The policy and objectives assigned to the Farm Credit System reflect the fact that the System was created as a result of a need by farmers for "a dependable source of adequate credit, on terms suited to the particular needs of agriculture, from lenders who understood their problems." W. Hoag, The Farm Credit System: A History Of Financial Self-Help, 1 (1976) [hereinafter referred to as "Hoag"]; see also McGowan & Noles, The Cooperative Farm Credit System, 4 Mercer L. Rev. 263 (1953)("[The System] is a complete, dependable and permanent system for the furnishing to farmers on a cooperative basis of various types of sound agricultural credit at reasonable rates of interest and costs."); see generally 11 N.

Harl, Agricultural Law, ch. 100 (1986); 2 J. Davidson Agricultural Law, ch. 10 (1981); K. Meyer, D. Pedersen, N. Thorson, and J. Davidson, Agricultural Law: Cases and Materials, 269-74 (1985).

II. THE HISTORY AND STRUCTURE OF THE FARM CREDIT SYSTEM

A. The European Cooperative Model

In response to the difficulties faced by farmers in obtaining credit in the early 1900's, two commissions, one appointed by President Taft and the other created by a private organization, undertook studies of the European rural credit systems. Three different proposals for responding to the credit needs of American farmers were generated from the combined work of the commissions:

1. obtaining loan funds through the sale of bonds to investors;
2. organizing cooperatives; and
3. making direct government loans to farmers.

The first proposal, the realization of funds through the sale of bonds to investors, was based on the method used by the German Landschaften banks. It ultimately became the method adopted by the federal land banks, the banks for cooperatives, and the federal intermediate credit banks. Those Farm Credit System institutions currently obtain loan funds by selling bonds and debentures on the money markets. 12 U.S.C.A. § 2160 (West Supp. 1988) (creating the Federal Farm Credit Banks Funding Corporation to replace the Fiscal Agency of the Farm Credit Banks, See 12 C.F.R. Part 615 (1988)).

The cooperative approach was based on the organization of the European Raiffeisen banks. This form was adopted by the local federal land bank associations and production credit associations. The third approach, direct governmental loans to farmers, was incorporated into the Farmers Home Administration programs. Brake, A Perspective On Federal Involvement In Agricultural Credit Programs, 19 S.D.L.Rev. 567, 568-69 (1974); [hereinafter referred to as "Brake"] see also Hoag, at 209-17; 12 N. Harl, Agricultural Law § 100.01[2] (1986); J. Knapp, The Rise of American Cooperative Enterprise: 1620-1920, 121-43 (1969); J. Knapp, The Advance of American Cooperative Enterprise: 1920-1945, 246-88 (1973); M. Abrahamsen, Cooperative Business Enterprise, 323-37 (1976); McGowan & Noles, The Cooperative Farm Credit System, 4 Mercer L. Rev. 263, 263-65 (1953); Horne, Sources of Agriculture Financing With an Emphasis on the Farm Credit System, Agric. L.J. 15 (1980-81).

B. The Federal Land Banks (FLB)

Acting on the recommendations contained in the commission reports, Congress, in 1916, enacted the Federal Farm Loan Act, Pub. L. No. 64-158, ch. 245, 39 Stat. 360 (1916), authorizing the establishment of federal land banks for the purpose of making long-term loans secured by real estate. Each federal land bank was initially capitalized by federal government subscription of the institution's stock, and supervision of the banks was placed in a five-member Federal Farm Loan Board serving under the Treasury Department. However, the Act provided that the government owned stock was to be eventually retired through

farmer-borrower purchases so that the federal land banks would eventually be solely owned by farmers. Since 1947, the federal land banks have been completely farmer owned.

Pursuant to the Farm Loan Act of 1916, the Federal Farm Loan Board created twelve federal land bank districts. Also established were national farm loan associations, later renamed federal land bank associations, to act as agents for the regional federal land banks. Farmer-borrower purchases of stock in local federal land bank associations which, in turn, purchase stock in the federal land banks, ultimately achieved farmer ownership of both entities. Brake, at 570-72; Hoag, at 213-17.

C. The Federal Intermediate Credit Banks (FICB)

In 1923, pursuant to the Agricultural Credits Act, Pub. L. No. 67-503, ch. 252, 42 Stat. 1454 (1923), the federal intermediate credit banks were created to discount the notes of other lenders made for short or intermediate term farm loans. Although initially capitalized by the federal government in a manner similar to the capitalization of the federal land banks, the federal intermediate credit banks differed from the federal land banks because they did not make direct loans to farmers. Rather, the initial function of the federal intermediate credit banks was to purchase notes made by other lenders. Brake, at 573; Hoag, at 231-43.

D. The Production Credit Associations (PCA)

Because existing lenders did not make substantial use of the federal intermediate credit banks, regional production credit corporations were authorized in 1933. The Farm Credit Act of 1933, Pub. L. No. 73-75, 48 Stat. 257 (1933), created twelve

regional production credit corporations, twelve regional banks for cooperatives, and the Central Bank for Cooperatives. The banks for cooperatives were established to make loans to farmer cooperatives. Brake, at 573; Hoag, at 231-43.

The Farm Credit Act of 1933 also authorized the establishment of local production credit associations modeled after the federal land bank associations. However, unlike federal land bank associations, the production credit associations were not merely agents of the regional production credit corporations. Rather, they made direct loans that were discounted by the regional corporations. Later, in 1956, the federal intermediate credit banks assumed the discounting function for production credit associations, and the assets of the twelve regional production credit corporatons were transferred to the federal intermediate credit banks. Brake, at 569. For a detailed account of the early history of the Farm Credit System, see McGowan & Noles, The Cooperative Farm Credit System, 4 Mercer L. Rev. 263 (1953).

E. The Farm Credit Administraton and the Department of Agriculture

The Farm Credit Act of 1933 created the Farm Credit Administration to coordinate all federal lending activities. For the first six years of its existence, the Farm Credit Administration operated as an independent agency of the executive branch. However, in 1939, an executive order placed the agency in the Department of Agriculture. Reorganization Plan No. 1 of 1939, 53 Stat. 1423, 1429 (April 25, 1939). The Farm Credit

Administration remained within the Department of Agriculture until the Farm Credit Act of 1953, Pub. L. No. 83-202, 67 Stat. 390 (1953), re-established its independent status.

F. Decentralization of the System--The Farm Credit Act of 1953

Not only did the Farm Credit Act of 1953 re-establish the independent status of the Farm Credit Administration, it redefined and redirected the System, moving it toward decentralization, farmer ownership and control, and cooperative development. The Act created the Federal Farm Credit Board as the policy making body of the Farm Credit Administration. The Farm Credit Administraton, with its Governor responsible to the Board rather than the President, was accorded supervisory authority over the regional banks, the federal land banks (FLBs) and federal intermediate credit banks (FICBs), and their local associations, the federal land bank associations (FLBAs) and production credit associations (PCAs), respectively. Farmer participation and control was increased by giving farmer members the authority to elect six of the seven members on each of the twelve district farm credit boards. Also, recommendations were sought for retiring all of the remaining government capital in the system. Partially because of the impetus of the Farm Credit Act of 1953, all government capital in the Farm Credit System was repaid by the end of 1968. Brake, at 574-76; Hoag, at 257-61.

G. The Modern System--The Farm Credit Act of 1971

The Farm Credit Act of 1971, Pub. L. No. 92-181, 85 Stat. 583 (1971), continued the trend toward decentralization by authorizing that more decisions be made at local district levels.

In that regard, lending authority was expanded in three areas by the authorization of the following:

1. long term mortgage loans for rural housing (12 U.S.C.A. § 2014 (West 1980));
2. loans to persons furnishing custom services to farmers (12 U.S.C.A. § 2016 (West 1980)); and
3. financial services to farmers including financial management, record keeping, and estate planning (12 U.S.C.A. § 2076 (West 1980)).

1. FLBs and FLBAs

As structured after the Farm Credit Act of 1971, the Farm Credit System was entirely farmer owned with the last government subscription having been retired in 1968. Long-term mortgage credit was provided through the FLBs and the FLBAs. Although each FLB and each FLBA were separate corporations, each FLBA owned a portion of the stock of the regional FLB. Farmers who sought FLB funds made application through their local FLBA. 12 U.S.C.A. § 2020 (West 1980).

The borrower was required to purchase capital stock in the FLBA in an amount at least equal to five percent of the face value of his loan. Id. With the purchase of stock, the borrower became a voting member of the FLBA, and the FLBA purchased a like amount of stock in the regional FLB. 12 U.S.C.A. § 2034 (West 1980). Each

stockholder is entitled to only one vote. Id. The FLB and FLBA held a first lien on the borrower's stock. 12 U.S.C.A. § 2054 (West 1980).

The primary source of FLB funds was derived from the sale of consolidated federal land bank bonds. The bonds are joint obligations of the twelve district FLBs. 12 U.S.C.A. § 2155 (West 1980 & Supp. 1988). The United States bears no liability on the bonds. 12 U.S.C.A. § 2155(c) (West Supp. 1988). For an extensive and highly critical study of the Farm Credit System's funding of loans with long-term, fixed rate bonds during the early 1980's, see General Accounting Office, Pub. No. GGD-86-150 BR, Farm Credit System: Analysis of Financial Condition (1986). See also Barry, Financial Stress For The Farm Credit Banks: Impacts On Future Loan Rates For Borrowers, 436 Agric. Finance Rev. 27 (1986).

2. FICBs and PCAs

PCAs made short and intermediate term loans that were, in turn, discounted by the regional FICBs. 12 C.F.R. §§ 600.40 and 600.50 (1988). The capital stock of the FICBs was owned by PCAs. The FICBs obtained funds through the sale of consolidated debentures. As was required of FLBA and FLB borrowers, PCA borrowers also were required to purchase stock in an amount equal to at least five percent of the fact value of the loan. 12 U.S.C.A. § 2094 (West 1980).

3. Boards of Directors

Each PCA and FLBA had a board of directors elected by its members. 12 U.S.C.A. §§ 2092 and 2032 (West 1980). Similarly, each of the twelve farm credit districts had a board of directors consisting of seven members. Prior to the enactment of the Farm Credit Amendments Act of 1985, one director was appointed by the Governor of the Farm Credit Administration and the remaining six were elected by the district's FLBAs, PCAs, and borrowers from the bank of cooperatives, with each of the three system institutions electing two directors. 12 U.S.C.A. § 2223 (West 1980). Under the 1985 Act, the seventh member of the district board was elected by the "borrowers at large in a district," a phrase defined as follows:

> (i) a voting shareholder of a Federal land bank association and a direct borrower, and a borrower through an agency, from a Federal land bank;
>
> (ii) a voting shareholder of a production credit association; and
>
> (iii) a voting shareholder or subscriber to the guaranty fund of a bank for cooperatives.

12 U.S.C.A. § 2223(a) (West Supp. 1986). A short, concise description of the System as it existed under the 1971 Act is found in Rosantrater, Farm Credit: An Overview, The Colorado Lawyer, 1594 (July, 1981).

H. The Farm Credit Amendments Act of 1985

The Farm Credit Amendments Act of 1985, Pub. L. No. 99-205, 99 Stat. 1678 (1985), also made structural changes in

levels above the district board of directors. Prior to the 1985 Act, the Federal Farm Credit Board was a part-time board consisting of thirteen members, one nominated by each of the twelve districts and appointed by the President and one appointed by the Secretary of Agriculture as his representative. The 1985 Act renamed the board the Farm Credit Administration Board and reduced its membership to three full-time members. 12 U.S.C.A. § 2242 (West Supp. 1988). The three members were appointed by the President with the advice and consent of the Senate. Id.

A second major structural change occasioned by the 1985 Act was the shift in the responsibilities of the Farm Credit Administration. Under prior law, the Farm Credit Administration directly participated in the supervision and management of the System. Under the 1985 Act, the Farm Credit Administration assumed the function of a regulatory agency. The enumerated powers of the Farm Credit Administration included the power to modify the boundaries of farm credit districts, approve the merger of districts, and promulgate regulations. 12 U.S.C.A. § 2252 (West Supp. 1988). In addition, the Farm Credit Administration was directed to examine System institutions in the same manner as followed by examiners under the National Bank Act, the Federal Reserve Act, and the Federal Deposit Insurance Act. 12 U.S.C.A. § 2254 (West Supp. 1988). Finally, the Farm Credit Administration was given broad enforcement powers under the 1985 amendments including the authority to issue cease and desist orders, 12 U.S.C.A. §§ 2261-63 (West Supp. 1988), and to suspend or remove System institution directors and officers. 12 U.S.C.A. §§ 2264-74 (West Supp. 1988). Under the 1985 Act, the chairman of the Farm

Credit Administration Board also serves as the chief executive officer of the Farm Credit Administration. 12 U.S.C.A. § 2244 (West Supp. 1988).

The Farm Credit Amendments Act of 1985 also centralized the power to raise and distribute funds within the System. The Act created the Farm Credit System Capital Corporation which, in turn, was granted the authority to require all of the System institutions to purchase its stock, to pay assessments to it, and to contribute to its capital. 12 U.S.C.A. §§ 2216-2218 and 2152 (West Supp. 1986). The purposes of the Capital Corporation included the following functions:

1. provide financial assistance to System institutions;
2. acquire from and participate with other System institutions the nonperforming assets of those institutions;
3. "hold, restructure, collect, and otherwise administer nonperforming assets acquired from or participated in with other Farm Credit System institutions, and guarantee performing and nonperforming assets held by other Farm Credit institutions"; and
4. provide technical and other services to other System institutions relatng to their loan portfolios. 12 U.S.C.A. § 2216 (West Supp. 1986).

Probably the most controversial of the powers accorded to the Capital Corporation was the authority to draw funds from

stronger districts to buttress weaker ones. The Corporation's attempts to exercise that authority spawned numerous lawsuits initiated by district banks and local associations. E.g., Federal Land Bank of Springfield v. Farm Credit Administration, 676 F. Supp. 1239 (D. Mass. 1987); Sikeston Production Credit Association v. Farm Credit Administration, 647 F.Supp. 1155 (E.D. Mo. 1986). See 3 FCA Bulletin No. 3 (March 1988) for a summary of current litigation on this issue.

The Farm Credit Amendments Act of 1985 also granted to the Secretary of the Treasury the authority to provide financial assistance to the system on a "certification. . .[of] need" by the Farm Credit System, 12 U.S.C.A. § 22161 (West Supp. 1986). Finally, as well be discussed in greater detail later in this outline, the 1985 Act granted to system borrowers certain rights not previously afforded to them, 12 U.S.C.A. §§ 2199-2202 (West Supp. 1986). A good, but brief, discussion of the structural changes mandated by the 1985 Act is contained in Note, The Congressional Response To A Crisis In Agricultural Credit: The 1985 Farm Credit Amendments, 31 S.D.L.Rev. 471 (1986); see also Duncan, Farm Credit System - Current Matters, 38 Ala. L. Rev. 537 (1987); see generally General Accounting Office, Pub. No. RCED-86-126BR, Farm Finance: Farm Debt, Government Payments, and Options to Relieve Financial Stress (1986).

I. The Farm Credit Act Amendments of 1986

The mid-1980's saw continuing deterioration in the financial condition of the Farm Credit System. Harshbarger and Chite, Financial Condition of the Farm Credit System, 47 Agric. Finance Rev. 19 (1987). The Congressional response, contained in

the Farm Credit Amendments Act of 1986, Pub. L. No. 99-509, 100 Stat. 1874, 1877 (1986), was to partially decentralize authority by giving district banks the power to set interest rates and to implement new "regulatory accounting practices" (RAP) that, among other things, allowed System institutions to amortize for up to twenty years the additions to their loss reserves. See generally Banner and Barry, RAPPING the Farm Credit System: Spreading Costs to the Future, Choices 31 (First Quarter 1988).

J. The Agricultural Credit Act of 1987

The Agricultural Credit Act of 1987, Pub. L. No. 100-233, 101 Stat. 1717 (1988), was signed by the President on January 6, 1988. The Act does two things that have resulted or will result in structural changes to the System. First, it makes available up to four billion dollars of federal funds to improve the financial condition of System institutions. Second, it mandates the merger of certain System institutions and provides for the voluntary consolidation of others.

1. Financial Assistance To System Institutions

Under the 1987 Act, the Farm Credit Administration remains as the regulatory authority over System institutions. However, a new threefold approach to financial assistance is undertaken. First, the Capital Corporation, a creation of the 1985 Act, has been abolished. 12 U.S.C.A. §§ 2216-16K (West Supp. 1988). In its place, an entity known as the Financial Assistance Board has been created to certify financially distressed institutions. 12 U.S.C.A. § 2278a (West Supp. 1988). See generally Pariser, Agricultural Real Estate Loans and

Secondary Markets, IV Agriculture and Human Values 29 (Spring-Summer 1987)(discussing the effect of the secondary market on the Farm Credit System). Once certified, an institution can issue preferred stock and receive financial assistance. 12 U.S.C.A. § 2278b-4 (West Supp. 1988). If the book value of the stock of a System institution is less than seventy-five per cent of the par value of the stock, that is, if its value is less than $3.75 per share, the institution is required to seek certification. 12 U.S.C.A. § 2278a-4(b) (West Supp. 1988).

Second, the 1987 Act also created an entity known as the Financial Assistance Corporation. 12 U.S.C.A. § 2278(b) (West Supp. 1988). That entity is authorized to issue federally guaranteed bonds and to purchase the preferred stock of system institutions that have been certified as eligible to issue preferred stock, thereby funneling the federal "bail-out" funds to those institutions. 12 U.S.C.A. §§ 2278b-6(a) and 2278b-7(b) (West Supp. 1988). The Financial Assistance Corporation will terminate on the maturity and full payment of its bonds. 12 U.S.C.A. § 2278b-11 (West Supp. 1988). The bonds will have a fifteen year maturity period. 12 U.S.C.A. § 2278b-6(a) (West Supp. 1988).

In addition to creating an "assistance" fund through the issuance of federally guaranteed bonds, the 1987 Act created a "trust" fund funded solely from the proceeds from a one-time required purchase of Financial Assistance Corporation stock by the PCAs and Farm Credit Banks. 12

U.S.C.A. § 2278b-5 (West Supp. 1988). The creation of the "trust" fund already has been challenged as an unconstitutional taking under the fifth amendment. Colorado Springs Production Credit Association v. Farm Credit Administration, Nos. 88-0574, 88-0583, and 88-0584 (D.D.C. July 18, 1988) (available on Westlaw, ALLFEDS database, 1988 WL 76531) (order denying in part and granting in part motion to dismiss).

Third, the 1987 Act also creates the Farm Credit System Insurance Corporation. 12 U.S.C.A. § 2277a-1 (West Supp. 1988). The Corporation's function is to create an insurance fund by assessing and collecting premiums from system institutions. The fund is intended to protect System institutions, investors, and stockholders beginning in 1992. 12 U.S.C.A. § 2277a-9(a) and (c) (West Supp. 1988).

The 1987 Act also created, as part of the Farm Credit System, the Federal Agricultural Mortgage Corporation to oversee a new agricultural mortgage secondary market. 12 U.S.C.A. §§ 2279aa-1 and 2279aa (West Supp. 1988). See generally Pariser, Agricultural Real Estate Loans and Secondary Markets, IV Agriculture and Human Values 29 (Spring-Summer 1987) (discussing the possible effect of the secondary market on the Farm Credit System). The Federal Farm Credit Banks Funding Corporation was created as the System's fiscal agent for the marketing of System bonds. 12 U.S.C.A. § 2160 (West Supp. 1988).

Questions have already been raised about the efficacy of the federal "bail-out." Bullock and Dodson, The

Farm Credit System: It Was A New Lease On Life, But . . ., Choices 32 (First Quarter 1988). Moreover, on Friday, May 20, 1988, the Federal Land Bank of Jackson was closed and placed in a receivership by the Farm Credit Administration after examiners determined that an additional infusion of federal funds would be "futile." Wall Street Journal, May 23, 1988, at 4, col. 1 (Chicago ed.); 53 Fed. Reg. 18812 (1988); see also Behind The Takeover of Jackson Farm Credit, Agri-Finance News, 1 (July, 1988); Hughes, Jackson FLB In Receivership, Agric. Outlook 20 (July, 1988).

2. Merger of System Institutions

The 1987 Act mandates the merger of the Federal Land Bank and the Federal Intermediate Credit Bank in each district within six months after January 6, 1988. Pub. L. No. 100-233, § 401, 101 Stat. 1568, 1622 (1988). The merged FLB and FICB within each district will be known as the Farm Credit Banks. 12 U.S.C.A. § 2011 (West Supp. 1988).

The Farm Credit Banks, acting through federal land bank associations, will continue to provide real estate loans. 12 U.S.C.A. §§ 2015, 2013(18), 2091 and 2093(9) (West Supp. 1988). However, the Farm Credit Banks can transfer direct loan making authority to a federal land bank association. 12 U.S.C.A. § 2279(b) (West Supp. 1988).

Production credit associations will continue to provide short and intermediate term loans. 12 U.S.C.A. § 2075 (West Supp. 1988). Those loans may be discounted by the Farm Credit Banks, and, associations, including both

federal land bank and production credit associations, will continue to be supervised by the Farm Credit Banks. 12 U.S.C.A. §§ 2015(b) and 2013(13) (West Supp. 1988).

Under the 1987 Act, a production credit association and a federal land bank association may merge. 12 U.S.C.A. § 2279c-1 (West Supp. 1988). If a merger occurs, the Farm Credit Banks must transfer the direct lending authority for long-term real estate mortgage loans to the federal land bank association. 12 U.S.C.A. § 2279b(b) (West Supp. 1988). Merged associations are referred to as "agricultural credit associations" (ACAs).

The Act also required the twelve banks for cooperatives and the Central Bank for Cooperatives to consider consolidation into one national bank for cooperatives. Pub. L. No. 100-233, § 413, 101 Stat. 1641 (1988). The St. Paul, Springfield, Jackson, and Spokane Banks recently voted not to consolidate; the remaining eight banks will consolidate into one national bank. National Bank for Cooperatives Formed by Merger Vote, Agri Finance News 4 (August 1988).

The 1987 Act removed the requirement that a borrower must purchase stock in the amount of five percent of the face value of the loan. A borrower now must purchase stock in an amount as set by the lender, subject to FCA regulation. 12 U.S.C.A. §§ 2074 and 2094 (West Supp. 1988). The FCA has issued proposed rules providing that the amount of stock required to be purchased must be not less than two percent of the loan amount or $1,000, whichever is less. 53 Fed. Reg. 34109, 34113 (1988) (to be codified at 12 C.F.R. § 614.5220).

Finally, the 1987 Act also requires the Farm Credit Administration to propose a plan for the merger of the twelve districts into no less than six districts. The various Farm Credit Banks are to submit the proposed merger affecting it to its members for their approval. Pub. L. No. 100-233, § 412, 101 Stat. 1568, 1638-39 (1988).

A more detailed explanation of the structural changes occasioned by the 1987 Act can be found in a Special Report On The Agricultural Credit Act Of 1987 available for $10.00 from the Farmers' Legal Action Group, Inc., 1301 Minnesota Building, 46 East Fourth Street, St. Paul, Minnesota 55101. See also Davidson, Agricultural Credit Act of 1987, Agric. Law Update 7 (Feb. 1988); Koenig and Hiemtra, More Than A Facelift For FCS, Agric. Outlook 22 (March 1988). Attached to this outline as Appendix A is a flow chart of the Farm Credit System as it is currently structured.

K. "Farm Credit Services" As a Trade Name, The Federal Farm Credit Corporation Of America, and The Farm Credit Council

As has been briefly described above and is discussed elsewhere in this outline, the Farm Credit System consists of various "System institutions," most notably the district Farm Credit Banks, Banks For Cooperatives, and various federal land bank associations and production credit associations within each district. Each System institution is a federally-chartered instrumentality and, as such, is a separate legal entity. However, the various institutions often hold themselves out as being, or being a part of, "Farm Credit Services." "Farm Credit

Services" is a trade name; it is not a legal entity. Accordingly, "Farm Credit Services," as such, is not capable of suing or being sued.

The various Farm Credit System banks are authorized to create organizations to perform certain functions or services for the banks. 12 U.S.C.A. § 2211 (West Supp. 1988). Two such organizations have been organized under charters issued by the FCA. The first, initially established in July, 1985, by the district banks, is the Farm Credit Corporation of America (FCCA) located in Denver, Colorado. Among other things, the FCCA provides centralized financial and management guidance to the district banks. The second, the Farm Credit Council, is the trade association of the System banks and associations. Essentially a lobbying organization, its offices are in Washington, D.C.

III. LITIGATION INVOLVING THE FARM CREDIT SYSTEM

A. Federal Jurisdiction:

Federal jurisdiation over FLBAs and PCAs is limited. Unless diversity of citizenship exists to satisfy the requirements of 28 U.S.C.A. § 1332 (West 1966 & Supp. 1988), the only other currently possible bases for federal jurisdiction over FLBAs and PCAs are (1) federal question jurisdiction under 28 U.S.C.A. § 1331 (West Supp. 1988) premised on the theory that the Farm Credit Act, as amended, implies a private cause of action; (2) the Racketeer Influenced And Corrupt Organizations Act, 18 U.S.C.A. §§ 1961-1968 (West 1984 & Supp. 1988); and (3) the Equal Credit

Opportunity Act, 15 U.S.C.A. §§ 1691-1691f (West 1982). As will be discussed, the prevailing view is that the Farm Credit Act of 1971 does not create an implied private cause of action. Whether claims based on the Farm Credit Amendments Act of 1985 and the Agricultural Credit Act of 1987 will be held to satisfy 28 U.S.C.A. § 1331 is currently an unresolved issue, at least at the appellate level. However, the Eighth Circuit and the Minnesota Court of Appeals have recently held that the 1985 Act did not create an implied private right of action for damages. Redd v. Federal Land Bank of St. Louis, 851 F.2d 219 (8th Cir. 1988); Ebenoh v. Production Credit Association of Southeast Minnesota, 426 N.W.2d 490 (Minn. Ct. App. 1988).

1. Status As Federally Chartered Instrumentalities: The mere status of the FLBA's and PCA's as federally chartered instrumentalities of the United States does not create federal court jurisdiction.

(a) The FLBAs and the PCAs are federally chartered instrumentalities of the United States. 12 U.S.C.A. §§ 2091 (West Supp. 1988) (FLBAs); 12 U.S.C.A. §§ 2071 (West Supp. 1988) (PCAs).

(b) 28 U.S.C.A. § 1349 (West 1976) provides as follows:

> The district courts shall not have jurisdiction of any civil action by or against any corporation upon the ground that it was incorporated by or under an Act of Congress, unless the United States is the owner of more than one-half of its capital stock.

(c) 28 U.S.C.A. § 1349 has been held to preclude federal court jurisdiction over a claim against an FLB premised on an allegation that the FLB was a federally chartered instrumentality. Federal Land Bank of Columbia v. Gloria Piper Cotton, 410 F.Supp. 169 (N.D. Ga. 1975) (also holding that the FLB was not an agency within the meaning of 28 U.S.C.A. §§ 451 and 1345 (West 1976)).

(d) Also, System institutions are generally not considered foreign corporations under state certificate of authority statutes. This is because

> [i]t is well settled that "[c]orporations created by the authority of the United States are not foreign corporations but have legal existence in every state in which they may transact business pursuant to the authority conferred upon them by Congress."

Federal Land Bank of St. Paul v. Gefroh, 390 N.W.2d 46, 47 (N.D. 1986) (citing Federal Land Bank of Omaha v. Felt, 368 N.W.2d 592 595 (S.D. 1985)) See also Federal Land Bank of St. Paul v. Bagge, 394 N.W.2d 694 (N.D. 1986), and Kolb v. Naylor, 658 F.Supp. 520 (N.D. Iowa 1987).

2. Citizenship:

For purpose of diversity and other jurisdictional bases, a System institution is "deemed to be a citizen of the State, commonwealth, or District of Columbia in which its principal office is located." 12 U.S.C.A. § 2258 (West 1980); Engelmeyer v. Production Credit Association of The Midlands, 652 F.Supp. 1235 (D.S.D. 1987).

3. Fifth Amendment:

There is no federal question jurisdiction under 28 U.S.C.A. § 1331 against an FLBA or PCA based on a claim arising under the fifth amendment to the United States Constitution because those entities are private rather than governmental. Birbeck v. Southern New England Production Credit Ass'n., 606 F.Supp. 1030, 1034-35 (D.Conn. 1985) (citing DeLaigle v. Federal Land Bank of Columbia, 568 F.Supp. 1432, 1439 (S.D.Ga. 1983)); Federal Land Bank of Wichita v. Jost, No. 86CA0510 (Colo. Ct. App. August 4, 1988) (available on Westlaw, ALLSTATES database, 1988 WL 82272). However the Eighth Circuit has found a "colorable basis" for jurisdiction for a fifth amendment claim against a PCA based on the "pervasive involvement of the federal government in the creation and operaton of the production credit associations." Schlake v. Beatrice Production Credit Ass'n., 596 F.2d 278, 281 (8th Cir. 1979) (citing Duke Power Co. v. Carolina Environmental Study Group, Inc. 438 U.S. 59 (1978)).

4. Federal Common Law:

There is no 28 U.S.C.A. § 1331 jurisdiction under the federal common law based on a claim of breach of fiduciary duty. Birbeck, 606 F.Supp. at 1039-44; Boyster v. Roden, 628 F.2d 1121, 1125 (8th Cir. 1980) (holding that the fiduciary obligations of the FCS institutions are governed by state law, not federal law.) The fiduciary obligations of FLBAs and PCAs will be discussed in greater detail later in this outline.

5. Section 1983:

There is no 28 U.S.C.A. § 1343 jurisdiction based on a claim arising under 42 U.S.C.A. § 1983 because federal instrumentalities are not persons subject to section 1983 liability. Birbeck, 606 F.Supp. at 1044-45.

6. Tucker Act:

Unless there is at issue a claim based on a substantive right, there is no jurisdiction under the Tucker Act, 28 U.S.C.A. § 1346(a)(2) (West Supp. 1988). The Tucker Act does not create substantive rights. Birbeck, 606 F.Supp. at 1045. Also, the Tucker Act does not extend to entities in which the United States has no proprietary interest.

7. Truth In Lending:

In virtually all instances, FLB and PCA loans will be exempt from the disclosure requirements of the Truth-In-Lending Act, 15 U.S.C.A. § 1601(a) (West 1982), because credit transactions primarily for agricultural purposes are exempt. 15 U.S.C.A. § 1603(1) (West 1982). Gregory v. Federal Land Bank of Jackson, 515 So.2d 1200 (Miss. 1987).

8. Federal Tort Claims Act:

The correct rule is that FLBAs and PCAs are not agencies for purposes of the Federal Tort Claims Act, 28 U.S.C.A. § 1346(b) (West 1976). South Central Iowa Production Credit Ass'n v. Scanlon, 380 N.W.2d 699, 700-03 (Iowa 1986) and Kolb v. Naylor, 658 F.Supp 520 (N.D.Iowa 1987). However, the Montana Supreme Court recently took the

opposite position on this issue. In Tooke v. Miles City Production Credit Association, No. 87-409 (Mont. March 3, 1988) (available on Westlaw, MT-CS database, 1988 WL 27167), the Montana Supreme Court held that PCAs are subject to the Federal Tort Claims Act. The Tookes brought suit against the PCA in state court, alleging that the PCA had breached its fiduciary duty and committed fraud in considering the Tookes' loan application. The court found that the case should have been brought under the Federal Tort Claims Act (FTCA) for two reasons. First, the PCA was a federal instrumentality under the test set out in Lewis v. U.S., 680 F.2d 1239 (9th Cir. 1982), and, as a federal instrumentality, it was subject to the FTCA unless the FTCA specifically exempted it from coverage. Second, while the FLB and the FICB were specifically exempted from the FTCA, PCAs were not; thus they were subject to the FTCA, at least in the opinion of the Montana Supreme Court.

The decision is unsound. In essence, it is premised on the notion that the federal government exercises" control over the . . . [PCA's] detailed physical performance and day to day operaton." Slip op. at 7. Although recent federal legislation governing the Farm Credit System has been increasingly prescriptive, and the FCA has acquired the status of an independent regulator, production credit associations continue to be farmer-owned cooperatives with considerable autonomy. See generally Sikeston Production Credit Association v. Farm Credit Administration, 647 F. Supp. 1155 (E.D. Mo. 1986); Colorado Springs Production

Credit Association v. Farm Credit Administration, Nos. 88-0574, 88-0583, and 88-0584 (D.D.C. July 18, 1988) (available on Westlaw, ALLFEDS database, 1988 WL 76531).

9. Securities Act:

FLBA and PCA Class B stock is not subject to the Securities Act of 1933, 15 U.S.C.A. § 77c(a)(2) (West 1981), or the Securities Exchange Act of 1934, 15 U.S.C.A. § 77a (West 1981). Dau v. Federal Land Bank of Omaha, 627 F.Supp. 346, 348 (N.D.Iowa 1985); Seger v. Federal Intermediate Credit Bank of Omaha, 850 F.2d 468 (8th Cir. 1988).

10. Federal Indenture Act:

FLBA and PCA stock is exempt under the Federal Indenture Act, 15 U.S.C.A. § 77 ddd(a)(4)(A) (West 1981). Dau, 627 F.Supp. at 349 (also rejects claim under the federal Real Estate Settlement Procedures Act, 12 U.S.C.A. §§ 2601-2617 (West 1980 & Supp. 1988), because of the exemptions for parcels in excess of 25 acres).

11. Equal Credit Opportunity Act:

Farm Credit System institutions are subject to the Equal Credit Opportunity Act, 15 U.S.C.A. §§ 1691-1691f (West 1982 & Supp. 1988).

12. Fair Debt Collection Practices Act:

In virtually all instances, FLBAs and PCAs will be exempt from the Fair Debt Collection Practices Act, 15 U.S.C.A. §§ 1692-1693r (West 1982 & Supp. 1988), because the debt was not incurred for "personal, family, or household purposes." 15 U.S.C.A. § 1692a(5). Munk v. Federal Land Bank of Wichita, 791 F.2d 130, 132 (10th Cir. 1986).

13. Implied Cause of Action Under The Farm Credit Act of 1971 And The Farm Credit Amendments Act of 1985:

Claims of an implied private right of action under the Farm Credit Act of 1971 as the Act existed prior to the effective date of the 1985 amendments have been unsuccessful. Aberdeen Production Credit Association v. Jarrett Ranches Inc., 638 F.Supp. 534 (D.S.D. 1986); Smith v. Russellville Production Credit Association, 777 F.2d 1544 (11th Cir. 1985); Bowling v. Block, 785 F.2d 556 (6th Cir. 1985); Spring Water Dairy Inc. v. Federal Intermediate Credit Bank of St. Paul, 625 F.Supp. 713 (D.Minn. 1986); Apple v. Miami Valley Production Credit Association, 614 F.Supp. 119 (S.D.Ohio 1985); Hartman v. Farmers Production Credit Association of Scottsburg, 628 F.Supp. 218 (S.D.Ind. 1983); Corum v. Farm Credit Services, 628 F.Supp. 707 (D.Minn. 1986); Production Credit Association of Worthington v. Van Iperen, 396 N.W.2d 35 (Minn. Ct. App. 1986); Johansen v. Production Credit Association of Marshall-Ivanhoe, 378 N.W.2d 59 (Minn. Ct. App. 1985); Yankton Production Credit Association v. Jensen, 416 N.W.2d 860 (S.D. 1987). In virtually all of those cases, the borrowers were seeking the benefit of the loan servicing regulations, 12 C.F.R. § 614.4510(d)(1) and (2) (1986), promulgated pursuant to the Act.

As it existed prior to the regulations promulgated under the 1985 amendments, 12 C.F.R. § 614.4510 provided, in relevant part, that System banks and associations that were originating lenders were to "adopt loan servicing policies

and procedures to assure that loans will be serviced fairly and equitably for the borrower while minimizing the risk for the bank and associations." Also, 12 C.F.R. § 614.4510(d)(1) and (2) provided that the "policy shall provide a means of forbearance for cases when the borrower is cooperative, making an honest effort to meet the conditions of the loan contract and is capable of working out of the debt burden."

At the risk of oversimplifyng the issue, the courts that have rejected the argument that the Farm Credit Act of 1971 implies a private cause of action have done so on two basic grounds. First, with the exception of one federal district court, courts have refused to find that the forbearance policies contemplated by the former 12 C.F.R. § 614.4510 are substantive rules having the force and effect of law. Compare DeLaigle v. Federal Land Bank of Columbia 568 F.Supp. 1432, 1436-38 (S.D.Ga. 1983) (concluding that section 614.4510 has the "force and effect of law") with Smith v. Russellville Production Credit Association, 777 F.2d at 1547-48 ("we disapprove of DeLaigle v. Federal Land Bank of Columbia, supra, to the extent that it may be inconsistent with this opinion"). Rather, the forbearance rules have been found to be merely "general statements of agency policy" and therefore did not provide a basis for an implied cause of action. Smith v. Russellville Production Credit Association, 777 F.2d at 1548; Federal Land Bank of Springfield v. Sanders, 108 A.D.2d 838, 485 N.Y.Supp.2d 342 (N.Y. App. Div. 1985).

The second ground for rejecting assertions of an implied cause of action under the Farm Credit Act of 1971 has been the absence of any legislative history reflecting a Congressional intent to imply a federal remedy. In applying the fourfold test for ascertaining the existence of an implied cause of action in a federal statute enunciated in Cort v. Ash, 422 U.S. 66, 78 (1978), the courts have tended to focus on the legislative intent prong of the test. The conclusion of the court in Bowling v. Block, 602 F. Supp. 667, 670-71 (S.D. Ohio 1985) is representative:

> It is readily apparent that the Farm Credit Act merely established the machinery by which its purpose, to augment the amount of credit available to the farming community, would be effected. It does not create specific enforceable rights which would necessitate the existence of a private right of action. Further, the Act intimates that the specific entities it creates for the purpose or providing the needed credit - the production credit associations, the federal land bank associations and the banks for cooperatives - are to be operated much like any other private lending institution. Therefore, whatever disputes arise between plaintiffs and the nonfederal defendants must be resolved in the same manner that such a dispute would be resolved if the defendants were common banks or savings and loans.

Thus, the issue of whether the Farm Credit Act of 1971, prior to its 1985 amendment, creates an implied cause of action appears to be firmly resolved in the negative. In light of recent decisions, the same also may be said for the issue of whether the Act, as amended in 1985, created an implied cause of action.

The enactment of the 1985 amendments arguably strengthed arguments for an implied cause of action in at least two respects. First, the availability of forbearance became no longer solely a matter of institutional policy. It was a congressional mandate. 12 U.S.C.A. § 2199(b) (West Supp. 1986). Second, the legislative history of the 1985 amendments appeared to support the argument in favor of an implied cause of action. In particular, during the floor debate in the House, Representative De La Garza, the Chairman of the House Committee on Agriculture and sponsor of the House bill (H.R. 3792) that formed the basis for the Act stated that ". . . it would be my understanding that the rights . . . [in the Act] shall be enforceable in courts of law." 131 Cong. Rec. H 11518-19 (daily ed. Dec. 10, 1985).

The test for determining whether one has an implied cause of action for relief under a federal statute was articulated by the United States Supreme Court in Cort v. Ash, 422 U.S. 66 (1975). In Cort v. Ash, the Court listed several factors that were "relevant" in determining whether a private remedy is implicit in a statute not expressly providing one. 422 U.S. at 78. Those factors are as follows:

> First, is the plaintiff "one of the class for whose especial benefit the statute was enacted . . . that is, does the statute create a federal right in favor of the plaintiff? Second, is there any indication of legislative intent, explicit or implicit, either to create such a remedy or to deny one? . . . Third, is it consistent with the underlying purposes of the legislative scheme to imply such a remedy for the

> plaintiff? . . . And finally, is the cause of action one traditionally relegated to state law, in an area basically the concern of the States, so that it would be inappropriate to infer a cause of action based solely on federal law?

422 U.S. at 78 (emphasis in original) (citations omitted).

Shortly after the enactment of the 1985 amendments, two courts offered, in dicta, observations as to whether the 1985 amendments to the Farm Credit Act would support a private cause of action. However, in both cases, the court did not need to resolve the issue because the plaintiff was asserting claims based on the Farm Credit Act arising prior to its amendment in 1985. In the first case to be reported, Aberdeen Production Credit v. Jarrett Ranches, Inc., 638 F. Supp. 534 (D.S.D. 1986), the court noted the remarks on the House floor by Representative De La Garza. However, because the acts challenged by the plaintiff occurred prior to the enactment of the 1985 amendments, the court's remarks were limited to the following:

> This Court does not read this statement to indicate that all regulations of the Farm Credit System were intended to be enforceable in courts of law. The statement was expressly made in reference to "borrowers' rights" established in Title III, § 301 et seq. of the 1985 Farm Credit Amendments Act - the "rights" of disclosure and access to documents. The defendants are not claiming any violation of rights alledgedly established under the 1985 amendments. Therefore, this Court is not required to consider the significance of the 1985 Farm Credit Amendments Act in determining the existence of a private case of action.

638 F. Supp. at 537.

In the second case, Production Credit Association of Worthington v. Van Iperen, 396 N.W.2d 35 (Minn. Ct. App. 1986), the court also found it unnecessary to resolve the issue of whether the 1985 amendments created a private cause of action. A decision was unnecesary because "the amendments referred to by the [appellants] were not effective until after the contract date between the parties herein." 396 N.W.2d at 38. In passing over the question, however, the court correctly noted that the "substance of the Act" must also be examined and that exclusive reliance could not be made on the statements of Representative De La Garza. Id. The Minnesota Court of Appeals later held that no implied private cause of action exists under the 1985 Act. Ebenhoh v. Production Credit Association of Southeast Minnesota, 426 N.W.2d 490 (Minn. Ct. App. 1988).

Subsequently, in actions where the issue was squarely presented, two federal district courts rejected contentions that the borrowers' rights provisions of the Farm Credit Amendments Act of 1985 created an implied cause of action in favor of Farm Credit System borrowers. Redd. v. Federal Land Bank of St. Louis, et al., 661 F. Supp. 861 (E.D. Mo. 1987) aff'd, 851 F.2d 219 (8th Cir. 1988); Mendel v. Production Credit Assoc. of the Midlands, 656 F. Supp. 1212 (D.S.D. 1987)(appeal pending). However, addressing a related issue, the Supreme Court of North Dakota held that a federal land bank's failure to comply with the System's forbearance regulations may afford a basis for an equitable

defense to a foreclosure action notwithstanding the absence of an implied cause of action. Federal Land Bank of St. Louis v. Overboe, 404 N.W.2d 445 (N.D. 1987). (This case is discussed in greater detail later in this outline.)

In Redd, the district court relied on the House Report's discussion of the rejection of an amendment to the 1985 legislation that would have held "directors and officers of the System personally and individually liable for damages suffered when they knowingly violate . . . [the] Act, or any rate regulation or order issued thereunder" as indicating an absence of any intention to create a private cause of action. H.R. Rep. No. 425, 99th Cong., 1st Sess. 44, reprinted in 1985 U.S. Code Cong. & Ad. News 2587, 2631. It bolstered its reliance on the House Report by concluding that the Act's granting of cease and desist powers to the Farm Credit Administration reflected a Congressional intention to so limit the remedy available for violations of the Act. Redd, 661 F. Supp. at 863 (citing 12 U.S.C.A. §§ 2261, 2264, 2267(b), 2268(a) and (g), and 2269 (West Supp. 1986)). The court discounted the statement by Representative De La Garza on the House floor expressing his understanding that the Act created a private cause of action by finding that understanding to be inconsistent with the Act's creation of a remedy in favor of the Farm Credit Administration. Redd, 661 F. Supp. at 863-64 (citing 131 Cong. Rec. H11518-19 (daily ed. Dec. 10, 1985)).

The Eighth Circuit affirmed the district court's decision in Redd by finding that the second and third tests under Cort v. Ash were not met. The Eighth Circuit agreed with the district court that the remarks of Representative De La Garza were not binding on the court in determining whether an implied cause of action exists. The court looked at the "substance of the amendment to determine whether a cause of action should be implied, rather than the comments of committee persons as they field questions about the the bill." Redd, 851 F.2d at 222. The Eighth Circuit reasoned that Congress was aware of the enforcement problems in the Act, but the court found that Congress had answered the problem by granting the FCA broad cease and desist powers. 12 U.S.C.A. § 2261 (West Supp. 1988). The granting of such broad regulatory powers suggested to the court that Congress did not intend to grant member-borrowers a private right of action.

The third test under Cort v. Ash also provided grounds for the Eighth Circuit to determine no implied cause of action exists. The court found that the purpose of the 1985 Act was to strengthen the financial condition of the System. Thus, the court reasoned that granting money damages to the Redds would deplete the already diminishing resources of the system and defeat the legislation's purpose.

In Mendel, the district court reached the opposite conclusion of the Redd court with respect to Representative De La Garza's remark. It found that Representative De La Garza's statement was sufficient to demonstrate intention to

create a private remedy. Nevertheless, the court also found that the underlying purpose of the 1985 amendments was to "shore up" the finances of the System, and that allowing borrowers who were not given their rights to recover monetary damages against a System institution would be inconsistent with that purpose. On that basis, the court invoked the third element of the Cort v. Ash test to deny a private right of action.

The cease and desist powers of the FCA were not addressed by the district court in Mendel. However, Mendel is currently on appeal to the Eighth Circuit, and, because Mendel presents essentially the same issue that was presented in Redd, it may be assumed that the FCA's cease and desist powers will again be addressed. Moreoever, as will be discussed subsequently in this outline, several recent federal district court decisions have addressed the issue of whether the 1987 Act created an implied private right of action. In each of these cases, the System institution defended on the grounds that the granting of cease and desist powers to the FCA in the 1985 Act reflects a Congressional intention to place the Act's enforcement in the hands of the FCA, not member-borrowers through an implied private right of action. The following argument, one made by the Federal Land Bank of St. Paul, is representative of the System's argument on the issue:

> Redd went beyond prior Circuit cases and held that there is no private right of action for damages under the 1985 amendments to the Farm Credit Act. In so holding, this Court

acknowledged that Congress, in enacting the 1985 amendments, was aware of tensions between the Farm Credit System and its borrowers and "intended the statute to provide additional protections for borrowers to ensure that they received fair treatment, due process, and every realistic opportunity to avoid liquidation and stay in business." The Court nonetheless concluded that nothing in the language or the legislative history of the 1985 amendments revealed any legislative intent to imply a private right of action on behalf of farmer-borrowers. In this regard, the Court focused on the grant to the FCA of 'extensive enforcement powers parallel to those of bank and thrift regulators,' and concluded: '[s]uch broad regulatory powers suggest that no private right of action was intended.'

The analysis applied to the 1985 amendments in Redd compels the conclusion that there is no private right of action under the 1987 Farm Credit Act amendments here at issue. Congress explicitly considered the question of private remedies during its deliberations over what became the 1987 Act. The House version included a provision that gave borrowers the right to sue any Farm Credit institution for violation 'of any duty, standard, or limitation prescribed under the [Farm Credit] Act and owing to the borrower.' H.R. Conf. Rep. No. 100-140, 100th Cong., 1st Sess. 178, reprinted in 1988 U.S. Code Cong. & Admin. News 2956, 2973. The Senate version contained no comparable provision. When the 1987 amendments went before the conference committee, the committee deleted the House provision, and its Report expressly noted this elimination of a "Borrower's right to sue" provision. See H.R. Conf. Rep. No. 100-140, 100th Cong., 1st Sess. 178, reprinted in 1988 U.S. Code. Cong. & Admin. News 2956, 2973.

Congress is presumed to know how courts and agencies have interpreted federal statutes. Reenactment of a statute, unchanged, is evidence of legislative recognition and approval of prior consistent judicial interpretation. See Midlantic Nat'l Bank v. New Jersey Dept. of Env. Prot., 474 U.S. 494, 501 (1986); National Lead Co. v. United States, 252 U.S. 140, 146 (1920); Johnson v. First National Bank, 719 F.2d 270, 277 (8th Cir. 1983). Here, the congressional approval is explicit, since Congress rejected a proposed private right of action in passing the 1987 Act. Compare Flood v. Kuhn, 407 U.S. 258, 283 (1972).

> In short, as was true of the 1985 amendments, Congress clearly intended to afford farmer-borrowers additional protections in enacting the 1987 Act. However, Congress did not create a private right of action to enforce these protections. Instead, as this Court concluded in Redd, Congress intended that the broad cease and desist and other regulatory powers vested in the FCA should be the exclusive means of enforcing the 1987 Act so as to reconcile the broad Congressional purposes of both protecting farmer borrowers and assisting farm credit lenders.

Brief of Appellant at 17-20, Martinson v. Federal Land Bank of St. Paul, No. 88-31 (D.N.D. April 2, 1988), appeal filed, No. 88-5202 N.D. (8th Cir. May 20, 1988) (footnotes omitted). Martinson has been consolidated for appeal with Leckband v. Naylor, No. CV3-88-167 (D. Minn. May 17, 1988), appeal filed, No. 88-5301 MN (8th Cir. July 18, 1988).

The flaw in the System's argument against an implied private right of action based on the FCA's cease and desist powers is that it does not acknowledge that the United States Supreme court has held that where the administrative authority or process created by the statutory scheme is inadequate to insure full participation by the aggrieved party, the existence of an administrative "remedy" will not be a bar to the exercise of federal court jurisdiction. Cannon v. University of Chicago, 441 U.S. 677, 704 n.41 (1979). For example, in Rosado v. Wyman, 347 U.S. 397 (1970), the Court permitted welfare recipients to challenge a New York statute as being incompatible with a federal statute despite the existence of an administrative remedy available to states participating in the welfare program. The Court noted:

> Whether HEW [the administrative agency] could provide a mechanism by which welfare recipients could theoretically get relief is immaterial. It has not done so, which means there is no basis for the refusal of federal courts to adjudicate the merits of these claims.

397 U.S. at 406 n.8.

With respect to the FCA's powers, although these powers could theoretically be used to protect borrowers' rights, the FCA has not promulgated any regulations authorizing their use in that manner. Moreover, there is neither statutory nor regulatory authority for a borrower to seek the invocation of the FCA's powers or to participate in any way in any FCA proceedings. As Rosado indicates, the mere theoretical availability of relief is not enough.

As a practical matter, the FCA simply does not have the staff to do much, if anything, about the infinite variety of the individual grievances that may arise with respect to the thousands of distressed loans held by the System if and when those loans are considered for restructuring. In addition, it is questionable whether Congress intended that the mission of the FCA should be to protect the rights of individual borrowers. To the extent that the FCA's functions were modeled on the examination authority of the examiners who act under the National Bank Act, the Federal Reserve Act, and the Federal Deposit Act, there is no reason to believe that Congress intended that the FCA be the arbitrator of individual member-borrower's

grievances against Farm Credit System lenders. Such disputes in analogous contexts are properly matters for the courts, not bank examiners.

Moreover, the member-borrower ownership of the Farm Credit System should not be diluted or destroyed by engrafting on it an administrative process similar to that in place for the Farmers Home Administration. The System's lending institutions are not federal agencies, and they should not be administered as federal agencies. Although they are federally chartered, the System's lending institutions are member-borrower owned, and that ownership should be respected. Respect for the member-borrower ownership of the System compels the conclusion that it is the member-borrower who should hold responsibility for initiating enforcement of the Farm Credit Act.

For a more detailed discussion of the law regarding implied private rights of action, see e.g. Note, Howard v. Pierce: Implied Causes of Action and the Ongoing Vitality of Cort v. Ash, 80 N.W.U.L. Rev. 722 (1986); Bruner, Implied Private Rights of Action: The Courts Search For Limitations In A Confused Area of the Law, 13 Cumb. L. Rev. 569 (1983); Goldstein, Implied Private Rights of Action Under Federal Statutes: Congressional Intent, Judicial Deference, or Mutual Abdication?, 50 Fordham L. Rev. 611 (1982).

Unlike the issues in Redd and Mendel, the issue presented to the North Dakota Supreme Court in Overboe assumed that the Farm Credit Act did not afford borrowers a

right of action. In Overboe, the question was whether, in the absence of a private right of action, a borrower could assert a federal land bank's failure to follow the System's forbearance regulations as a defense to a foreclosure action. Relying on a line of cases that have allowed a mortgagee's failure to follow HUD mortgage servicing regulations promulgated under the National Housing Act to be asserted as an affirmative defense notwithstanding the absence of a private cause of action under that Act, the court resolved the issue favorably to the borrower. See e.g. Brown v. Lynn, 392 F. Supp. 559 (N.D. Ill. 1975).

The administrative forbearance defense permitted by the Overboe court permits judicial consideration of both the procedural and substantive aspects of the System institution's action. In that regard, the initial inquiry is whether the institution "has established a general policy of forbearance and whether it applied that policy in arriving at its decision to seek foreclosure." 404 N.W.2d at 449-450. If the trial court finds that the borrower's qualifications were considered by the institution in accordance with its procedures, the court's review of the merits of that consideration must be confined to whether the institution abused its discretion. In other words, to prevail, the borrower must show that the institution acted in an "arbitrary, capricious, unreasonable or unconscionable manner." 404 N.W.2d at 450. The Overboe court indicated that appellate review of a trial court's determination of the substantive issue will be guided by the standard of

whether the abuse of discretion standard of review "appears to have been misapprehended or grossly misapplied." Id. (citing Universal Camera Corp. v. National Labor Relations Board, 340 U.S. 474, 491 (1951)).

14. Implied Cause of Action Under The Agricultural Credit Act of 1987.

The 1987 Act does not expressly provide a private cause of action against institutions of the Farm Credit System. However, member-borrowers have asserted in actions in several jurisdictions that the 1987 Act created an implied private cause of action. The following cases involve borrowers' attempts to enforce the borrowers' rights provisions of the 1987 Act through the assertion of an implied cause of action:

A. Right of First Refusal.

Martinson v. Federal Land Bank of St. Paul, No. 88-31 (D.N.D. April 21, 1988) (order granting preliminary injunction), appeal filed, No. 88-5202 ND (8th Cir. May 20, 1988). The Martinsons had voluntarily conveyed their land to the FLB in order to avoid foreclosure. On March 7, 1988, the Martinsons received a letter from the FLB advising them that the FLB had elected to sell their land at a public auction and that they could exercise their right of first refusal by matching the high bid at the auction. The Martinsons filed suit asking the court to enjoin the scheduled auction because the method selected by the FLB to fulfill the right of first refusal would deprive them of their right to reacquire their land at its appraised fair

market value. The court enjoined the proposed sale after finding that the Martinsons had demonstrated the likelihood of success on the merits. Tr. of Proceedings at 1.

Leckband v. Naylor, No. 3-88-167 (D. Minn., May 17, 1988) (order granting preliminary injunction), appeal filed, No. 88-5301 MN (8th Cir. July 18, 1988). The Leckbands asked the court to enforce the right of first refusal granted them under the 1987 Act. See 12 U.S.C. § 2219a(b) (West Supp. 1988). The FLB had scheduled a public auction of their formerly owned farmland and had not given them the right to purchase the land at its fair market value. The FLB argued that by using the public auction method of selling land in their inventory, they were not required to comply with the provision requiring notice to the former owner, and that the court, in any event, should not decide the issue before the FCA published proposed regulations which would interpret the statute. The court enjoined the FLB from selling the land by auction without first offering the Leckbands the right to purchase the land at its appraised valve. Slip op. at 9.

B. Restructuring

Stainback v. Federal Land Bank of Jackson, No. GC88-25-NB-0 (N.D. Miss. Feb. 5, 1988) (order granting preliminary injunction) (set for trial). The Stainbacks own a farm in Leflore County, Mississippi. The Stainbacks moved for a temporary restraining order and preliminary injunction to stop the foreclosure sale of their farm. The Stainbacks had submitted a written application to the FLB on January 5,

1988, asking that their loan be considered for restructuring under the 1987 Act. The FLB responded that it would not consider plaintiff's loan for restructuring and it would continue with the foreclosure sale set for February 8, 1988. The court held that the Stainbacks were entitled to "consideration for restructuring of their loan by the defendant to determine the least cost alternative." Slip op. at 2.

Harper v. Federal Land Bank of Spokane, No. CV88-449 JU (D. Ore., May 5, 1988) (order granting preliminary injunction), appeal filed, No. 88-4033 (9th Cir. July 26, 1988). The Harpers own and operate a farm in Marion County, Oregon. The FLB and the PCA filed actions to foreclose on the property in September and October 1987. The sheriff's sale was held in March, 1988. The Harpers asked the court to enjoin the sale or transfer of their property pending resolution of their request for restructuring under the 1987 Act. See 12 U.S.C. § 2001(c) (West Supp. 1988). Citing Martinson and Stainback, the court enjoined the sale. Slip op. at 4-5.

A trial on the merits of the claims against the FLB and the PCA was held recently in the Harper case. The court held that an implied cause of action is available under the 1987 Act. The court enjoined the FLB and PCA from evicting the Harpers until they are considered for restructuring. Harper v. Federal Land Bank of Spokane, CV88-4449JU (D. Ore., June 27, 1988).

Zajac v. Federal Land Bank of St. Paul, No. A3-88-115, (D.N.D. July 19, 1988) (order granting summary judgment), appeal filed, NO. 88-5353 ND (8th Cir. Aug. 15, 1988). The Zajacs challenged the decision by the FLB not to restructure their loan. The FLB advised the Zajacs that the cost of restructuring their loan was greater than the cost of foreclosing, and that pursuant to the 1987 Act, the FLB was not required to restructure such loans. The foreclosure sale was set for July 20, 1988, and the Zajacs asked the court to stay the sheriff's sale, based on two arguments. First, the FLB was not using the proper methodology for restructuring analysis, and second, the Zajacs had asked for an independent appraisal and the FLB had refused to authorize an independent appraisal. The court refused to stop the foreclosure sale, holding that the FLB was not required to provide an independent appraiser during restructuring considerations under the 1987 Act, and, without addressing the issue of whether the FLB was using a proper method of determining which loans are eligible for restructuring, merely found that Congress had not authorized private causes of action under the 1987 Act.

Several other cases involving claims under the 1987 Act have been decided. However, none squarely presents or addresses the implied private right of action issue. The cases include the following:

In the Matter of Dilsaver, 17 B.C.D. 785 (Bankr. D. Neb. 1988) (appeal pending). The FLB held mortgages on the properties involved in these five bankruptcy proceedings.

The FLB asked the court to sequester rents and profits from the estates. The debtors objected, arguing that the estates were eligible for restructuring under the 1987 Act. The court agreed with the debtors and refused to award the FLB the rents and profits unless the FLB first considered the loans for restructuring.

In the Matter of Kraus, No. BK86-2677 (Bankr. D. Neb. May 20, 1988). Kraus had filed a petition under Chapter 11 of the Bankruptcy Code in October, 1986. The plan was confirmed on November 16, 1987. The Trustee filed a notice of intent to sell Kraus' property as allowed under the confirmed plan. Kraus filed a motion to dismiss the Chapter 11 case, arguing that since the creditors were institutions of the Farm Credit System, he was eligible for restructuring under the 1987 Act. The court held that because the Chapter 11 plan had been confirmed, it was "entitled to finality" and the subsequent passage of the 1987 Act would not alter or amend the plan.

In re Pennington, No. 87-01485-BKC-DTW (Bankr. N.D. Miss. March 22, 1988) (1987 Act does not affect the valuation of secured property in bankruptcy).

In re Neff, No. 2-87-01838 (Bankr. S.D. Ohio June 10, 1988) (1987 Act does not preclude borrower's surrender of Class B stock to FLB to eliminate a portion of the FLB's allowed secured claim in bankruptcy).

In re Bellman Farms, 86 Bankr. 1016 (Bankr. D.S.D. June 24, 1988) (1987 Act does not mandate restructuring at liquidation value).

Federal Land Bank of Omaha v. Engelken, No. C85-2062 (N.D. Iowa Aug. 25, 1988) (1987 Act does not apply to foreclosure action where sheriff's sale was held prior to effective date of the Act).

Meredith v. Federal Land Bank of St. Louis, No. J-C-88-134 (E.D. Ark. July 29, 1988) (private negotiations between FLB and third party regarding sale of acquired property is not a "public offering" for purposes of right of first refusal under 1987 Act).

C. The Courts' Treatment of the Implied Cause of Action Issue In The Cases Raising The Issue Under The 1987 Act.

The Cort v. Ash test was squarely addressed in Leckband. The Leckbands had argued that an analysis of the Cort test should result in the conclusion that an implied cause of action exists under the 1987 Act with regard to the right of first refusal, and the court agreed.

The first inquiry under Cort v. Ash is whether the plaintiff is "one of the class for whose especial benefit the statute was enacted." 422 U.S. at 78. In Martinson and Leckband, the plaintiffs were clearly members of the class who were meant to be protected by the right of first refusal:

> Agricultural real estate that is acquired by an institution of the System as a result of a loan foreclosure or a voluntary conveyance by a borrower (hereinafter in this section referred to as the 'previous owner') . . . shall be subject to the right of first refusal of the previous owner to repurchase or lease the property, as provided in this section.

12 U.S.C. Sec. 2219a(a) (West Supp. 1988).

The same must be said for Stainbacks and the Harpers who had a right to have their FLB loan considered for restructuring, and, if the cost of restructuring was less expensive to the FLB than foreclosure, to have the loan restructured.

With respect to the second inquiry under Cort v. Ash, the legislative intent underlying the Act, the House of Representatives debated an amendment to the House bill which expressly would have given borrowers the right to sue. In introducing legislation, Representative Watkins of Oklahoma stated:

> My amendment would allow the borrower the right to sue. I really believe in my heart that the right to sue is implied within the bill itself, but I think it is our responsibility and our obligation to make sure that there is no question that the borrower has that right. If a person has a loan and has worked with the Farm Credit System and has suffered some legal wrong or been aggrieved or adversely affected by certain violations of the Farm Credit System, they should have a right to be able to sue.
>
> Every one of us in this Chamber today has heard of dictatorial actions, and we have heard of rigid abuses from individuals against the farmer and against the landowner, and they really have had no recourse to try to remedy their problems. I think my amendment assures them that they have that right if they can prove the wrong.

131 Cong. Rec. H-7692 (September 21, 1987) (emphasis added).

Further discussion of the amendment brought about the following exchanges with Representatives Glickman and De La Garza:

Mr. GLICKMAN: Mr. Chairman, I thank for gentleman for yielding to me.

What actually right now is the state of the law as it relates to a borrower's right to sue? He is allowed to sue under State law, but not Federal law?

It would be useful to know what right a borrower would have to enforce a decision by the Farm Credit System right now in court.

Mr. WATKINS: I think, if the gentleman from Kansas might recall, some States do allow it, and some States do not.

What we are saying is, so there will not be any mistake under this particular Federal legislation, that it be established that they do have the right to be able to sue if they feel like they have been legally wronged or adversely affected by some actions from the Farm Credit System.

Mr. DE LA GARZA: Mr. Chairman, I thank the gentleman for yielding to me.

I have no problem with the gentleman's intention in allowing borrowers to sue, although I think basically they have that right now.

Id. at 7693 (emphasis added).

The Senate also debated the right of individuals to sue FCS institutions. Senator Burdick of North Dakota offered an amendment which gave any person, not just borrowers, the right to sue:

This amendment is made necessary only because the House, in their Farm Credit bill, included a right to sue provision that actually restricts the right to sue.

Currently, any person has the right to sue these two entities. However, the House provision arguably limits this right to borrowers of the System. This restricts rights of persons who are not yet borrowers, or who are former borrowers, to sue.

My amendment simply clears up this problems and restores the rights to all persons, whether borrowers or not.

My amendment also gives persons the right to sue in Federal court. This does not create additional litigation, as some will argue, but only gives the option of suing in Federal court.

131 Cong. Rec. S 16995 (December 2, 1987) (emphasis added).

Following Senator Burdick's statement, the following exchange occurred:

Mr. BOREN: Mr. President, I have listened with interest as my good friend and colleague from North Dakota has explained the purpose of his amendment. I have certainly a high degree of sympathy with the principles that he has set forth.

It has been our hope since we have carefully crafted this legislation in the committee that we not reopen this matter at this time. However, I am told that the house has unduly restricted the right of the borrower to bring suit and that ths is the proposal that is in the House bill. It would be my thought, and I have also discussed this with Senator LEAHY, and Senator LUGAR will speak for himself, that we would oppose that House provision in the conference committee. That would have much the same effect as the adoption of the Burdick amendment would have without our attempting to write the actual language of the amendment here on the floor at this time.

I wonder if the Senator might consider withholding the actual offering of this amendment with the understanding that the Senate conferees would oppose the House amendment in the conference.

Mr. BURDICK: The proposal of the Senator is very acceptable.

Mr. BORDEN: I thank my colleague, and I believe the Senator from Indiana also has the same view.

> Mr. LUGAR: Mr. President, I would confirm the understanding that the distinguished Senator from this amendment. We will in fact oppose the House amendment in conference. We understand the problem, and we would appreciate the Senator's not pursusing this amendment on this occasion with that assurance.

Id. (emphasis added).

The Senate was concerned that the House amendment would limit the existing right of individuals to sue FCS institutions. The Senate opposed the House amendment in Conference Committee and the House amendment was deleted. H.R. Rep. No. 100-490, 100th Cong., 1st Sess. 178, reprinted in 1988 U.S. Code Cong. & Admin. News 2723, 2973. The plaintiffs in Leckband relied on that legislative history to successfully argue that Congress intended to provide a private cause of action under the amendments. Leckband, slip op. at 7-9.

In Dilsaver, the court found evidence of legislative intent that borrowers already under the protection of the bankruptcy court were entitled to restructuring. The court relied heavily on legislative history which showed that the phrase "bankruptcy proceeding" was used in the House Conference Report's discussion of the definition of distressed loans. A distressed loan was defined as "a loan that the borrower does not have the financial capacity to pay according to its terms, but that is not yet subject to a foreclosure or bankruptcy proceeding." H. Rep. No. 100-490, 100th Cong., 1st Sess 161. reprinted in 1988 U.S. Code Cong. & Admin. News 2959.

The words "bankruptcy proceeding" were deleted from the final enactment of the Act. The court interpreted the exclusion to mean that Congress intended to allow borrowers already in bankruptcy to be able to obtain the benefits of the 1987 Act.

The third inquiry under Cort v. Ash is whether "it is consistent with the underlying purpose of the legislative scheme to imply such a remedy for plaintiff." 422 U.S. at 78. In Leckband, the court expressly rejected the argument that enforcement should be limited to the Farm Credit Administration and implicitly found that Congress intended the plaintiffs to be protected by including borrowers' rights in the 1987 Act, and, accordingly, to have a cause of action to enforce those rights.

In Zajac, however, the court relied on Redd in holding that an implied cause of action does not exist under the 1987 Act. While the Zajac decision does not specifically discuss the cease and desist power, borrower's attorneys should expect that this aspect of the Redd decision will be relied on heavily by the Farm Credit System. See pages 35-40 for a discussion of the cease and desist powers of FCA in relationship to the implied cause of action issue.

The final Cort v. Ash test is whether the cause of action is "one traditionally relegated to state law, in an area basically the concern of the States, so that it would be inappropriate to infer a cause of action based solely on federal law." 422 U.S. at 78. FCS borrowers' rights have

been found to be matters that have not been traditionally relegated to state law. See Leckband, slip op. at 7.

15. RICO:

The federal RICO statute, 18 U.S.C.A. § 1961-68 (West 1984 & Supp. 1988), appears to offer a basis for federal jurisdiction over PCAs and FLBs. However, there are no reported successful RICO actions against a PCA or FLB. See Jacobson v. Western Montana Production Credit Association 643 F. Supp. 391 (D. Mont. 1986). See also, Criswell v. Production Credit Association, 660 F. Supp. 14 (S.D. Ohio 1985); Schroder v. Volcker, 646 F. Supp. 132 (D. Colo. 1986); Creech v. Federal Land Bank of Wichita, 647 F. Supp. 1097 (D. Colo. 1987); Federal Land Bank of Omaha v. Gibbs, 809 F.2d 493 (8th Cir. 1987); and Brekke v. Volcker, 652 F. Supp. 651 (D. Mont. 1987). At least one federal district court, in an unreported order in an action brought pro se, has held, without elaboration, that because Farm Credit System institutions are federal instrumentalities, they are immune from liability under RICO. Wiley v. Federal Land Bank of Louisville, No. IP 85-1441-C (S.D. Ind. March 31, 1987).

16. Other Theories

The following are other theories or claims which have been unsuccessfully asserted against system institutions:

(a) Purchase of stock.

FLBA and PCA required purchases of stock are valid requirements in order to obtain financing. Gregory v. Federal Land Bank of Jackson, 515 So. 2d 1200 (Miss. 1987).

(b) Renouncing citizenship.

A farmer's attempt to stop foreclosure by renouncing his U.S. citizenship was rejected in Federal Land Bank of Wichita v. Deatherage, 739 P.2d 905 (Colo. Ct. App. 1987).

(c) Land Patent.

Arguing that possession of an original land patent precludes foreclosure has been found to constitute a frivolous lawsuit under Rule 11 of the Federal Rules of Civil Procedure and warranted sanctions. Britt v. Federal Land Bank Association of St. Louis, 505 N.E.2d 387 (Ill. Ct. App. 1987), Federal Land Bank of Spokane v. Redwine, 755 P.2d 822 (Wash. Ct. App. 1988).

B. State Court Jurisdiction:

The amenability of Farm Credit System institutions to suits in state court on common law causes of action is beyond dispute. E.g., Boyster v. Roden, 628 F.2d 1121, 1125 (8th Cir. 1980); Bowling v. Block, 602 F. Supp. 667, 670 (S.D. Ohio 1985); Johansen v. Production Credit Association of Marshall-Ivanhoe, 378 N.W.2d 59, 62 (Minn. Ct. App. 1985).

C. Lender Liability:

For a discussion of various "lender liability" common law theories, see Flick and Replansky, Liability of Banks To Their Borrowers: Pitfalls and Protections, 1986 Banking L.J. 220; Bahls, Termination Of Credit For The Farm Or Ranch: Theories Of Lender Liability, 48 Mont. L. Rev. 213 (1987); Kelley, Some Observations On Lender Liability And Representing The Farmer/Borrower, Agric. Law Update 4 (Dec. 1986); Kelley, Imposing The Duties Of Fairness, Good Faith, And Honesty On The Agricultural Lender, Ark. L. Notes 18 (1987); Tyler, Emerging Theories Of Lender Liability In Texas, 24 Houston L. Rev. 411 (1987); Note, The Fiduciary Controversy: Injection Of Fiduciary Principles Into The Bank-Depositor And Bank Borrower Relationships, 20 Loyola L. Rev. 795 (1987). Further information on agricultural lender liability may be obtained by calling or writing Christopher Kelley, one of the authors of this outline. Lender liability litigation on behalf of borrowers against system institutions can be frustrating. For an example, see Lawrence v. Farm Credit System Capital Corporation, Nos. 87-167 and 87-168 (Wyo. Aug. 24, 1988) (available on Westlaw, ALL STATES database, 1988 WL 87780).

IV. MISCELLANEOUS MATTERS

A. Punitive Damages:

The prevailing view is that punitive damages are not awardable against a Farm Credit System institution although they are awardable against individual directors, officers, or employees of the institution.

1. The general rule is that a federal instrumentality enjoys immunity from suit unless it waives that immunity. In re Sparkman, 703 F.2d 1097, 1101 (9th Cir. 1983) (citing Federal Housing Administration v. Burr, 109 U.S. 242 (1940)).

2. Congress has waived immunity from suit for the Farm Credit System institutions by giving them the authority "to sue and be sued".
12 U.S.C.A. § 2013(4) (West Supp. 1988) (Farm Credit Banks);
12 U.S.C.A. § 2073(4) (West Supp. 1988) (PCAs); and
12 U.S.C.A. § 2093(4) (West Supp. 1988) (FLBAs).

3. However, a federal instrumentality "retains its immunity from punitive damages unless Congress explicitly authorizes liability for such damages." In re Sparkman, 703 F.2d at 1101 (emphasis in original); see also Smith v. Russellville Production Credit Association, 777 F.2d 1544, 1549-50 (11th Cir. 1985).

4. Several courts, including the Eighth Circuit, have held that the "sue and be sued" clause for PCAs does not waive immunity from punitive damages. In re Sparkman, 703 F.2d at 1101; Rohweden v. Aberdeen Production Credit Association, 765 F.2d 109, 113 (8th Cir. 1985); Accord Smith

v. Russellville Production Credit Association, 777 F.2d at 1549-50; see generally PCAs And Other Chameleons, 3 Agric. Law Update 1 (March 1986).

5. By analogy to the law governing federal and other public officers and employees, Farm Credit System directors, officers, or employees enjoy no immunity from punitive damage awards for unlawful acts or conduct outside the scope of their authority when they are sued in their individual capacities. E.g. Davis v. Passman, 442 U.S. 228 (1979); Hobson v. Wilson, 737 F.2d 1 (D.C. Cir. 1984), cert. denied, 105 S.Ct. 1843 (1985) (FBI agent held subject to punitive damages under 42 U.S.C.A. § 1985(3)). Attorneys representing borrowers should be aware that the bylaws of many FLBAs and PCAs forbids indemnification of directors, officers, and employees for liabilities arising out of the person's gross negligence or willful misconduct in the performance of official duties. Therefore, a suit against an individual based on gross negligence or willful misconduct is not, in effect, a suit against the institution. But see Reilly v. Production Credit Association of the Midlands, No. 11243 (Osceola Co., Iowa, Dist. Ct. Sept. 4, 1986) (holding that punitive damages were not awardable against a PCA employee sued in his capacity as an employee). The bylaws of System institutions are available to member-borrowers on request. 12 U.S.C.A. § 2200 (West Supp. 1988).

B. Discovery:

Rather than operating as a shield from discovery, the Farm Credit System regulations have been held "to disclose an intent to provide information in a court proceeding . . ." AgriVest Partnership v. Central Iowa Production Credit Association, 373 N.W.2d 479, 485 (Iowa 1985). In that litigation, the PCA declined to produce certain certain board minutes as requested by the plaintiff. The PCA asserted a privilege based on 12 C.F.R. § 618.8300 and 618.8320 (1985) which impose both specific and general confidentiality requirements.

In resolving the issue under an evidentiary rule similar to Rule 501 of the Federal Rules of Evidence, the court noted that "privileges should not be called into play merely because an agency, acting on only general authority, issues regulations declaring certain information privileges." 373 N.W.2d at 483 (citations omitted). From that point, the court reviewed other Farm Credit System regulations relating to the dissemination of information. It found that 12 C.F.R. § 618.8330 (1985), which authorizes employee testimony of production of documents "to the extent as under the conditions directed by the court," as counseling "greater liberality" than that shown by the PCA in the action before it. 323 N.W.2d at 485. Moreover, the court held that the regulations invoked by the PCA were not intended to apply to discovery requests, and that the PCA had no statutory or regulatory privilege. The court also declined to find a common law governmental privilege. 373 N.W.2d at 485-86.

In Minnesota, borrowers were successful in obtaining orders directing a PCA to turn over FCA examination reports,

relying on Agrivest. Rieks v. Production Credit Association of River Falls, No. 95566 (Dakota Co., Minn., Dist. Ct. December 11, 1986, and August 14, 1987) (orders compelling production of documents).

C. No Agency Relationship Between FLBs and FLBAs:

There is no agency relationship implied by law between a FLB and a FLBA within the FLB's district. The two are distinct and separate entities. Although the FLBAs accept applications to the district FLB for loans, the United States Supreme Court has held that an association could not be deemed the agent of the FLB in disbursing the proceeds of a loan. Federal Land Bank of Columbia v. Gaines, 290 U.S. 247, 254 (1933); see also Federal Deposit Insurance Corp. v. Langley, 792 F.2d 541, 548-49 (5th Cir. 1986) (FLB not bound by the misrepresentations and omissions of the president of an FLBA); Federal Land Bank of New Orleans v. Jones, 456 So. 2d 1, 5-10 (Ala. 1984). Nevertheless, the Farm Credit Banks (FLBs and FICBs prior to the Agricultural Credit Act of 1987) have the authority to supervise the associations within their respective districts and to "delegate to Federal land bank associations such functions as the bank determines appropriate." 12 U.S.C.A. §§ 2013(13) and (18) (West Supp. 1988).

D. Incorporation of Farm Credit System Regulations In Contract Documents:

Members of some PCAs will have signed a "Membership Agreement" in connection with their loan application. Paragraph 10 of one such agreement provides as follows:

> 10. One Agreement/Interpretation: The Agreement includes and incorporates all amendments and supplements hereto, and all

> notes, security instruments, documents, and other writings submitted by Debtor to PCA in connection with this Agreement. Neither debtor nor the PCA shall be bound by any agreement or undertaking, nor shall this Agreement be amended or supplemented except as expressed in writing and signed by the party against whom enforcement is sought. The invalidity or unenforceability of any term or provision of this Agreement shall not affect the validity or enforceability of the remaining terms and provisions hereof.
>
> This Agreement and the transactions between the Debtor and PCA shall be governed by the Farm Credit Act of 1971 as amended, the Regulations adopted thereunder, the PCA bylaws and, where not inconsistent, applicable state law.

That agreement provision appears to contemplate that all existing and future provisions of the Farm Credit Act of 1971 and the regulations promulgated under it are incorporated into the terms of the contractual relationship between borrower-members and the PCA. If so, then any failure by the PCA to abide by the Act or the regulations would be a breach of contract. This may be one way for the borrower to avoid the obstacles inherent in attempting to assert claims based on violations of the regulations under an implied cause of action theory. However, such an attempt was rebuffed in Production Credit Association of Worthington v. Van Iperen, 196 N.W.2d 35, 38 (Minn. Ct. App. 1986). Because the court's analysis with respect to that aspect of the case in Van Iperen was cursory and poorly developed, the decision is virtually worthless as precedent. However, on the subject of incorporation of regulations into contract documents, see Smithson v. United States, 847 F.2d 791 (Fed. Cir. 1988).

E. Negligent Failure To Follow Loan Policies

The Eighth Circuit and the Minnesota Court of Appeals each recently rejected the argument that a PCA's internal policies set a standard of conduct that creates a cause of action based on common-law negligence if the policies are not followed. Overvaag v. Production Credit Associations of the Midlands, No. 87-5332 (8th Cir. March 7, 1988); Ebenhoh v. Production Credit Association of Southeast Minnesota, 426 N.W.2d 490 (Minn. Ct. App. 1988). It should be noted that the argument advanced by the borrowers in each of these cases overlooked the fundamental premise that tort duties are created by the law, not a lender's internal policies. For a properly developed negligence claim, see Jacques v. First National Bank of Maryland, 307 Md. 527, 515 A.2d 756 (Md. Ct. App. 1986).

V. THE FARM CREDIT SYSTEM'S FICUCIARY DUTY TO ITS MEMBER-BORROWERS

In several recently reported actions, Farm Credit System borrowers have advanced claims premised on the assertion that the FLBA or the PCA of which they were a member owed them a fiduciary duty. The alleged sources of that duty have varied. For example, in Boyster v. Roden, 628 F.2d 1121 (8th Cir. 1980), the plaintiff-borrowers sought to sustain federal question jurisdiction on the assertion that the White River PCA in Newport, Arkansas, owed them a fiduciary duty as a matter of federal common law. The borrowers alleged that the duty was breached when the

PCA disclosed confidential information about the borrowers to a third-party. In support of their claim, the borrowers argued that the various Farm Credit Administration regulations specifying the standards of conduct for system officers and employees coupled with the "pervasive involvement of the federal government" in the creation and operation of PCAs established that the federal interest was of such a nature as "to require that the fiduciary responsibilities of production credit association officers and directors be governed by a body of federal common law rather than state law." 628 F.2d at 1123-24.

In rejecting the borrowers' claim, the Eighth Circuit held as follows:

> We are not persuaded that the substantial federal interest in successful operation of the Farm Credit System will be impaired by application of state law to appellants' claims. Even if the fiduciary law varies somewhat from state to state, no burden to the System is perceived; each production credit association is a separate entity with a local situs, and its business transactions are with farmers and ranchers in its locale.

628 F.2d at 1125. The court indicated, however, that the regulations imposing certain standards of conduct on System employees, specifically, 12 C.F.R. § 612.2110 and 612.2160(b), could "probably be used by appellants as evidence in a trial of their claim under state law." 628 F.2d at 1125, n.5.

Boyster v. Roden was followed in Hartman v. Farmers Production Credit Association of Scottsburg, 628 F. Supp. 218 (S.D. Ind. 1983). There, the borrowers had asserted various claims against the PCA including a claim based on an assertion of

an implied right of action under the Farm Credit Act of 1971. In rejecting the borrower's argument that the purpose of the Farm Credit Act would be frustrated if a private cause of action was not implied, the court concluded that the borrower's state law remedies, including a claim for breach of fiduciary duty, would adquately protect the borrower's rights. 628 F. Supp. at 222. Accord Birbeck v. Southern New England Production Credit Association, 606 F. Supp. 1030, 1034-44 (D. Conn. 1985); Bowling v. Block, 602 F. Supp. 667, 672, n.3 (S.D. Ohio 1985); Apple v. Miami Production Credit Association, 614 F. Supp. 119, 122 (S.D. Ohio 1985); Spring Water Dairy, Inc. v. Federal Intermediate Bank of St. Paul, 625 F. Supp. 713, 720 (D. Minn. 1986).

In Umbaugh Pole Building Co., Inc. v. Scott, 58 Ohio St.2d 282, 390 N.E.2d 320 (1979), the borrowers sought to establish that a PCA owed them a fiduciary duty, apparently as a result of the course of dealing between the borrowers and the PCA arising from a series of loans during a two year period. Although the trial court found that a fiduciary relationship existed, the Supreme Court of Ohio reversed that finding.

In reaching its decision, the court in Umbaugh noted that, ordinarily, the relationship between a debtor and creditor is not a fiduciary relationship. Nevertheless, a fiduciry relationship may be created out of an informal relationship, but "only when both parties understand that a special trust or confidence has been reposed." 390 N.E.2d at 323. When the court examined the dealings between the borrowers and the PCA, it concluded as follows:

> There was no property or interest of the Scotts entrusted to the association. The only basis for the finding of the fiduciary relationship was the association's giving of advice and counseling to the Scotts relevant to their loans and business activities. But here the offering and giving of advice was insufficient to create a fiduciary relationship. While the advice was given in a congenial atmosphere and in a sincere effort to help the Scotts prosper, nevertheless, the advice was given by an institutional lender in a commercial context in which the parties dealt at arms length, each protecting his own interest.
>
> * * * *
>
> There was no promise for a continuing line of credit, and while a limited amount of advice and counseling was given, this did not vitiate the business relationship because neither party had, nor could have had, a reasonable expectation that the creditor would act solely or primarily on behalf of the debtor. Also, the rendering of advice by the creditor to the debtors does not transform the business relationship into a fiduciary relationship. The borrowers could not reasonably believe that the association was acting in a fiduciary capacity.

390 N.E.2d at 323. (citations omitted)

The law in Ohio has changed since the Umbaugh decision. In Stone v. Davis, 66 Ohio St.2d 74, 419 N.E.2d 1094, cert. denied, 454 U.S. 1081 (1981), the Ohio Supreme Court made a distinction between loan negotiation and "loan processing" in characterizing the relationship between the lender and borrowers. At issue was a mortgage lender's failure to advise and assist the borrowers in procuring mortgage insurance. In essence, the court found that the relationship between the parties changed after the loan agreement was completed and the loan transaction entered the processing or servicing state. In the court's words,

> [t]he facts surrounding and the setting in which a bank gives advice to a loan customer on the subject of mortgage insurance warrant a conclusion that, in this aspect of the mortgage loan process, the bank acts as its customer's fiduciary and is under a duty to fairly disclose to the customer the medhanics of procuring such insurance.
>
> We observe that, while a bank and its customer may be said to, stand at arm's length in negotiating the terms and conditions of a mortgage loan, it is unrealistic to believe that this equality of position carries over into the area of loan processing, which customarily includes advising the customer as to the benefits of procuring mortgage insurance on the property which secures the bank's loan.

390 N.E.2d at 1098; Walters v. First National Bank of Newark, 69 Ohio St.2d 677, 433 N.E.2d 608 (1982) ("The fiduciary nature . . . of the bank-customer relationship is predicated upon the bank's superior conversance with the area of loan processing . . . ." 433 N.E.2d at 610). The reasoning of the Ohio Supreme Court in Stone v. Davis is beneficial to borrowers in that most breaches of the lender's duties of honesty, disclosure, good faith, and fair dealing occur in the loan servicing stage.

In Jacobson v. Western Montana Production Credit Association, 643 F. Supp. 391 (D. Mont. 1986) a PCA was held to a fiduciary standard in its dealings with a borrower. However, in that case, unlike the allegations based solely on a lender-borrower relationship as in Umbaugh, the borrower alleged that the fiduciary relationship existed as a result of the PCA's involvement with a commodities broker in advising the borrower to participate in a futures trading venture. Under those circumstances, the court found that the "obligation of the PCA was

that of a fiduciary and the law would imply a duty to use reasonable care in giving of advice." 643 F. Supp. at 395.

In Production Credit Association of Lancaster v. Croft, 423 N.W.2d 544 (Wis. Ct. App. 1988), the borrowers attempted to establish that the PCA owed them a fiduciary duty and that the PCA was negligent in making loans to the borrowers which the PCA knew the borrowers could not repay. The trial court granted the PCA summary judgment and the borrowers appealed. On appeal, the Crofts argued that the PCA owed them a fiduciary duty which was implied in law because (1) the loan agreements gave the PCA control of the repayment requirements and (2) there was a great disparity in knowledge and experience between PCA and the Crofts. The court held that the loan agreement did not create a fiduciary relationship because the provisions in the agreement which appeared to give the PCA control were necessary to protect PCA's interest in the collateral. The court also held that the advice offered by the PCA to the Crofts did not create a fiduciary relationship because the advice was not outside of what a lender would normally offer in protecting its interests. In reaching its decision, the court relied heavily on Bahls, Termination of Credit For The Farm Or Ranch: Theories of Lender Liability, 48 Mont. L. Rev. 213, 232 (1987)("So long as the farmer makes his or her own business decisions and the advice given by the lender is nothing more than optional advice or is reasonably related to protection of the lender's interest in its collateral, lenders should not be treated as having a fiduciary responsibility to the borrower.")

A review of the foregoing cases reveals at least the following three points pertaining to the PCA's and FLBA's fiduciary obligations, if any:

1. There is no federal common law fiduciary duty for PCAs and FLBSs, and any fiduciary obligation will arise solely under state law;

2. When the PCA or FLB/FLBA is characterized simply as a lender in a lender-borrower relationship, "extraordinary circumstances" must be present before a fiduciary relationship will arise; and

3. If a PCA or FLBA acts as a financial advisor or a broker, or in some other capacity where the law will ordinarily impose a fiduciary relationship, the PCA or FLBA will be treated no differently than any other entity so acting. (Note that Farm Credit Banks, FLBAs, and PCAs are authorized to provide financial services to borrowers. 12 U.S.C.A. §§ 2020, 2093(15), and 2076 (West Supp. 1988)). See also Federal Land Bank of St. Paul v. Asbridge, 414 N.W.2d 596 (N.D. 1987).

With regard to a fiduciary obligation of Farm Credit System officers and directors to their respective institutions and shareholders, both Congress and the Farm Credit Administration Board have acknowledged that a fiduciary duty may be imposed under state law. For example, 12 U.S.C.A. § 2264(a) (West Supp. 1988) provides that an institution's officers and directors may be removed from office by the Farm Credit Administration for a "breach of fiduciary duty as such director or officer." Similarly, the Farm Credit Administration Board, in supporting certain regulations requiring financial disclosures by FCS

officers and directors, has asserted that "such disclosure is needed to provide shareholders with sufficient information to hold directors and officers accountable for the performance of their fiduciary duties . . ." 51 Fed. Reg. 42084-085 (1986).

It is unlikely that any Farm Credit System institution would contend that its officers and directors do not owe a fiduciary duty to the institution. Of course, because the system is a cooperative entirely owned by its member-borrowers, the borrowers are the "institution." Moreover, because PCAs and FLBAs are cooperatives, they are subject to a body of law that applies only to cooperative associations and not to other entities such as corporations. See e.g., Knox National Farm Loan Association v. Phillips, 300 U.S. 194 (1937).

Cooperatives owe unique duties to their members. As expressed in a widely recognized treatise on agricultural cooperatives, "the relationship between the members and the [cooperative] association is much more intimate and personal than that between other corporations and their stockholders." Legal Phases Of Farmers Cooperative, 10-11, Farmer Cooperative Service, USDA (1976) (hereinafter, "Legal Phases").

This "more intimate and personal" relationship between a cooperative's members and the cooperative institution arises from the basic aim of a cooperative "to create 'a union of men, not a union of capital, as does the ordinary commercial corporation." E. Nourse, The Legal Status Of Agricultural Co-Operation, 268 (1927). Thus, ". . . it is particularly important to remember that the [cooperative] association is an organization of individuals rather than a mere abstract and impersonal entity.

The personal character of the ownership in a cooperative is one of the main distinctions between the cooperative and the ordinary corporation." I. Packel, The Law Of The Organization And Operation Of Cooperatives, 81-82 (2nd ed. 1947); see generally Note, Legal Aspects of Cooperative Organizational Structure, 27 Ind. L.J. 377 (1952)

The unique relationship between a cooperative and its members has led some courts to impose, as a matter of law, fiduciary obligations on officers of marketing cooperatives in their dealings with cooperative members. E.g., Rhodes v. Little Falls Dairy Co., Inc., 230 App. Div. 571, 245 N.Y.S. 432, 434-35 (1930), aff'd 256 N.Y. 559, 177 N.E. 140 (1931); see also Snyder v. Colwell Cooperative Grain Exchange, 231 Iowa 1210, 3 N.W.2d 507 (1942)(ruling that a cooperative has a duty to each member to fully disclose all material facts regarding the cooperative and that member's dealings with the cooperative.) To some extent, the imposition, as a matter of law, of fiduciary duties on marketing cooperatives may be motivated by the fact of the entrustment of the member's crop with the cooperative for marketing purposes. If that is the case, then a different basis will need to be found for imposing a fiduciary duty on non-marketing cooperatives such as financial or lending cooperatives as are the institutions of the Farm Credit System.

The authors of this outline are currently preparing an analysis of the law governing the relationship between a cooperative and its members. The working thesis is that there is, as a matter of law, a fiduciary obligation on the part of a

cooperative towards its members. In large part, that obligation flows from the following seven criteria or hallmarks of a cooperative:

> 1. [t]he basic purpose of cooperatives is to render economic benefits to members;
>
> 2. [c]ooperatives are organized around the mutual interest of members;
>
> 3. [r]isks, costs, and benefits are shared 'equitably' among members;
>
> 4. [c]ooperatives are non-profit enterprises in the sense that they are organized for the economic benefit of members as users of the cooperatives' services and not to make profits for the cooperatives as legal entities or for their members as investors;
>
> 5. [c]ooperatives are democratically controlled;
>
> 6. [m]embers of cooperatives have an obligation to patronize their cooperative; and
>
> 7. [c]ooperatives do business primarily with members.

Legal Phases, at 4. For example, in considering those attributes, because cooperatives are nonprofit organizations in the sense that they operate at cost, it has been held that "the cooperative stands in the relationship of a trustee to the members." White, The Farmer and His Cooperative, 7 Kansas L. Rev. 334, 335 (1959)(citing San Joaquin Valley Poultry Producers v. Comm'r, 136 F.2d 382 (9th Cir. 1943); see also Bakken, Principles And Their Role In The Statutes Relating To Cooperatives, 1954 Wis. L. Rev. 550, 559. Thus, the nature of cooperatives, coupled with increasing judicial recognition that lending institutions should be held to a higher standard than the law of the marketplace,

strongly suggests that the cooperative institutions of the Farm Credit System would be held to a high standard of care in their dealings with their members in a properly presented case. See Barrett v. Bank of America, 183 Cal. App. 3d 1362, 229 Cal. Rptr. 16 (1986) (holding the relationship between a bank and its borrower to be "at least quasi-fiduciary." 182 Cal. App. 3d at 1369, 229 Cal. Rptr. at 20); Lash v. Cheshire County Savings Bank, 474 A.2d 980 (N.H. 1984) (upholding a jury finding of a commercial bank's breach of fiduciary duty).

Of current concern to many FCS borrowers is the standard of care that a cooperative owes to its members when the cooperative seeks to expel a member from the cooperative. When a member is in default on a loan from a PCA, Farm Credit Bank, or FLBA, the member's stock in the PCA or FLBA is subject to liquidation. 12 U.S.C.A. §§ 2094(k) and 2097 (West Supp. 1988). Liquidation of the stock effectively expels the members from the cooperative.

Courts have consistently held that a cooperative seeking to expel a member must act fairly and in good faith. In essence, courts have resolved cooperative expulsion issues on the basic principle that "[a] private organization, especially if it has some public stature or purpose, may not expel or discipline a member and adversely affect substantial property, contract, or other economic rights unless such action results from proceedings conducted in an atmosphere of good faith and fair play." Copeland, Expulsion of Members by Agricultural Cooperatives, J. Agric. Cooperation, 76, 82 (1986); see also Developments in the Law - Judicial Control Of Actions Of Private Associations, 76 Harv. L. Rev. 983 (1963). The significance of the judicially

imposed standards of good fair and fair play in the context of expelling member-borrowers from Farm Credit System institutions is that those standards may afford the basis for enforcing or challenging the institution's consideration of the borrower for loan restructuring under 12 U.S.C.A. § 2202(a) (West Supp. 1988). See also Federal Land Bank of St. Paul v. Overboe, 404 N.W.2d 445 (N.D. 1987); Benson Cooperative Creamery Association v. First District Association, 151 N.W.2d 422 (Minn. 1967)(holding that a cooperative member who is wrongfully expelled from a cooperative may recover for any resulting damages from that wrongful expulsion.)

VI. FARM CREDIT SYSTEM BORROWER RIGHTS

As a result of the Farm Credit Amendments Act of 1985 and the Agricultural Credit Act of 1987, borrowers from System institutions have statutory rights in the following areas:

1. protection of stock;
2. disclosure of interest rates and related information;
3. access to certain documents and information;
4. written notice on loan applications and review of loan application denials;
5. protection from foreclosure when loan obligations are current;
6. written notice of loan restructuring policies and review of loan restructuring denials;

7. prohibition against waiver of mediation rights;

8. rights of first refusal on land acquired by an institution from a borrower as a result of foreclosure or certain voluntary conveyances;

9. review of System lender decisions establishing the interest rate applied to a loan;

10. application of funds in uninsured accounts to borrower's outstanding loans; and

11. use of FmHA guaranteed loans or other state or federal loan programs in restructuring.

Proposed regulations implementing the rights created by the Agricultural Credit Act of 1987 were published on May 12, 1988, at 53 Fed. Reg. 16934-16947 (1988). The final regulations appear at 53 Fed. Reg. 35427-458 (1988). Descriptive summaries of the borrowers' rights provisions of the Agricultural Credit Act of 1987 can be found in N. Hamilton, Borrowers' Rights And The Agricultural Credit Act of 1987: A Guide For Farmers Home Administration And Farm Credit System Borrowers And Their Attorneys, (Jan. 1988) available for $10.00 from the Agricultural Law Center, Drake University School of Law, Des Moines, Iowa, 50311, and Special Report On The Agricultural Credit Act of 1987, Farmers Legal Action Report (Jan.-Feb. 1988) available for $10.00 from the Farmers' Legal Action Group, Inc., 1301 Minnesota Building, 46 East Fourth Street, St. Paul, Minnesota 55101.

CAVEAT: This outline was prepared under a September 15, 1988, deadline. The discussion that follows was completed contemporaneously with FCA Board's adoption of final rules relating to borrowers' rights. Time constraints precluded

extensive discussion of those rules and the comments accompanying them. Accordingly, a reading of the discussion that follows should be supplemented with a careful reading of those rules and comments.

A. Protection of Borrower Stock

"Eligible borrower stock" in a system institution must be retired at par value. 12 U.S.C.A. § 2162(a) (West Supp. 1988). The term "eligible borrower stock" is defined as follows:

> (a) is outstanding on January 6, 1988;
>
> (b) is required to be purchased, and is purchased, as a condition of obtaining a loan made after January 6, 1988, but prior to the earlier of--
>
> (i) in the case of each bank and association, the date of approval, by the stockholders of such bank or association, of the capitalization requirements of the institution in accordance with section 4.9B; or
>
> (ii) the date that is 9 months after January 6, 1988;
>
> (c) was, after January 1, 19833, but before January 6, 1988, frozen by an institution that was placed in liquidation; or
>
> (d) was retired at less than par value by an institution that was placed in liquidation after January 1, 1983, but before January 6, 1988.

12 U.S.C.A. § 2162(d)(2) (West Supp. 1988).

B. Disclosure of Interest Rates and Related Information

The stock purchase requirement for system loans increases the equivalent annual rate by one-half to two percentage points depending on the level of the stock requirement, the

interest rate, whether "automatic or end-of-period cancellation" is used, and other factors. LaDue, Influence of the Farm Credit System Stock Requirement on Actual Interest Rates, 43 Agric. Finance Rev. 50 (1983). Prior to the 1985 Act, that increased cost was not always disclosed to borrowers. Enacted in 1985 and amended by the 1987 Act, 12 U.S.C.A. § 2199(a) (West Supp. 1988) requires that system lenders provide borrowers with "meaningful and timely disclosure not later than the time of the loan closing of:

> (1) the current rate of interest on the loan;
>
> (2) in the case of an adjustable or variable rate loan, the amount and frequency by which the interest rate can be increased during the term of the loan or, if there are no such limitations, a statement to that effect, and the factors (including, but not limited to, the cost of funds, operating expenses, and provision for loan losses) that will be taken into account by the lending institution in determining adjustments to the interest rate;
>
> (3) the effect, as shown by a representative example or examples, of the required purchase of stock or participation certificates in the institution on the effective rate of interest; and
>
> (4) any change in the interest rate applicable to the borrower's loan.
>
> (5) except with respect to stock guaranteed under section 2162 of this title [protection of borrower stock], a statement indicating that stock that is purchased is at risk; and
>
> (6) a statement indicating the various types of loan options available to borrowers, with an explanation of the terms and borrowers' rights that apply to each type of loan.

Under 12 U.S.C.A. § 2199(b) (West Supp. 1988), system lenders that offer more than one rate of interest to borrowers, often referred to as interest rate "tiers", must, at the request of a borrower holding a loan, provide the following information:

> (1) provide a review of the loan to determine if the proper interest rate has been established;
>
> (2) explain to the borrower in writing the basis for the interest rate charged; and
>
> (3) explain to the borrower in writing how the credit status of the borrower may be improved to receive a lower interest rate on the loan.

(The regulations governing disclosure of loan information will be codified at 12 C.F.R. Part 614, Subparts K and L, consisting of §§ 614.4365-614.4368 and 614.4440-614.4444.)

C. Access To Certain Documents and Information

The 1985 Act added 12 U.S.C.A. § 2200 (West Supp. 1986) to provide as follows:

> In accordance with regulations of the Farm Credit Administration, System institutions shall provide their borrowers, at the time of execution of loans, copies of all documents signed or delivered or by the borrower and at any time, on request, a copy of the institution's articles of incorporation or charter and bylaws.

That provision and other borrowers' rights provisions and regulations prompted the only farmer on the Farm Credit Administration Board to comment, "I think it's a shame when the FCA has to issue regulations to ensure the rights of stockholders as loan applicants." AgriFinance, Dec. 1966, at 12. That

statement is most telling when it is noted that an act of Congress was required to give borrowers access to loan documents that they had signed. Therefore, many observers of Farm Credit System behavior were not surprised when Congress chose to act again in 1987 to expand section 2200 to give borrowers the right to receive "copies of each appraisal of the borrower's assets made or used by the qualified lender." 12 U.S.C.A. § 2200 (West Supp. 1988).

D. Written Notice On Loan Applications And Review Of Loan Application Denials

12 U.S.C.A. § 2201(a) (West Supp. 1988) provides as follows:

> Each qualified lender to which a person has applied for a loan shall provide the person with prompt written notice of--
>
> (1) the action on the application;
>
> (2) if the loan applied for is reduced or denied, the reasons for such action; and
>
> (3) the applicant's right to review under section 2202 of this title.

(The regulations governing notice of action on loan applications will be codified at 12 C.F.R. § 614.4441.)

If an application for a loan is denied, the applicant may request a review of that denial before the institution's credit review committee. The institution must be the lender with the "ultimate decision making authority on the loan" 53 Fed. Reg. 34527, 35453 (1988) (to be codified at 12 C.F.R. § 614.4442). The request must be made in writing within 30 days "after receiving a notice denying or reducing the amount of the loan application. 12 U.S.C.A. § 2202(b)(1) (West Supp. 1988).

The institution's credit review committee is usually composed of three individuals. It must include a farmer board member. 12 U.S.C.A. § 2202(a)(1) (West Supp. 1988). "The duties of the members of the review committees may not be delegated to any other person, except that the credit review committee duties of the board member may be performed from time to time by an alternate designated by the board who shall also be a board member." 52 Fed. Reg. 45162-63 (1987) (to be codified at 12 C.F.R. § 614.4442); see also 53 Fed. Reg. 34527, 35453 (1988). A loan officer who was involved in the initial decision on a loan may not serve on the credit review committee reviewing that loan. 12 U.S.C.A. § 2202(a)(2) (West Supp. 1988). However, that loan officer may "participate" in the review to answer questions but may not "serve" on the committee by being present or voting in the final deliberations. See 53 Fed. Reg. 35427, 35436 (1988). The borrower has a right to appear before the credit review committee and may be accompanied by an attorney or other representative. 12 U.S.C.A. § 2202(e) (West Supp. 1988).

In the prefatory comments of the Farm Credit Administration preceding the publication of the current regulations governing credit review committee procedures in the Federal Register, the FCA noted that "[t]he regulation does not change the existing review practices of System institutions, which is not to accept any information in a review that is not included in an application." 51 Fed. Reg. 39,494 (1986). For that reason, the initial application should contain all of the basic information that the applicant will desire to use to support his claim in the review process should review become necessary. See 12 C.F.R. § 614.4443 (1988).

Unsuccessful applicants for a loan who appeal to the credit review committee may include in their request for review a request for an independent appraisal of any interests in property securing the loan other than the stock held by the borrower in the institution. 12 U.S.C.A. § 2202(d)(1) (West Supp. 1988). The procedure for obtaining the independent appraisal is as follows:

> Within 30 days after a request for an appraisal under paragraph (1), the credit review committee shall present the borrower with a list of three appraisers approved by the appropriate qualified lender from which the borrower shall select an appraiser to conduct the appraisal the cost of which shall be borne by the borrower and shall consider the results of such appraisal in any final determination with respect to the loan.

U.S.C.A. § 2202(d)(2) (West Supp. 1988). A copy of the appraisal must be provided to the borrower. 12 U.S.C.A. § 2202(d)(3) (West Supp. 1988).

"Promptly" after a review by a credit review committee, the committee must notify the applicant in writing of its decision and the reasons for that decision. 12 U.S.C.A. § 2202(e) (West Supp. 1988). See 53 Fed. Reg. 35427, 35453 (1988) (to be codified at 12 C.F.R. § 614.4443(d)).

E. Protection From Foreclosure When Loan Obligations Are Current

The Agricultural Credit Act of 1987 added a new provision that prohibits system institutions from foreclosing on any loan "because of the failure of the borrower thereof to post additional collateral, if the borrower has made all accrued payments of principal, interest, and penalties with respect to the loan." 12 U.S.C.A. § 2202d(a) (West Supp. 1988). In addition, 12 U.S.C.A. §§ 2202d(b) and (c) (West Supp. 1988) provide as follows:

(b) Prohibition against required principal reduction

A qualified lender may not require any borrower to reduce the outstanding principal balance of any loan made to the borrower by any amount that exceeds the regularly scheduled principal installment payment (when due and payable), unless--

(1) the borrower sells or otherwise disposes of part or all of the collateral; or

(2) the parties agree otherwise in a written agreement entered into by the parties.

(c) Nonenforcement

After a borrower has made all accrued payments of principal, interest, and penalties with respect to a loan made by a qualified lender, the lender shall not enforce acceleration of the borrower's repayment schedule due to the borrower having not timely made one or more principal or interest payments.

(See 53 Fed. Reg. 35427, 35454 (1988) (to be codified at 12 C.F.R. § 614.4514).

The 1987 Act also affords borrowers certain rights with respect to the placing of a loan in nonaccrual status. Specifically, 12 U.S.C.A. § 2202d(d) (West Supp. 1988) provides as follows:

(d) Placing loans in nonaccrual status

(1) Notification

If a qualified lender places any loan in nonaccrual status, the lender shall document such change of status and promptly notify the borrower thereof in writing of such action and the reasons therefore.

(2) Review of denial

If the borrower was not delinquent in any principal or interest payment under the loan at the time of such action and the borrower's request to have the loan placed back into accrual status is denied, the borrower may obtain a review of such denial before the appropriate credit review committee under section 2202 of this title.

(3) Application

This subsection shall only apply if a loan being placed in nonaccrual status results in an adverse action being taken against the borrower.

(See, 53 Fed. Reg. 35427, 35454 (1988) (to be codified at 12 C.F.R. § 614.4514(d))

F. Written Notice Of Loan Restructuring Policies And Review Of Loan Restructuring Denials

The Agricultural Credit Act of 1987 imposed new "mandatory" restructuring requirements on system lenders. The requirements are mandatory in the sense that an institution desiring to foreclose on a distressed loan must, except in limited circumstances, notify the borrower of the right to apply for restructuring not later than 45 days before commencing foreclosure proceedings, and, after consideration of such an application, the institution must restructure the loan if the "cost" of the proposed restructuring plan is equal to or less than the "cost" of foreclosure. The regulations governing restructuring appear at 53 Fed. Reg. 35427, 35454 (1988) (to be codified at 12 C.F.R. Part K, Subpart N, consisting of §§ 614.4512 and 614.4514-4522).

As a threshhold matter, "restructuring" is broadly defined as follows:

> The terms "restructure" and "restructuring" include rescheduling, reamortization, renewal, deferral of principal or interest, monetary concessions, and the taking of any other action to modify the terms of, or forbear on, a loan in any way that will make it probable that the operations of the borrower will become financially viable.

12 U.S.C.A. § 2202a(7) (West Supp. 1988). (See 12 U.S.C.A. § 2202b (West Supp. 1988) for the effect of restructuring on the borrower's stock in the institution.) A borrower seeking to have a loan restructured must apply in writing on forms provided by the institution and, where appropriate, must support the proposed restructuring plan with "sufficient financial information and repayment projections." 12 U.S.C.A. § 2202(a)(1) (West Supp. 1988).

The general criteria for evaluating a restructuring proposal are as follows:

> When a qualified lender receives an application for restructuring from a borrower, the qualified lender shall determine whether or not to restructure the loan, taking into consideration--
>
> (a) whether the cost to the lender of restructuring the loan is equal to or less than the cost of foreclosure;
>
> (b) whether the borrower is applying all income over and above necessary and reasonable living and operating expenses to the payment of primary obligations;
>
> (c) whether the borrower has the financial capacity and the management skills to protect the collateral from diversion, dissipation, or deterioration;
>
> (d) whether the borrower is capable of working out existing financial difficulties, reestablishing a viable operation, and repaying the loan on a rescheduled basis; and

> (e) in the case of a distressed loan that is not delinquent, whether restructuring consistent with sound lending practices may be taken to reasonably ensure that the loan wil not become a loan that it is necessary to place in nonaccrual status.

12 U.S.C.A. § 2202a(d)(1) (West Supp. 1988). Of those five criteria, the initial two warrant explanation and discussion.

A comparison of the "cost of foreclosure" with the "cost of restructuring" is at the core of the evaluation process. Indeed, because 12 U.S.C.A. § 2202a(e)(1) (West Supp. 1988) provides that:

> [i]f a qualified lender determines that the potential cost to a qualified lender of restructuring the loan in accordance with a proposed restructuring plan is less than or equal to the potential cost of foreclosure, the qualified lender shall restructure the loan in accordance with the plan,

the comparison may be determinative.

"Cost of foreclosure" is specifically defined as follows:

> The term "cost of foreclosure" includes--
>
> (a) the difference between the outstanding balance due on a loan made by a qualified lender and the liquidation value of the loan, taking into consideration the borrower's repayment capacity and the liquidation value of the collateral used to secure the loan;
>
> (b) the estimated cost of maintaining a loan as a nonperforming asset;
>
> (c) the estimated cost of administrative and legal actions necessary to foreclose a loan and dispose of property acquired as the result of the foreclosure, including attorneys' fees and court costs;

> (d) the estimated cost of changes in the value of collateral used to secure a loan during the period beginning on the date of the initiation of an action to foreclose or liquidate the loan and ending on the date of the disposition of the collateral; and
>
> (e) all other costs incurred as the result of the foreclosure or liquidation of a loan.

12 U.S.C.A. § 2202a(a)(2) (West Supp. 1988). "Cost of restructuring", or the computation of it, takes into account "all relevant factors" including the following:

> (a) the present value of interest income and principal forgone by the lender in carrying out the restructuring plan;
>
> (b) reasonable and necessary administrative expenses involved in working with the borrower to finalize and implement the restructuring plan and cash-flow analysis taking into account income from all sources to be applied to the debt and all assets to be pledged, showing a reasonable probability that orderly debt retirement will occur as a result of the proposed restructuring; and
>
> (d) whether the borrower has furnished or is willing to furnish complete and current financial statements in a form acceptable to the institution.

12 U.SA.C.A. § 2202a(e)(2) (West Supp. 1988).

Because the "cost of restructuring" considers "the present value of interest income and principal forgone by the lender in carrying out the restructuring plan", the conceptual approach to restructuring under the 1987 Act has generated confusion and questions as to whether Congress intended that the System apply traditional approaches to restructuring.

Traditionally, most lenders and borrowers have used the recovery value of the assets securing the note together with any other unencumbered, nonexempt assets as the benchmark for assessing the propriety of restructuring. If the borrower could "cash flow" a restructured note that had a present value equal to or greater than the value of the recoverable assets, then the lender could justify restructuring on the grounds that the restructured note would pay the same sum than the lender would realize through foreclosure or in a Chapter 12 bankruptcy proceeding.

Although each of the Farm Credit districts are operating under the same statute and essentially the same restructuring policies, at least three different approaches to computing the appropriateness of restructuring appear to be in use. One approach, apparently employed only by the Seventh Farm Credit District based in St. Paul, Minnesota, is discussed in detail in this outline. Described charitably, the Seventh Farm Credit District's approach is nonsensical. As can be seen by examining the worksheets and their accompanying instructions set forth in this outline, the Seventh Farm Credit District determines the cost of restructuring essentially by subtracting the present value of the proposed restructured note from the present value of the outstanding principal and interest on the original note computed at an interest rate, currently 12.5 percent, that is higher than the discount rate, currently 9 percent. In effect, the computational formula used by the Seventh Farm Credit District allows the sum of money owed on the original rate that will never be paid, under any circumstances, to be the reference point for comparing all other costs. Under traditional, commonsense

approaches to restructuring, the reference point is the recovery value of the collateral together with any other recoverable assets, not a sum of money that the borrower is unable to repay.

No other districts appear to be following the Seventh Farm Credit District's approach. Most appear to be using a liquidation analysis. A liquidation analysis first determines the recovery value of any collateral and/or other recoverable assets. Next, it determines the present value of the proposed restructured note. Finally, it compares the recovery value of the assets with the present value of the proposed restructured note. To the extent that other districts incorporate into their analysis "the present value of interest income and principal forgone by the lender in carrying out the restructuring plan," those districts compute that figure under both the cost of foreclosure and the cost of restructuring so that the the sum is "cancelled out". In that way, the restructuring decision is not based on the sum of money that the borrower is unable to repay and that will never be recovered by the institution. However, at least one court has ruled that the 1987 Act "does not mandate the restructuring of the debt at the liquidation value of the collateral." In re Bellman, 86 Bankr. 1016, 1022 (Bankr. D.S.D. 1988).

At least one of the districts, the Fifth Farm Credit District based in Jackson, Mississippi, appears to be using what might be described as an "institutional cash flow analysis" approach to restructuring. The analysis has many of the same features of a liquidation analysis, but it also incorporates the institution's "cost of funds" in the computations. A copy of the

relevant portions of the Fifth Farm Credit District's restructuring manual is appended to this outline as Appendix B.

Although the authors of this outline have examined restructuring "worksheets" given to borrowers by System institutions in a number of districts, the authors only have copies of the internal restructuring manuals for the St. Paul and Jackson districts. Because the authors reside in the St. Paul district, that district's restructuring formula is the focus of this outline. Readers who represent borrowers in other districts may find common issues in the discussion that follows, but they should be aware that St. Paul may be the only district employing the formula discussed.

Currently, borrowers seeking to apply for restructuring are encountering at least two practical difficulties. First, the computational process contemplated by the restructuring provisions of the 1987 Act are not discernable from anything less than a laborious, time-consuming reading of the statute. The restructuring policies issued to date pursuant to 12 U.S.C.A. § 2202 a(g) (West Supp. 1988) and provided to borrowers as a part of the restructuring application "packet" generally parrot the language of the statute. In some cases, the language of the policies, such as is found in the policy of the Seventh Farm Credit District, is inconsistent with and contrary to the language of the statute. See text of letter from Christopher R. Kelley to Carl Rudeen, infra pages 102-04. In other words, as a matter of course, borrowers are not being provided with a clear, simple explanation of the computational steps involved in computing and comparing the cost of foreclosure and the cost of restructuring.

The second difficulty is that borrowers, as a matter of course, are not being provided with the institution's anticipated "costs" of foreclosure. In addition, some of the cost projections used by some institutions are either not justified or are not justifiable.

At least one of the Farm Credit Districts, the Seventh, has issued a manual to its employees explaining the computational steps and the cost figures to be used in restructuring. The manual includes worksheets that are to be completed by the loan officer and presented to the borrower at the credit review committee should review be necessary and requested. The current practice of the Seventh Farm Credit District is not to provide those worksheets to the borrower prior to the credit review committee meeting. Even then, some institutions will not provide the borrower with a photocopy of the worksheets.

The text of two of the basic worksheets currently in use by the Seventh Farm Credit District together with the text of the instructions provided by the District to its loan officers follows. The worksheets included here are used for analysing a restructuring proposal contemplating level payments. A restructuring proposal contemplating a cash-out, partial deed-back, or debt set aside requires the use of different restructuring worksheets. However, most of the basic concepts and calculations remain the same regardless of the terms of the restructuring proposal.

Because the worksheets and instructions require the use of present value calculations, present value and annuity tables based on a nine percent discount rate follow the worksheets and

instructions. The Seventh Farm Credit District has chosen nine percent as its discount factor, and the tables must be consulted to complete the worksheets.

Following the tables is a brief discussion of several aspects of the worksheets and the instructions that require clarification or comment. Finally, the discussion of the worksheets and instructions is concluded with a sample letter designed to elicit from a system institution the information that a borrower will need to complete a restructuring application.

F O R E C L O S U R E C O S T S

WORKSHEET

MEMBER VIEW $_____

PRINCIPAL $_____

INTEREST $_____

			COSTS
1.	INVESTMENT		$_____
2.	ADD: COSTS		
	A) TAXES	$_____	
	B) DISPOSITION COSTS	$_____	
	C) LEGAL	$_____	
	D) INSURANCE AND REPAIR	$_____	$_____
3.	TOTAL INVESTMENT		$_____
4.	LESS: RECOVERABLE ASSETS		
	A) STOCK	$_____	
	B) AV OF PROPERTY X (.8780) NPV	$_____	
	C) OTHER RECOVERABLE ASSET (PV)	$_____	$_____
5.	FORECLOSURE COSTS		$_____

C O S T O F F O R E C L O S U R E

PROCEDURE

1. INVESTMENT - This line shows our total investment to date, including all expenses advanced and accrued interest.

2. ADD: COSTS -

   a) TAXES - This represents all past due taxes (excluding those advanced and shown above in Line 1) and two years of estimated future taxes.

   b) DISPOSITION COSTS - This represents our anticipated sales costs. Based on projections and experience in acquired property sales, this is a flat 3% of appraised value. Calculation: AV X 3%.

   c) LEGAL - Again, these are anticipated legal expenses which are not already included in Line 1. We expect 1-2% of AV for legal expenses; however, your legal expense levels must be based on individual service center experience.

   d) INSURANCE AND REPAIR - Enter estimated insurance and repair expenses during the foreclosure process.

3. TOTAL INVESTMENT - This represents our investment after adding the foreclosure costs FCS faces in a foreclosure action. Please note that the added costs are not calculated on a net present value basis. The timing of expenses is so varied, including many front-end expenses, such that a present value calculation would require an inordinate amount of time and would show only a slight impact on the costs presented.

4. LESS: RECOVERABLE ASSETS

   a) STOCK - Enter the current amount of stock held by the borrower. Remember that on a foreclosure in process stock may have been applied as a reduction in the vestment amount (Line 1). If that is the case, Line 4a should be zero.

   b) AV OF PROPERTY - This line represents the present value of the property we would recover in foreclosure. We recommend calculating an amount by multiplying the appraised value of the property by a .8780 discount factor (based on a 9% discount rate over one and a half years). However, if the loan officer has <u>strong</u> evidence that the property value will change (up or down), you may use the present value of the appreciated or depreciated property. Also, the length of foreclosure may vary if properly supported.

c) OTHER RECOVERABLE ASSETS - This line includes the present value of any other assets we could recover in the foreclosure process, including the value of any deficiency judgments. The asset should reflect present values.

5. COST OF FORECLOSURE - This line represents the cost of foreclosure for comparison with restructuring costs. It is calculated by subtracting the Total Recoverable Assets from Total Investment. Line 3 - (Lines 4a + 4b)

COMMENTS - If foreclosure costs exceed restructure costs, explain here the appropriate credit factors which support foreclosure over restructure. This section must address factors supporting foreclosure such as:

a) borrower applying all vailable income to the payment of primary obligations

b) borrower's financial capacity and management skills to protect collateral

c) borrower's capacity to work out of existing financial difficulties

RESTRUCTURE COSTS - LEVEL PAYMENTS

WORKSHEET

1. RESTRUCTURE TERMS

   A) PRINCIPAL $_____
   B) CASH _____
   C) STOCK _____
   D) OTHER CONSIDERATIONS _____
   E) TOTAL CONSIDERATIONS $_____
   F) INTEREST RATE/TERMS _____

		COSTS
2.	PRESENT VALUE ORIGINAL LOAN	$_____
3.	ADD: PRESENT INTEREST FORGIVEN	
	A) PRESENT INTEREST $_____	
	B) LESS: CASH PAYMENT _____	
	C) LESS: STOCK _____	
	D) LESS: OTHER CONSIDERATIONS _____	_____
4.	LESS: PRESENT VALUE RESTRUCTURED LOAN	$_____
5.	OTHER RESTRUCTURE COSTS	
	A) $_____	
	B) _____	$_____
6.	COMPROMISE/RESTRUCTURE COSTS	$_____

Note: The Seventh Farm Credit District has changed the restructure costs worksheet that formerly accompanied the instructions that follow. The preceding worksheet is the newer one. Thus, Item 2 in the instructions that follow, "Present Interest Forgiven", is now found at Item 3 on the new worksheet. Item 4 is the instructions, "Present Value of Interest Concessions", is omitted from the newer worksheet. Item 3(a) in the instructions, "Present Value of Foregone Principal And Interest -- Original Amount", is now shown at Item 2 on the newer worksheet. Item 3(b) of the instructions, "Less: Restuctured Amount", is shown at Item 4 of the newer worksheet.

* * * * * *

R E S T R U C T U R E C O S T S - L E V E L P A Y M E N T S

PROCEDURES/DEFINITIONS

1. RESTRUCTURE TERMS -

   a) PRINCIPAL - This line shows the principal balance of the loan after the restructure is completed and accounted for.

   b) CASH - Enter any cash payment received.

   c) STOCK - Enter the value of all stock reductions which are applied to the loan in the restructure.

   d) OTHER CONSIDERATIONS - This category includes any other monetary considerations received for the restructrue, including up-front cash, set aside loans or net recovery value of collateral deeded to FCS. In complex restructures, loan officers have the option to add lines (d, e, f . . .) if necessary to clarify the restructure terms. Do not include the value of additional collateral as other considerations.

   e) TOTAL CONSIDERATION - This line is the sum of Lines 1a, 1b, 1c and 1d.

f) INTEREST RATE/TERMS - This line briefly defines the interest rates charged on the restructured loan, including any concessionary rates (and their duration). It also should identify the term of the restructured loan. This format is for level payments.

2. PRESENT INTEREST FORGIVEN - The Agricultural Credit Act of 1987 provides Farm Credit institutions with the ability to consider foregone principal and interest as part of its Restructure Costs. This section identifies the cost associated with present interest forgiven.

a) PRESENT INTEREST - Enter the present interest balance.

b) LESS: CASH PAYMENT - Enter any cash payment (if any) intended to be a payment of interest. Show the net of Lines 2a and 2b under the "Cost" column.

c) LESS: STOCK - Enter the value of any stock applied to the loan as part of the restructure.

d) LESS: OTHER CONSIDERATIONS - Enter the value of other considerations identified on Line 1d. Enter the result of Lines 2a minus 2b minus 2c minus 2d in the right hand column.

3. PRESENT VALUE OF FOREGONE PRINCIPAL AND INTEREST - This section evaluates the present value of foregone principal and interest by comparing the present value of the original loan with the present value of the restructured loanl We use the present value of the original loan with the present value of the restructured loan. We use the present value of an annuity concept (annual payments over a defined period of time) to determine the present value of a flow of equal payments. The difference is foregone for the life of the loan.

a) ORIGINAL AMOUNT - Enter the result of the original payment amounttimes the appropriate present value factor (PVF) to show the present value of the original loan.

b) LESS: RESTRUCTURED AMOUNT - This line begins with a restructured payment amount which is calculated from the restructured principal amount and the general interest rate that would apply to the loan without any interest rate concessions. Enter the result of the restructured payment times the appropriate present value factor to show the present value of the restructured loan. Subtract this amount from the result in Line 3a and enter this difference in the right hand column.

4. PRESENT VALUE OF INTEREST CONCESSIONS - There are costs associated with interest concessions which can be calculated on a present value basis. There are costs associated with interest concessions which can be calculated on a present value basis. These calculations are less axact, but provide a sound approximation of the cost of an interest rate concession. Use this only when offering a concessionary interest rate for part of the loan term.

   a) RESTRUCTURED PAYMENT AMOUNT - Enter the same payment amount as shown on Line 3b.

   b) LESS: CONCESSION PAYMENT AMOUNT - Enter the payment amount based on the concessionary interest rate and the term of the concessionry rate.

   c) FOREGONE ANNUAL PAYMENT AMOUNT - Enter the difference between Line 4a and 4b on this line.

   d) TIMES: PRESENT VALUE FACTOR - Multiply the result on Line 4c by appropriate present value factor based on the interest rate concession and the length of the concession. Show the results of this calculation under the "Cost" column. (We are using a present value of an annuity table - further directions will be provided in the final draft.)

5. OTHER RESTRUCTURE COSTS - Recognizing there may be additional out of pocket costs for the Farm Credit lender in restructuring a loan, this section allows for consideration of those costs. Most will likely be up-front costs and, therefore, no present value calculations are necessary. Show the total other restructure costs under the "Cost" column.

6. COMPROMISE/RESTRUCTURE COSTS - Add the costs for each section and show the total at Line 6 under the "Cost" column.

O R D I N A R Y A N N U I T Y T A B L E

(Present Value Factors)

DISCOUNT FACTOR: 9% annual rate

DIRECTIONS: To use this ordinary annuity table to determine appropriate present value factors, begin by identifying the number of years the periodic payments will be made. Moving down the year column to the appropriate year identifies the present value factors available for monthly, quarterly, semi-annual and annual payment options. Move across from the year column at the selected number of years to the payment option that fits the loan being present valued. The present value factor is the number under the appropriate payment option and across from the appropriate year. For example, the present value factor for a 20 year loan with annual payments is 9.129.

	P A Y M E N T O P T I O N S			
YEAR	MONTHLY	QUARTERLY	SEMI-ANNUAL	ANNUAL
1	11.435	3.785	1.873	.917
2	21.889	7.247	3.588	1.759
3	31.447	10.415	5.158	2.531
4	40.185	13.313	6.596	3.240
5	48.173	15.964	7.913	3.890
6	55.477	18.389	9.119	4.486
7	62.154	20.608	10.223	5.033
8	68.258	22.638	11.234	5.535
9	73.839	24.495	12.160	5.995
10	78.942	26.194	13.008	6.418
11	83.606	27.748	13.784	6.805
12	87.606	29.170	14.495	7.161
13	91.770	30.470	15.147	7.487
14	95.335	31.660	15.743	7.786
15	98.593	32.749	16.289	8.061
16	101.573	33.745	16.789	8.313
17	104.297	34.656	17.247	8.544
18	106.787	35.490	17.666	8.756
19	109.064	36.252	18.050	8.950
20	111.145	36.950	18.402	9.129
21	113.048	37.588	18.724	9.292
22	114.788	38.172	19.018	9.442
23	116.378	38.706	19.288	9.580
24	117.832	39.195	19.536	9.707
25	119.162	39.642	19.762	9.823
26	120.377	40.051	19.969	9.929
27	121.488	40.425	20.159	10.027
28	122.504	40.767	20.333	10.116
29	123.433	41.080	20.492	10.198

P R E S E N T V A L U E T A B L E S

DISCOUNT FACTOR: 9% annual rate

DIRECTIONS: Use this table to determine the present value of a single payment at a future point in time. Determine the present value factor by moving down the Year column to the year in which you will receive the single payment. Then move across to the Present Value Factor column and identify the appropriate present value factor. For example, the present value factor or a single payment in year 20 is .178. These factors assume annual compounding of the discount factor.

YEAR	PRESENT VALUE FACTOR
1	.917
2	.842
3	.772
4	.708
5	.650
6	.596
7	.547
8	.502
9	.460
10	.422
11	.388
12	.356
13	.326
14	.299
15	.275
16	.252
17	.231
18	.212
19	.194
20	.178
21	.164
22	.150
23	.138
24	.126
25	.116
26	.106
27	.098
28	.090
29	.075
30	.069

The preceding worksheets and instructions are largely self-explanatory. However, they are imprecise at points and possibly inaccurate with respect to certain foreclosure costs. Therefore, the several comments are in order. The comments are based on one of the author's experiences in representing borrowers seeking restructuring and on conversations with other attorneys and borrowers.

FORECLOSURE COSTS

Item 2(b) Disposition Costs: The use of 3% of the appraised value of the collateral for the disposition cost of that collateral appears to be extraordinarily conservative. The instructions offer no justification for that figure. Bearing in mind that arbitrary and capricious behavior by the institution may be the basis for a defense to a foreclosure action, the institution should be put to the task of justifying all of its foreclosure costs figures. See, Federal Land Bank of St. Paul v. Overboe, 404 N.W.2d 445 (N.D. 1987). See Appendix C for a listing of possible foreclosure costs.

Item 2(c) Legal Costs: Note that the instructions require that those costs be based on actual service center experience. As with disposition costs, legal costs must be justified. If the institution is assuming incorrectly that the foreclosure will be uncontested and not followed by a bankruptcy reorganization proceeding, the institution should be requested to adjust its legal costs accordingly.

Item 2(c) Insurance and Repair: Generally, the insurance cost for bare land will be 0. For buildings, it will be $9.00 per $1,000 of insurable value. Repair needs and costs should be brought to the attention of the institution. Some institutions are using 1-1/2% of appraised value for their cost.

Item 4(b) Net Present Value of the Collateral: The .8780 net present value factor reflects a 9% discount rate for 1-1/2 years. If a longer time before recovery is anticipated, such as where a contested foreclosure or reorganization proceeding is contemplated, a lower net present value factor should be used.

Item 4(c) Other Recoverable Assets: This figure should reflect net recovery value discounted from the date of anticipated recovery. In other words, there will be costs associated with the recovery of those assets, and the institution should take those costs into account.

COST OF RESTRUCTURING:

Item 2 Present Interest Forgiven: Make sure that this figure has not been improperly included in the item 2 calculation above it. If the item 2 calculation runs from the date of the initial default, it necessarily will have included the accrued interest reflected in the item 3(a) figure. Thus, the institution will have "double-dipped" and improperly increased the cost of restructuring amount.

Item 3 Present Value of Foregone Principal and Interest: Make sure that the original loan payment used in the item 2 calculation is not based on a default interest rate. Using a default interest rate is inappropriately punitive and will result in a higher cost of restructuring. The institution should assume that the foregone payments on the original note will be based on the interest rate applicable to the loan prior to default. Also, be sure that the calculation is based only on foregone payments. In other words, the present value factor used should correlate with the number of payments that will not be made, not the full term of the note from its inception. Otherwise, the borrower is not given credit for payments made prior to default.

Item 5 Other Restructure Costs: This figure will usually be $500.00.

* * * * *

As previously mentioned, system institutions, including those in the Seventh Farm Credit District, do not, as a matter of course, explain to borrowers the conputational steps involved in determining and comparing cost of foreclosure and cost of restructuring. Similarly, those institutions do not reveal, as a matter of course, their anticipated costs of foreclossure. The

following letter is included in this outline as a suggested format for requesting that information prior to the borrower's submission of a restructuring application.

Mr. Carl Rudeen
Farm Credit Services
P.O. Box 828
Fairmont, MN 56031

RE: Mr. and Mrs. FLB Loan #[_____]

Dear Mr. Rudeen:

In conjunction with the William Mitchell College of Law's Rural Debtor-Creditor Clinic, I represent Mr. and Mrs. _____ of _____, Minnesota. On March 4, 1988, Mr. and Mrs. _____ received a letter dated the previous day from David R. Hoelmer, Legal Counsel of Farm Credit Services of Mankato. That letter advised Mr. and Mrs. _____ of their opportunity to apply for the restructuring of the above-referenced loan under the Seventh Farm Credit District's distressed loan restructuring policy and provided a copy of that policy to them together with application documents. In addition, the letter requested that any questions regarding the restructuring policy be directed to you.

Mr. and Mrs. _____ desire that their loan be considered for restructuring, and they intend to submit an application for that consideration. However, I have some questions that I believe will need to be answered before I can properly assist Mr. and Mrs. _____ with their application. Accordingly, I am directing those questions to you on the assumption and with the understanding that you will be able to respond to them in a timely and sufficient manner to allow me to incorporate the direction and information that you provide in the application of _____ for the restructuring of their loan.

As we both are aware, the Seventh Farm Credit District's restructuring policy was prompted by the enactment of the Argricultural Credit Act of 1987. Because that Act was enacted on January 6, 1988, and the District's policy is even more recent, I suspect that I am not alone in my desire for additional information. My understanding at this time is that the Act and the District's policy, in their most general sense, contemplate a comparison between certain specified "costs of foreclosure" and "costs of restructuring." Where an otherwise complete and supportable application reveals that the cost of restructuring is less than or equal to the potential cost of foreclosure, the lender, here, the Federal Land Bank of St. Paul, will restructure the loan.

Based upon my current understanding of the Act and the District's policy, my initial question concerns the method that the District believes should be employed to determine the potential "costs of foreclosure" and "costs of restructuring" with respect to a loan. Specifically, I would appreciate it if you would advise me of the computational steps that the District believes must be followed to

arrive at the sum of the "cost of foreclosure" and the sum of the "cost of restructuring." If the District has prepared a worksheet that sets forth the various steps in those computations, your sending me a copy of that worksheet and its accompanying instructions would be very helpful.

As best as I can now determine, the computational process contemplated by the Act and by the District's policy to determine the costs of foreclosure and restructuring requires the consideration of certain specified and unspecified cost figures. For example, the "cost of foreclosure" calculation requires an estimate of the "cost of maintaining a loan as a nonperforming asset," the "estimated cost of administrative and legal actions necessary to foreclose a loan and dispose of property acquired as the result of foreclosure," and "all other costs incurred as the result of the foreclosure or liquidation of a loan." The "cost of restructuring" is based on similar costs or other considerations. Obviously, Mr. and Mrs. _____ do not know now what those costs might be because they are costs to the Federal Land Bank of St. Paul. Those costs were not provided to them with Mr. Hoelmer's letter. Nevertheless, notwithstanding their lack of knowledge of those costs and the basis on which they were computed, the application of Mr. and Mrs. _____ for restructuring will be evaluated by a formula that takes into account those costs. Accordingly, Mr. and Mrs. _____ will need that information in order to prepare their application so that they can properly address each cost and other factor that will be considered when their application is submitted. Therefore, my second request is that you provide me with the figures that the Federal Land Bank of St. Paul believes represents each cost associated with the cost of foreclosure and the cost of restructuring that can be estimated at this time. I would also appreciate it if you would explain the basis for each cost estimate. If any of those costs cannot now be estimated or will need to be adjusted over time, I would appreciate it if you would advise me of the time and of the additional information needed for their estimation and when and under what conditions the costs will need to be adjusted. I recognize that, depending upon the computational methodology that the District believes must be employed, some of those costs may be dependent upon the terms of the proposed restructured loan. Of course, with respect to those costs, I assume that we will work together in assessing their amounts through the mutual exchange of information that the restructuring process requires.

My third request is for a copy of each appraisal of the assets of Mr. and Mrs. _____ that the Federal Land Bank of St. Paul has made or used. Please consider this to be a continuing request covering any future appraisals that may be made or used. This request is made pursuant to Section 104 of the Agricultural Credit Act of 1987.

My final request is one for clarification. Under Section III, "Restructuring Criteria," of the District's policy, the term "cost" is defined as including "all factors relevant to making a sound credit decision." So defined, the use of that definition of cost in the context of determining whether the "cost of restructuring" is less than or equal to the "cost of foreclosure" appears to be inconsistent with the way that "cost of foreclosure" and "cost of restructuring" are defined in the Agricultural Credit Act of 1987, at least with respect to distressed loans that are delinquent as is the loan of Mr. and Mrs. _____. Most certainly, the definition is imprecise. I would appreciate it if you would advise me whether you intend to rely on that definition. If you intend to rely on it, please advise me of the factors in addition to those explicitly stated in the Act and the District's policy that you will use to evaluate Mr. and Mrs. _____ application for restructuring, and the weight that you will assign to those factors.

I appreciate your attention to this request. Please call me if you desire any clarification or explanation of it. Again, your prompt response will be essential for the timely preparation and submission of my client's application for restructuring.

Yours very truly,

Christopher R. Kelley
Attorney at Law

In applying for restructuring, borrowers should be aware of the "least cost alternative" provisions of 12 U.S.C.A. § 2202a(f) (West Supp. 1988). That section provides as follows:

> If two or more restructuring alternatives are available to a qualified lender under this section with respect to a distresed loan, the lender shall restructure the loan in conformity with the alternative that results in the least cost to the lender.

If a borrower's restructuring proposal does not contemplate paying to his primary creditors all of his income in excess of his reasonable living and operating expenses, section 2202a(f) appears to give the institution the option of proposing an alternative that captures that income. See 12 U.S.C.A. § 2202a(d)(1)(B) (West Supp. 1988) (a consideration in determining whether a borrower is eligible for restructuring is "whether the borrower is applying all income over and above necessary and reasonable living and operating expenses to the payment of primary obligations"), and § 2202a(d)(2) (West Supp. 1988) ("This section shall not prevent a qualified lender from proposing a restructuring plan for an individual borrower in the absence of an application for restructuring from the borrower.")

System institutions are required to provide written notice to a borrower that the borrower's loan "may be suitable for restructuring" when the institution determines that the loan is or has become a "distressed loan." 12 U.S.C.A. § 2202(b)(1) (West Supp. 1988). The notification must include a copy of the appropriate restructuring policy and "all materials necessary to

enable the borrower to submit an application for restructuring the loan." Id. A distressed loan is defined as follows:

> The term "distressed loan" means a loan that the borrower does not have the financial capacity to pay according to its terms and that exhibits one or more of the following characteristics:
>
> (a) The borrower is demonstrating adverse financial and repayment trends.
>
> (b) The loan is delinquent or past due under the terms of the loan contract.
>
> (c) One or both of the factors listed in subparagraphs (A) and (B), together with inadequate collateralization, present a high probability of loss to the lender.

Notice must also be given not later than 45 days before the commencement of foreclosure proceedings against the borrower. 12 U.S.C.A. § 2202(b)(2) (West Supp. 1988). In addition, 12 U.S.C.A. § 2202(b)(3) (West Supp. 1988) provides as follows:

> No qualified lender may foreclose or continue any foreclosure proceeding with respect to any distressed loan before the lender has completed any pending consideration of the loan for restructuring under this section.

The term "foreclosure proceeding" is specifically defined in the statute as follows:

> The term "foreclosure proceeding" means:
>
> (a) a foreclosure or similar legal proceeding to enforce a lien on property, whether real or personal, that secures a nonaccrual or distressed loan; or
>
> (b) the seizing of and realizing on nonreal property collateral, other than collateral subject to a statutory lien arising under subchapters I or II of this chapter, to effect collection of a nonaccrual or distressed loan.

12 U.S.C.A. § 2202a(4) (West Supp. 1988). Apparently, an action to collect on an unsecured note would not be a foreclosure proceeding within the meaning of section 2202a(4).

12 U.S..A. § 2202a(c) (West Supp. 1988) requires institutions to give borrowers a "reasonable opportunity" for a meeting between the borrower and a loan officer or other representative. Specifically, that section provides as follows:

> On determination by a qualified lender that a loan made by the lender is or has become a distressed loan, the lender shall provide a reasonable opportunity for the borrower thereof to personally meet with a representative of the lender -
>
> (a) to review the status of the loan, the financial condition of the borrower, and the suitability of the loan for restructuring; and
>
> (b) with respect to a loan that is in nonaccrual status, to develop a plan for restructuring the loan if the loan is suitable for restructuring.

If the restructuring proposal is denied, the borrower may request a review of the denial by a credit review committee. The request must be made in writing within 7 days after receiving the notice of denial. 12 U.S.C.A. § 2202(b)(2) (West Supp. 1988).

At the credit review committee, the borrower may appear in person accompanied by counsel or any other representative. 12 U.S.C.A. § 2202(c) (West Supp. 1988). Prior to the enactment of the Agricultural Credit Technical Corrections Act of 1988, the borrower seeking review of a denial of restructing did not have the right to an independent appraisal except when "additional collateral for a loan is demanded by the qualified lender when

determining whether to restructure the loan." 12 U.S.C.A. § 2202(d)(4) (West Supp. 1988). However, under the 1988 Act, the borrower now has a right to request an independent appraisal. H.R. 3980, 100th Cong. 2d Sess. 134 Cong. Rec. S 10798, 10301 (daily ed. Aug. 3, 1988). The borrower must be notified in writing of the decision of the credit review committee and the reasons for that decision. 12 U.S.C.A. § 2202(e) (West Supp. 1988).

The credit review committee's review ends the institution's review process. If the credit review committee affirms the initial denial of the restructuring, the institution may and usually will commence the appropriate legal proceedings to foreclose on the collateral and obtain judgment on the note. However, if the institution has been certified by the Assistance Board pursuant to 12 U.S.C.A. § 2278a-4 (West Supp. 1988), there is one more stage in the review process. Specfically, 12 U.S.C.A. § 2202c(a) (West Supp. 1988) provides as follows:

> Within 9 months after a qualified lender is certified under section 2278a-4 of this title, such lender shall review each loan that has not been previously restructured and that is in nonaccrual status on the date the lender is certified, and determine whether to restructure the loan.

The review contemplated by section 2202c(a) is to be done by a special asset group established by each district. 12 U.S.C.A § 2202 2202c(b)(1) (West Supp. 1988). If the district special asset group determines that a loan should be restructured, "the group shall prescribe a restructuring plan for the loan that the qualified lender shall implement." 12 U.S.C.A. § 2202c(b)(2)

(West Supp. 1988). If the group determines that a loan should not be restructured, it must submit a report to the National Special Asset Council described below explaining that decision. 12 U.S.C.A. § 2202c(e) (West Supp. 1988).

The statute is silent as to the borrower's right to participate in the review by the district special asset group. The proposed regulations governing that review are also silent as to that issue. 53 Fed. Reg. 16934, 16956 (1988).

Pursuant to 12 U.S.C.A § 2202c(c)(1) (West Supp. 1988), the Assistance Board is to establish a National Special Asset Council to do the following:

> (a) monitor compliance with the restructuring requirements of this section by qualified lenders certified to issue preferred stock under section 2278b-7 of this title, and by special asset groups established under subsection (b) of this section; and
>
> (b) review a sample of determinations made by each special asset group that a loan will not be restructured.

In addition, 12 U.S.C.A. § 2202c(c)(2) (West Supp. 1988) provides that the National Special Asset Council "shall review a sufficient number of determinations made by each special asset group to foreclose on any loan to assure the Council that such group is complying with this section." For each determination reviewed, "the Council shall make an independent judgment on the merits of the decision to foreclose rather than restructure the loan." In addition,

> If the National Asset Council determines that any special asset group is not in substantial compliance with this section, the

> Council shall notify the group of the determination, and may take such other action as the Council considers necessary to ensure that such group complies with this section.

12 U.S.C.A. § 2202c(c)(3) (West Supp. 1988).

As with reference to the district special asset group, the statute and the proposed regulations are silent regarding the borrower's right to participate in any review by the National Special Asset Council. 53 Fed. Reg. 16945, 16946 (1988).

G. Right of First Refusal

The 1987 Act requires system institutions, except for the bank for cooperatives, holding agricultural real estate acquired through foreclosure or voluntarily conveyed by a borrower who, in the institute's determination, did not have the financial resources to avoid foreclosure to give the former owner the right of first refusal to repurchase or lease the property. 12 U.S.C.A. § 2219a (West Supp. 1988). With respect to the right of first refusal to purchase the property, 12 U.S.C.A. § 2219a(b)(1)-(5) (West Supp. 1988) provides as follows:

> (1) Election to sell and notification
>
> Within 15 days after an institution of the System first elects to sell acquired real estate, or any portion of such real estate, the institution shall notify the previous owner by certified mail of the owner's right -
>
> (a) to purchase the property at the appraised fair market value of the property, as established by an accredited appraiser, or

(b) to offer to purchase the property at a price less than the appraised value.

(2) Eligibility to purchase

To be eligible to purchase the property under paragraph (1), the previous owner must, within 15 days after receiving the notice required by such paragraph, submit an offer to purchase the property. (Note: The 15 day period was changed to 30 days by the Agricultural Technical Corrections Act of 1988, H.R. 3980, 100th Cong. 2d Sess., 134 Cong. Rec. S 10798, 10802 (daily ed. Aug. 3, 1988)).

(3) Mandatory sale

An institution of the System receiving an offer from the previous owner to purchase the property at the appraised value shall, within 30 days after the receipt of such offer, accept such offer and sell the property to the previous owner. (Note: The 30 day period was changed to 15 days by the Agricultural Technical Corrections Act of 1988, H.R. 3980, 100th Cong. 2d Sess., 134 Cong. Rec. S 10798, 10802 (daily ed. Aug. 3, 1982)).

(4) Permissive sale

An institution of the System receiving an offer from the previous owner to purchase the property at a price less than the appraised value may accept such offer and sell the property to the previous owner. Notice shall be provided to the previous owner of the acceptance or rejection of such offer within 15 days after the receipt of such offer.

(5) Rejection of offer of previous owner

(a) Duties of institution

An institution of the System that rejects an offer from the previous owner to purchase the property at a price less than the appraised value may not sell the property to any other person -

(i) at a price equal to, or less than, that offered by the previous owner, or

> (ii) on different terms and conditions than those that were extended to the previous owner,
>
> without first affording the previous owner an opportunity to purchase the property at such price or under such tems and conditions.

(b) Notice

> Notice of the opportunity in subparagraph (a) shall be provided to the previous owner by certified mail, and the previous owner shall have 15 days in which to submit an offer to purchase the property at such price or under such terms and conditions.

The provisions governing the right of first refusal to lease acquired property are similar. 12 U.S.C.A. § 2219a(c)(1)-(6) (West Supp. 1988).

The right of first refusal as set forth in sections 2219a(b)(1)-(5) presents several potential difficulties for borrowers. First, neither the statute nor the proposed regulations specifically defines the event constituing the institution's "first elect[ion] to sell." 53 Fed. Reg. 16934, 16946-47 (1988). In states where corporations are prohibited from owning agricultural real estate, it might be argued that the "election to sell" occurs as soon as the land is acquired since the institution is not permitted to retain it. On the other hand, it might be argued that no election to sell occurs until an eligible purchaser actually has agreed to buy the parcel.

A more troublesome difficulty for borrowers is the absence of any express mechanism for challenging the appraisal of the property. In addition, neither the statute nor the proposed

regulations define the statute's term "accredited appraiser". 53 Fed. Reg. 16934, 16946-47 (1988). It can be expected that some Farm Credit Banks will use "in-house" appraisers who may base their appraisals on sales of other inventory land that has been sold with inflationary inducements such as moneyback guarantees and low interest rate financing that would not be offered to former owners under the right of first refusal. See 12 U.S.C.A. § 2219a(f) (West Supp. 1988) (". . . a system institution shall not be required to provide financing to the previous owner in connection with the sale of acquired real estate.")

The former owner who cannot match the appraised price faces uncertainty as to whether he will receive another opportunity to elect to buy the land. The statute permits the former owner to offer a sum less than the appraised value. However, if that offer is rejected, the institution must again offer the right of first refusal only if it subsequently desires to sell the land at "a price equal to, or less than, that offered by the previous owner" or "on different terms and conditions than these that were extended to the previous owner." 12 U.S.C.A. § 2219a(b)(5) (West Supp. 1988). In areas where land values are increasing, it is unlikely that the institution will desire to sell the land at a price equal to, or less than, that offered by the previous owner. However, it is very likely that the terms and conditions will be different. This is because the only "terms and conditions" that likely will have been initially offered to the former owner are the sale of the land at a lump sum cash price. On the other hand, a third-party prospective purchaser is likely to be offered many other "terms and conditions" such as a

money-back guarantee, apportionment of real estate taxes, etc. (Financing is not considered a "term or condition" of sale. 12 U.S.C.A. § 2219a(e) (West Supp. 1988)) The uncertainty arises because even if the "terms and conditions" differ, it is possible that the institution may neglect to inform the former owner not only of those differences but also, and more fundamentally, of the transaction itself, because the institution may choose to ignore or narrowly read 12 U.S.C.A. § 2219a(b)(5) (West Supp. 1988).

To date, some system institutions have attempted to avoid giving former owners the benefits of 12 U.S.C.A. § 2219a(b)(1)-(5) (West Supp. 1988) by choosing to sell the acquired property by auction without first giving the former owner the opportunity to buy it at its appraised value. Institutions may sell acquired land by auction. In that regard, 12 U.S.C.A. § 2219a(d)(1)-(3) (West Supp. 1988) provides as follows:

> (d) Public Offerings
>
> (1) Notification of previous owner
>
> If an institution of the System elects to sell or lease acquired property or a portion thereof through a public auction, competitive bidding process, or other similar public offering, the institution shall notify the previous owner, by certified mail, of the availability of the property. Such notice shall contain the minimum amount, if any, required to qualify a bid as acceptable to the institution and any terms and conditions to which such sale or lease will be subject.
>
> (2) Priority
>
> If two or more qualified bids in the same amount are received by the institution under paragraph (1), such bids are the highest received, and one of the qualified bids is offered by the previous owner, the institution shall accept the offer by the previous owner.

(3) Nondiscrimination

> No institution of the System may discriminate against a previous owner in any public auction, competitive bidding process, or other similar public offering of property acquired by the institution from such person.

However, at least two federal district courts have held that sales by auction must be preceded by giving the former owner the opportunity to buy the acquired land at its appraised value. Martinson v. Federal Land Bank of St. Paul, No. A2-88-31 (D.N.D. April 21, 1988) (appeal pending); Leckband v. Naylor, No. Civ. 3-88167 (D. Minn. May 17, 1988) (appeal pending). Those cases are discussed in this outline at pages 42-43.

Finally, with respect to the right of first refusal, 12 U.S.C.A. § 2219 a(h) (West Supp. 1988) provides that "[t]he rights provided in this section shall not diminish any such right of first refusal under the law of the State in which the property is located." This provision appears to provide that state first refusal statutes will supplement the federal right.

H. Prohibition Against Waiver of Mediation Rights

The 1987 Act encourages the states to establish mediation programs (such as already exist in Iowa and Minnesota). The Farm Credit System is required to participate in mediation. Agricultural Credit Act of 1987, Pub. L. No. 100-233, Sec. 503, 101 Stat. 1663 (1988). In addition, Congress had the foresight to realize that the right to mediation could be used as a chip in negotiations for a loan. In order to avoid that, the 1987 Act contains the following language:

> No System institution may make a loan secured by a mortgage or lien on agricultural property to a borrower on the condition that the borrower waive any right under the agricultural loan mediation program of any State.

12 U.S.C.A. § 2202e (West. Supp. 1988). FCA is required to promulgate rules regarding FCS participation in mediation. The proposed rules are found at 53 Fed. Reg. 16946 (1988) (to be codified at 12 C.F.R. § 614.4521).

I. Differential Interest Rates.

Farm Credit System institutions in the past have used different interest rates on loans. This is commonly known as the "three-tier" method. The interest rate was based on a number of factors, including borrower qualifications. The 1987 Act allows the system institutions to continue this practice. Pub. L. No. 100-233, Sec. 109, 101 Stat. 1584 (1988). However, the borrower can now ask an system institution:

1) to provide a review of the loan to determine if the proper interest rate has been used;

2) give the borrower a written explanation of the basis for charging the interest rate used; and

3) give the borrower a written explanation of what the borrower must do to improve his credit status to receive a lower interest rate.

12 U.S.C.A. § 2199(b) (West Supp. 1988).

J. Uninsured Accounts.

Some System institutions have used uninsured accounts in the past as part of their loan servicing procedures. 12 C.F.R. § 614.4510 (1988). Borrowers would deposit funds in these accounts over a period of time in order to insure that they would meet their scheduled payments. The 1987 Act provided that if the institution becomes insolvent, all of the funds in uninsured accounts are to be applied to a borrower's debt. 12 U.S.C.A. § 2219(b). See 53 Fed. Reg. 35427, 35454 (1988) (to be codified at 12 C.F.R. § 614.413).

K. Use of FmHA Guaranteed Loans, etc.

The 1987 Act also expresses the desire that Congress wants the Farm Credit System to look outside the system in restructuring;

> It is the sense of Congress that the banks and associations (except for the banks for cooperatives) operating under the Farm Credit Act of 1971, should administer loans to farmers with the objective of using the loan guarantee programs of the Farmers Home Administration and other loan restructuring measures, including participation in interest rate buy down programs that are Federally or State funded or other federal or state sponsored financial assistance programs that offer relief to financially distressed farmers, as alternatives to foreclosure, considering the availability and appropriateness of such programs on a case-by-case basis.

Pub. L. No. 100-233, Sec. 102, 101 Stat. 1579 (1988). While this section has not been codified, it may prove helpful to the borrower who wishes to use the FmHA guaranteed loan program or other program in order to qualify for restructuring.

VII. JUDICIAL REVIEW OF RESTRUCTURING DENIALS

At least one court has declined to review decisions adverse to the borrower under the former forbearance policies developed by System institutions. In Federal Land Bank of Wichita v. Read, 703 P.2d 777 (Kan. 1985), the borrower's request for forbearance under the FLB's forbearance policy adopted pursuant to 12 C.F.R. § 614.4510 (1985) had been denied. The policy conditioned forbearance on the borrower meeting three conditions: the borrower must be cooperative; the borower must make an honest effort to meet the conditions of the loan contract; and the borrower must be capable of working out of the debt burden. See 12 C.F.R. § 614.4510(1) (1986). The FLB found that the borrower did not satisfy the third condition. In declining to review the forbearance decision, the court expressed the belief that the "matter is best left to those in whom the land bank places that responsibility . . . . We find no statutory authority for court review of such a determination". 703 P.2d at 780. See also Tuepker v. FmHA, 708 F.2d 1329 (8th Cir. 1983).

However, despite the absence of express statutory authority for judicial review under former versions of the Farm Credit Act and the regulations and policies adopted pursuant to it and despite the current absence of any statutory or regulatory provision for judicial review, there are several theories available to borrowers seeking judicial review. Listed in order of their current state of judicial development, the respective bases for each of those theories are as follows:

1. invocation of the maxim "he who seeks equity, must do equity" as an equitable

affirmative defense to the institution's foreclosure proceeding;

2. failure to follow statutory directives asserted as an implied cause of action under the Farm Credit Act, as amended by the Agricultural Credit Act of 1987; and

3. failure to adhere to state cooperative law requiring procedural and substantive fairness in the expulsion of members from cooperative institutions.

The latter two theories are discussed elsewhere in this outline at pages 28-53 and 61-72, respectively. The following is a discussion of the first theory, the equitable defense.

In most, if not all jurisdictions, a proceeding to foreclose a mortgage is a proceeding in equity. See, e.g. Continental Federal Savings and Loan Ass'n. v. Fetter, 564 P.2d 1013, 1019 (Okla. 1977) ("Foreclosure of a real estate mortgage is an equitable action, and it is within the province of the court exercising its equitable power to see that the party seeking equity shall have dealt fairly before relief is given.")

One of the fundamental precepts of equitable relief is that it "cannot be demanded as a matter of right whenever specified facts are shown . . .", rather it "is granted in the discretion of the court." H. McClintock, Principles of Equity, § 23 at 49 (2nd ed. 1948). Judicial dicretion is ". . . to be exercised by applying established principles of equity to the situation presented by all of the facts in the case, and adapting the remedy to accomplish the most equitable result possible." Id.

The discretionary nature of equitable relief is "rooted in the historical concept of [a] court of equity as a vehicle for affirmatively enforcing the requirements of conscience and good

faith." Precision Inst. Mfg. Co. v. Automative M.M. Co., 324 U.S. 806, 814 (1945). As emphasized by the United States Supreme Court:

> A court of equity acts only when and as conscience commands, and if the conduct of the plaintiff be offensive to the dictates of natural justice, then, whatever may be the rights he possesses and whatever use he may make of them in a court of law, he will be held remediless in a court of equity.

Deweese v. Reinhard, 165 U.S. 386, 390 (1897).

The discretion inherent in the granting or denial of equitable relief is guided by maxims or general principles. See Precision Inst. Mfg. Co. v. Automobile M.M. Co., 324 U.S. 806, 814 (1945) ("The guiding doctrine . . . that he who comes into equity must come with clean hands' . . . is far more than a mere banality. It is a self-imposed ordinance that closes the doors of a court of equity to one tainted with inequitableness or bad faith relative to the matter in which he seeks relief . . . ."). One of those maxims is "he who seeks equity must do equity". As explained by Pomeroy, "this maxim expresses the governing principles that every action of a court of equity in determining rights and awarding remedies must be in accordance with conscience and good faith." 1 J. Pomeroy, Equity Jurisprudence § 385 at 419 (1881). More specifically,

> The meaning is, that whatever be the nature of the controversy between two definite parties, and whatever be the nature of the remedy demanded, the court will not confer its equitable relief upon the party seeking its interposition and aid, unless he has acknowledged and conceded or will admit and provide for all the equitable rights, claims,

> and demands justly belonging to the adversary party, and growing out of or necessarily involved in the subject-matter of the controversy.

Id.

The principle requires the plaintiff to do "equity." Id. In essence, a condition precedent to the equity court's granting of relief to the plaintiff is the awarding to the defendant any rights possessed by the defendant, including those that have their genesis in the principles of fair dealing.

The failure of a FLB to consider a borrower for forbearance has been held to be a defense to a foreclosure action. Federal Land Bank of St. Paul v. Overboe, 404 N.W.2d 445 (N.D. 1987). In Overboe, the borrower obtained funds from the Federal Land Bank of St. Paul. The loan was secured by a mortgage. The borrower became late in his payments, and in June, 1983, he requested that his annual payment date be changed from July 1 to December 31 of each year to coincide with the cash flow of his farm. The federal land bank advised the borrower that a change in payment dates would require a reamortization of his loan, and that, based on the borrower's financial information on file, it was unable to grant a reamortization. The borrower subsequently provided new financial information but the federal land bank declined to change its position. The federal land bank then initiated a foreclosure action.

The borrower defended the foreclosure action on the grounds that the federal land bank had failed to follow its policies, regulations, and procedures adopted under the Farm

Credit Act of 1971 relating to forbearance when it denied his request for reamortization. The federal land bank responded by asserting that its failure to follow its policies and the regulations governing it could not be raised as a defense to foreclosure and, in the alternative, that it had not violated its policies and the applicable regulations.

The forbearance regulation at issue in Overboe, 12 C.F.R. § 614.4510(d)(1), was adopted prior to the enactment of the Farm Credit Amendments Act of 1985. The regulation provided that the federal land bank was to develop loan servicing policies that included a provision for "a means of forbearance for cases when the borrower is cooperative, making an honest effort to meet the conditions of the loan contract, and is capable of working out of the debt burden." Overboe, 404 N.W.2d at 447 (citing 12 C.F.R. § 614.4510(d)(1)). Pursuant to that regulation, the federal land bank had adopted a policy authorizing the extension of "appropriate assistance" to borrowers who met certain criteria. Overboe, 404 N.W.2d at 447 (citing "District Policy 2501" of the Federal Land Bank of St. Paul).

The federal land bank argued that its failure to follow the policy that it adopted pursuant to 12 C.F.R. § 614.4510(d)(1) could not be asserted as a defense because of the holding of several courts that borrowers do not have a private cause of action for damages under the Farm Credit Act of 1971 or the regulations promulgated pursuant to that Act. See e.g. Farmers Production Credit Association of Ashland v. Johnson, 24 Ohio St. 3d 69, 493 N.E.2d 946 (1986), cert. denied, 107 S. Ct. 878 (1987).

Although the Overboe court acknowledged that the Farm Credit Act of 1971 and 12 C.F.R. § 614.4510 did not create a private cause of action, it rejected the federal land bank's argument that the absence of a private cause of action precluded a borrower's assertion of noncompliance with the Act or 12 C.F.R. § 4510 as a defense in a foreclosure action. The Overboe court's analysis of the issue was grounded on the recognition that "an action to foreclose a mortgage is an equitable proceeding." Overboe, 404 N.W.2d at 448 (citations omitted). With that recognition forming the basis of the court's analysis, the court then examined other instances, specifically, cases involving noncompliance with Department of Housing and Urban Development ("HUD") regulations, where federal regulations which have been held not to imply a private cause of action may nevertheless provide a basis for an equitable defense to a foreclosure action. Overboe, 404 N.W.2d at 449.

With respect to the notions of fair dealing applicable to the Farm Credit System, the Overboe court noted that the Congressional goal under the Farm Credit Act was "fostering agricultural development." Id. (citing Federal Land Bank of St. Paul v. Lillehaugen, 404 N.W.2d 432 (N.D. 1987)). With that Congressional objective in mind, the Supreme Court of North Dakota held as follows:

> Allowing FLB to foreclose its mortgages without regard to the administrative forbearance regulation would be inimical to the achievement of this goal. We therefore conclude that the failure of FLB to comply with administrative forbearance regulation and policies adopted pursuant to the regulation gives rise to a valid equitable defense to a foreclosure action under state law.

Id.

Having held that a federal land bank's failure to abide by its forbearance policies and the regulations governing it was a permissible affirmative defense to a foreclosure action, the Overboe court also concluded that the administrative forbearance defense permits judicial consideration of both the procedural and substantive aspects of the System institution's action. In that regard, the initial inquiry is whether the institution "has established a general policy of forbearance and whether it applied that policy in arriving at its decision to seek foreclosure." Overboe, 404 N.W.2d at 449. If the trial court finds that the borrower's qualifications were considered by the institution in accordance with its procedures, the court's review of the merits of that consideration is to be confined to whether the institution abused its discretion. In other words, to prevail, the borrower must show that the institution acted in an "arbitrary, capricious, unreasonable or unconscionable manner." Overboe, 404 N.W.2d at 450. Finally, the Overboe court indicated that appellate review of a trial court's determination of the substantive issue will be guided by the standard of whether the abuse of discretion standard of review "appears to have been misapprehended or grossly misapplied." Id. (citing Universal Camera Corp v. National Labor Relations Board, 340 U.S. 474, 491 (1951)).

In jurisdictions providing for nonjudicial foreclosure, borrowers seeking to invoke the equitable defense employed in Overboe will have to seek injunctive relief in order to obtain judicial intervention. For a recent discussion and collection of

authorities regarding the enjoining of the nonjudicial foreclosure process, see Note, Nonjudicial Foreclosure in Arkansas with the Statutory Foreclosure Act of 1987, 41 Ark. L. Rev. 373, 389-403 (1988).

Note: On September 15, 1988, a federal district court in Oregon declined to review a restructuring denial. Troutman v. Federal Land Bank of Spokane, No. CV 88-726-PA (D. Ore. Sept. 15, 1988) (order denying preliminary injunction).

VIII. POSSIBLE FUTURE ISSUES IN BORROWER LITIGATION AGAINST THE FARM CREDIT SYSTEM

Litigation by member-borrowers against System institututions will undoubtedly continue. The current interest in lender liability in the farm community suggests that some of that litigation will take the form of "generic" lender liability claims. See Welsh, Are Banks to Blame?, Farm Journal, 11 (June-July 1988). However, a number of issues to the borrowers' rights provision of the Agricultural Credit Act of 1987 remain unresolved.

Two specific and fundamental issues relating to the new borrowers' rights provisions are in need of immediate attention. A third, more general, issue is not likely to arise until the secondary agricultural mortgage market is implemented.

The first issue arises from the failure of most, if not all, of the farm credit districts to adopt loan restructuring policies that require the institutions within the district to

explain in simple, understandable terms the computational steps involved in the determination of the cost of foreclosure and the cost of restructuring. That information, which has been made available to loan officers, is not routinely provided to borrowers holding distressed loans. Without that information, the borrower is faced with the extraordinarily difficult task of gleaning the computational steps and arriving at an understanding of the restructuring formula from language in current policies that merely restates the language of the statute. Because the statutory language is not so specific as to make the computational steps self-evident, the practical effect is that the borrower "shoots in the dark" when submitting a restructuring application. Moreover, without knowledge of the computational steps involved, the borrower is not in a position to identify and urge the correction of computational errors made at either the initial stage of the review of his application or at the credit reivew committee level. As a matter of fundamental fairness, both parties to the restructuring process should have the instructions before them.

The second issue arises from the failure of most institutions to disclose or justify their "costs of foreclosure." That information is readily accessible to the institutions, but completely inaccessible to members unless the institution chooses to make it available. Although member-borrowers are required to make a full disclosure of their current and projected financial and operational conditions when applying for restructuring, institutions have routinely chosen not to disclose their costs. Without that information, a member-borrower cannot submit a

restructuring proposal that will properly address each cost and other factor that will be considered by the institution in evaluating that application.

If one accepts the premise that restructuring is intended to produce "win-win" results, the failure of System institutions to make the process accessible to its members by providing them with adequate instructions and to disclose and justify their anticipated costs of foreclosure is inexcusably short-sighted. Moreover, if system institutions are under either an equitable or legal duty to be fair, that failure may be actionable. As discussed elsewhere in this outline, ample authority exists to impose enforceable duties of good faith and fairness on system institutions in the restructuring process. See e.g., Federal Land Bank of St. Paul v. Overboe, 404 N.W.2d 445 (N.D. 1987); Copeland, Explulsion of Members by Agricultural Cooperatives, 1 J. Agric. Cooperation 76 (1986).

The third, less immediate, issue arises from 12 U.S.C.A § 2279 aa-9(a)(b) (West Supp. 1988). Those provisions, concerning loans from System institutions that may be pooled in the secondary market for farm mortgages, a market that is being created pursuant to 12 U.S.C.A. §§ 2279 aa-2279aa-14 (West Supp. 1988), provide as follows:

> (a) Restructuring
>
> Notwithstanding any other provision of law, sections 2202, 2202a, 2202b, 2202c, and 2219b of this title shall not apply to any loan included in a pool of qualified loans backing securities or obligations for which the Corporation provides guarantee. The loan servicing standards established by the Corporation shall

be patterned after similar standards adopted by other federally sponsored secondary market facilities.

(b) Borrowers rights

At the time of application for a loan, originators that are Farm Credit System institutions shall give written notice to each applicatn of the terms and conditions of the loan, setting forth separately terms and conditions for pooled loans and loans that are not pooled. This notice shall include a statement, if applicable, that the loan may be pooled and that, if pooled, sections 2202, 2202a, 2202b, 2202c, and 2219b of this title shall not apply. This notice also shall inform the applicant that he or she has the right not to have the loan pooled. Within 3 days from the time of commitment, an applicant has the right to refuse to allow the loan to be pooled, thereby retaining rights under sections 2202, 2202a, 2202b, 2202c, and 2219b of this title, if applicable.

It remains to be seen whether System institutions will attempt to pool significant numbers of loans and thus avoid the administrative expenses created by the restructuring provisions and whether borrowers will be "encouraged" to waive their rights in order to allow the pooling of loans.

Finally, an overriding issue is the general one of the availability of agricultural credit and the Farm Credit System's role in providing that credit. For a recent discussion of those issues, see Boehlje and Pederson, Farm Finance: The New Issues, Choices, 16 (Third Quarter, 1988) and Duncan, Rural Credit Markets: More Changes Ahead, Choices, 20 (Third Quarter, 1988).

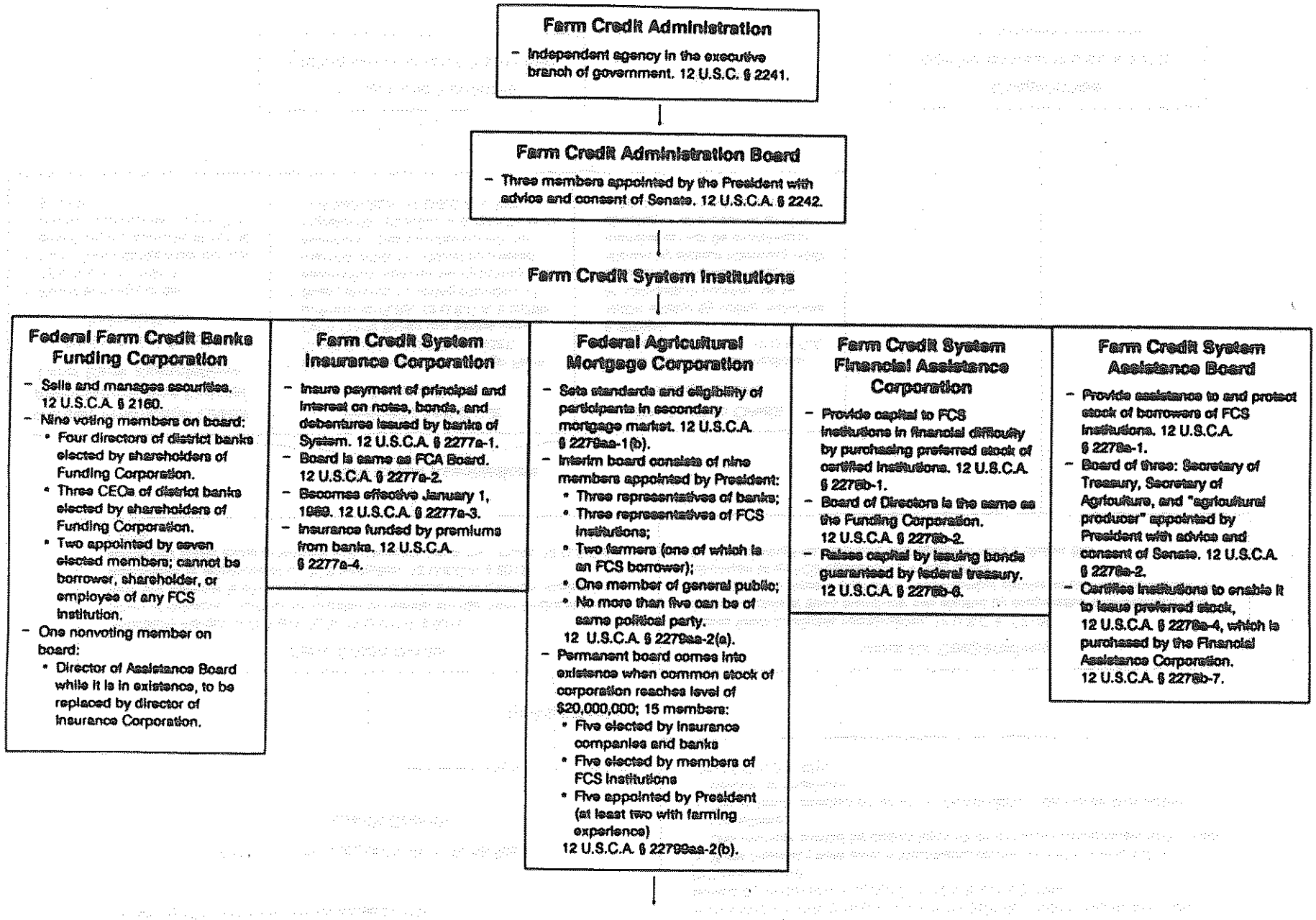
IX. RECOMMENDED PERIODICALS COVERING FARM CREDIT SYSTEM ISSUES

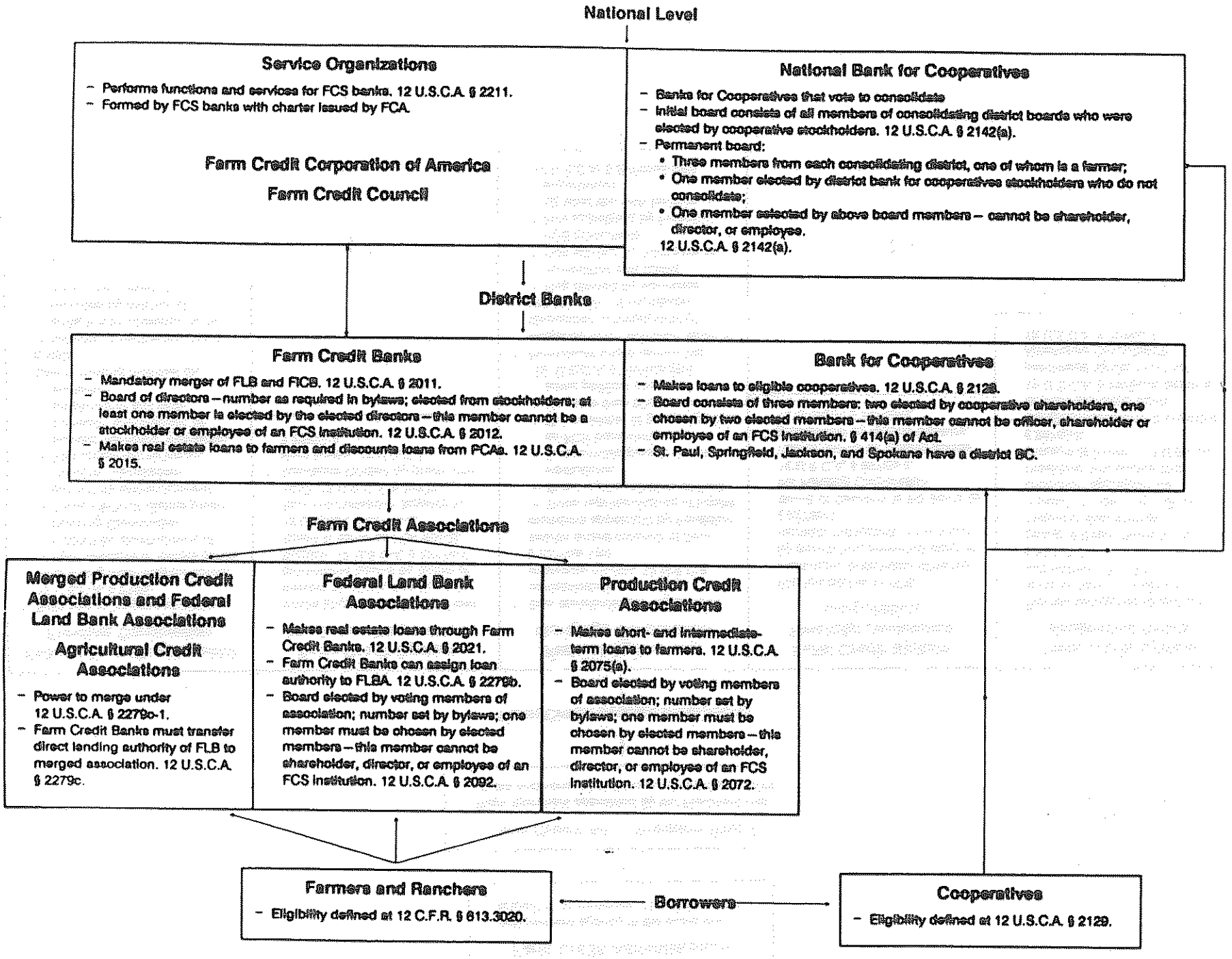
Agricultural Law Update -	Available through membership in the American Agricultural Law Association, contact Mason E. Wiggins, Jr., Heron, Burchette, Ruckert & Rothwell, 1025 Thomas Jefferson St., N.W., Suite 700, Washington, D.C. 20007
Farmers' Legal Action Report -	Subscriptions are $15.00 per year from Farmers' Legal Action Group, Inc. 1301 Minnesota Building 46 East Fourth Street St. Paul, Minnesota 55101
Iowa Agricultural Law Reporter -	Subscriptions are free from Iowa Agriculture Law Reporter Drake University Law School Agricultural Law Center Des Moines, Iowa 50311
Center for Rural Affairs Newsletter	Available from the Center for Rural Affairs P.O. Box 405 Walthill, NE 68067
Small Farm Advocate -	Available from the Center for Rural Affairs See above address

PUBLICATIONS COVERING THE AGRICULTURAL CREDIT ACT OF 1987

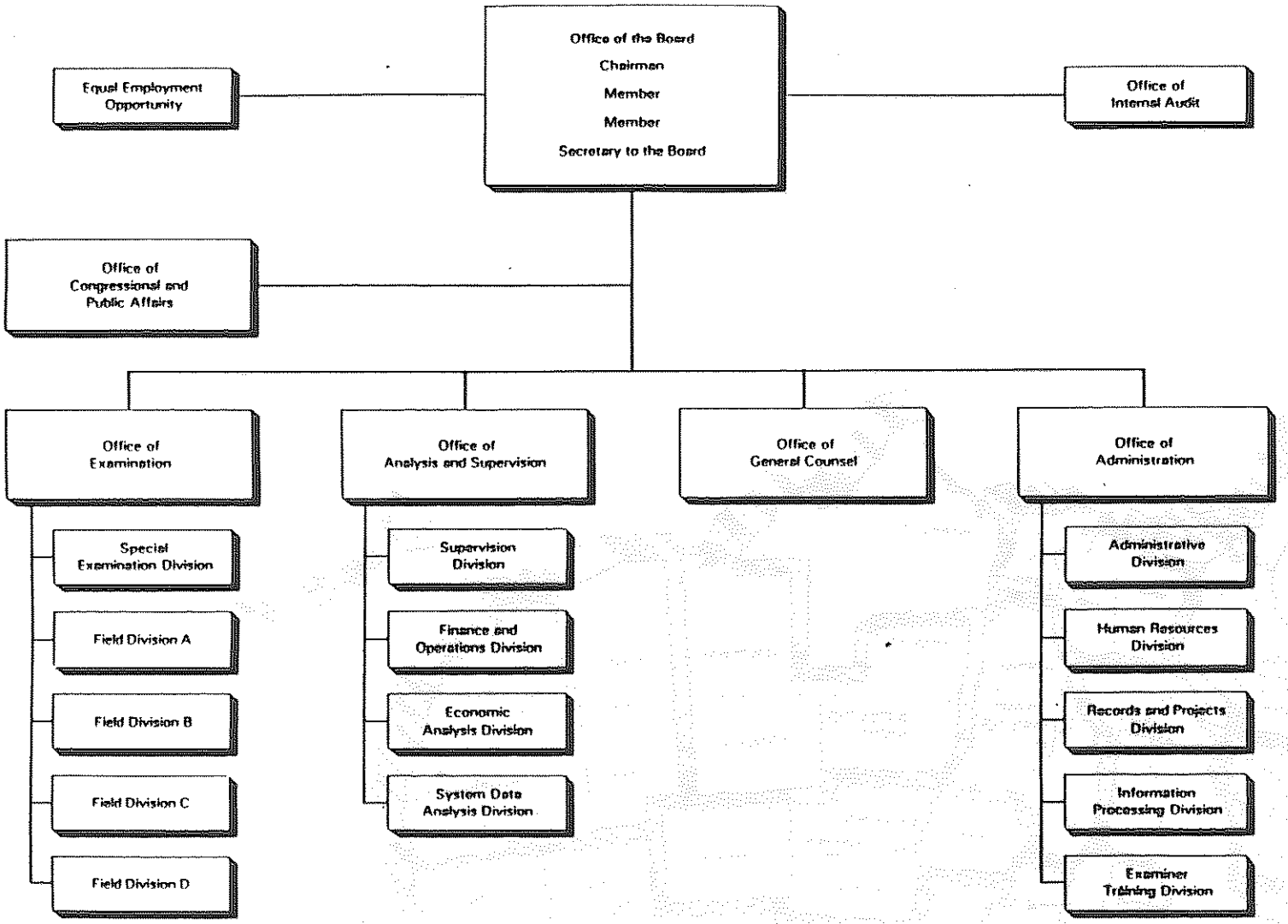
Special Report on the Agricultural Credit Act -	Available from Farmers' Legal Action Group, Inc. 1301 Minnesota Building 46 East Fourth Street, St. Paul, Minnesota 55101 Cost is $10.00
Borrowers Rights and the Agricultural Credit Act of 1987	Available from Drake University Law School Agricultural Law Ctr. Des Moines, Iowa 50311 Price is $10.00

Structure of the Farm Credit System

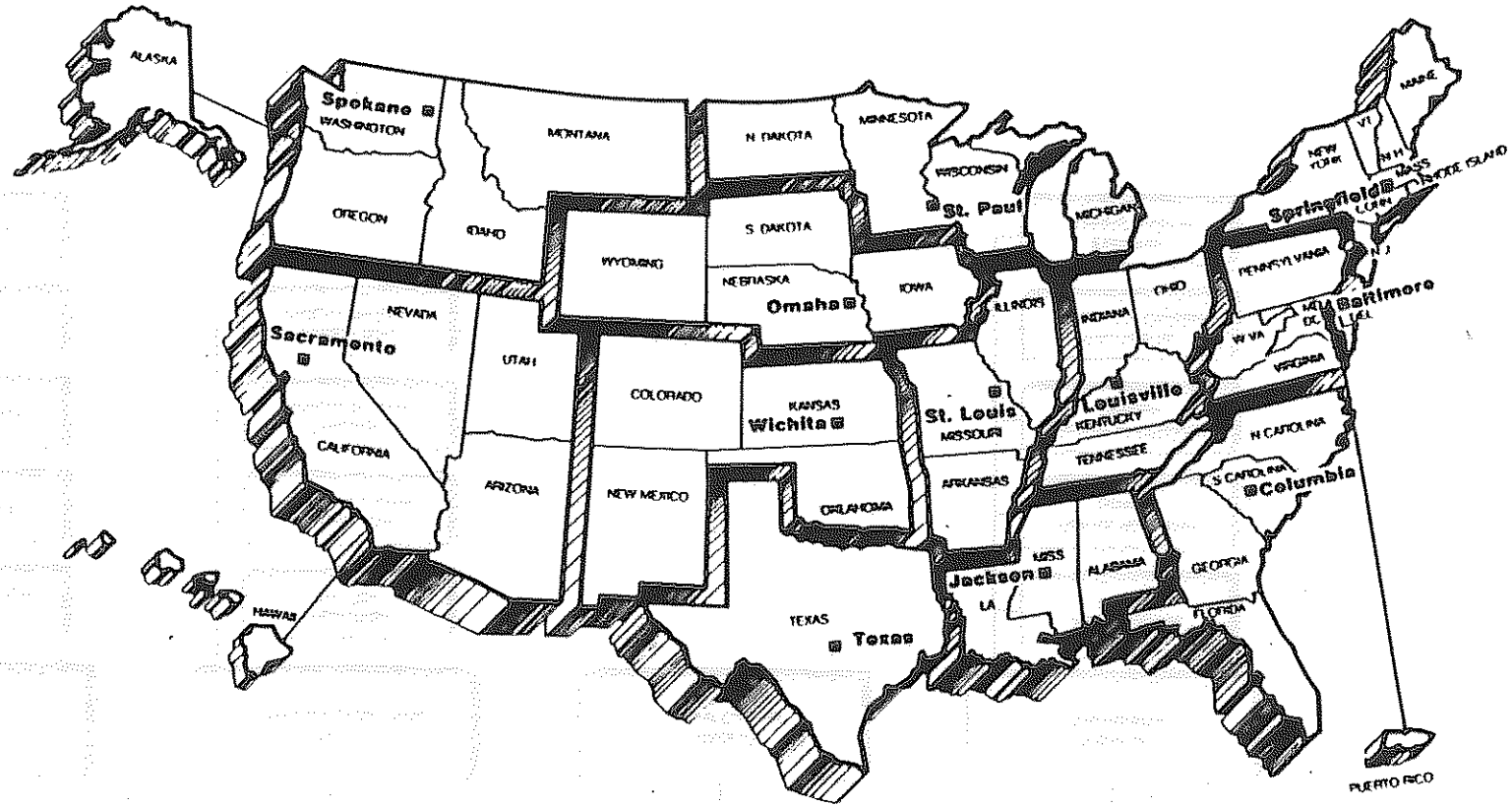



National Level
Service Organizations
- Performs functions and services for FCS banks. 12 U.S.C.A. § 2211.
- Formed by FCS banks with charter issued by FCA.
Farm Credit Corporation of America
Farm Credit Council
National Bank for Cooperatives
- Banks for Cooperatives that vote to consolidate
- Initial board consists of all members of consolidating district boards who were elected by cooperative stockholders. 12 U.S.C.A. § 2142(a).
- Permanent board:
• Three members from each consolidating district, one of whom is a farmer;
• One member elected by district bank for cooperatives stockholders who do not consolidate;
• One member selected by above board members – cannot be shareholder, director, or employee.
12 U.S.C.A. § 2142(a).
District Banks
Farm Credit Banks
- Mandatory merger of FLB and FICB. 12 U.S.C.A. § 2011.
- Board of directors – number as required in bylaws; elected from stockholders; at least one member is elected by the elected directors – this member cannot be a stockholder or employee of an FCS institution. 12 U.S.C.A. § 2012.
- Makes real estate loans to farmers and discounts loans from PCAs. 12 U.S.C.A. § 2015.
Bank for Cooperatives
- Makes loans to eligible cooperatives. 12 U.S.C.A. § 2128.
- Board consists of three members: two elected by cooperative shareholders, one chosen by two elected members – this member cannot be officer, shareholder or employee of an FCS institution. § 414(a) of Act.
- St. Paul, Springfield, Jackson, and Spokane have a district BC.
Farm Credit Associations
Merged Production Credit Associations and Federal Land Bank Associations
Agricultural Credit Associations
- Power to merge under 12 U.S.C.A. § 2279b-1.
- Farm Credit Banks must transfer direct lending authority of FLB to merged association. 12 U.S.C.A. § 2279c.
Federal Land Bank Associations
- Makes real estate loans through Farm Credit Banks. 12 U.S.C.A. § 2021.
- Farm Credit Banks can assign loan authority to FLBA. 12 U.S.C.A. § 2279b.
- Board elected by voting members of association; number set by bylaws; one member must be chosen by elected members – this member cannot be shareholder, director, or employee of an FCS institution. 12 U.S.C.A. § 2092.
Production Credit Associations
- Makes short- and intermediate-term loans to farmers. 12 U.S.C.A. § 2075(a).
- Board elected by voting members of association; number set by bylaws; one member must be chosen by elected members – this member cannot be shareholder, director, or employee of an FCS institution. 12 U.S.C.A. § 2072.
Farmers and Ranchers
- Eligibility defined at 12 C.F.R. § 613.3020.
Borrowers
Cooperatives
- Eligibility defined at 12 U.S.C.A. § 2129.

FARM CREDIT ADMINISTRATION



Farm Credit System Districts



APPENDIX B

DISTRESSED LOAN RESTRUCTURING ANALYSIS

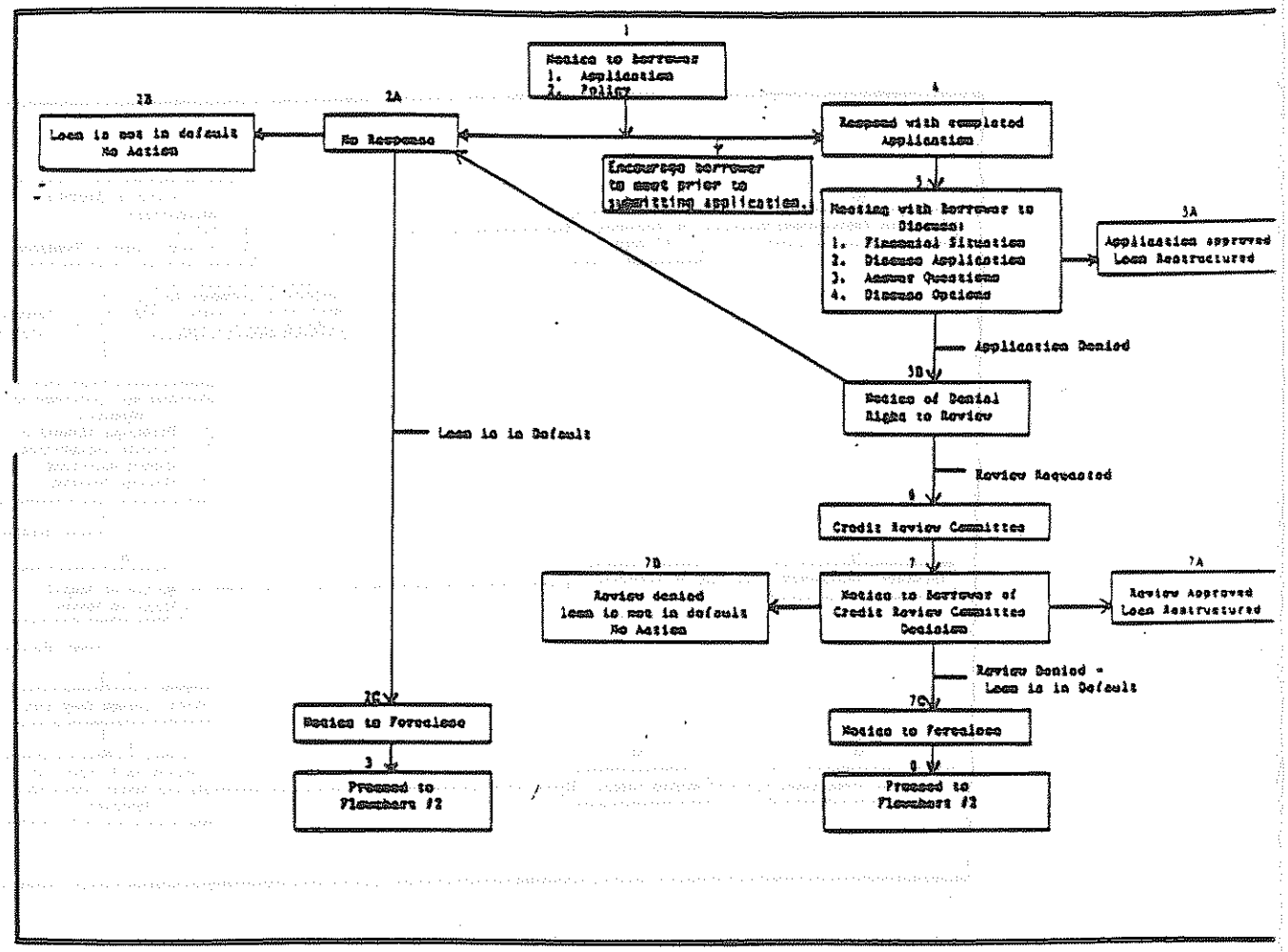
DISTRESSED LOAN RESTRUCTURING	SECTION FLOWCHARTS
	SUBJECT Distressed Loan, Not In Default

SUMMARY:

If a loan is determined to be distressed, but is not in default, the following instructions will be observed.

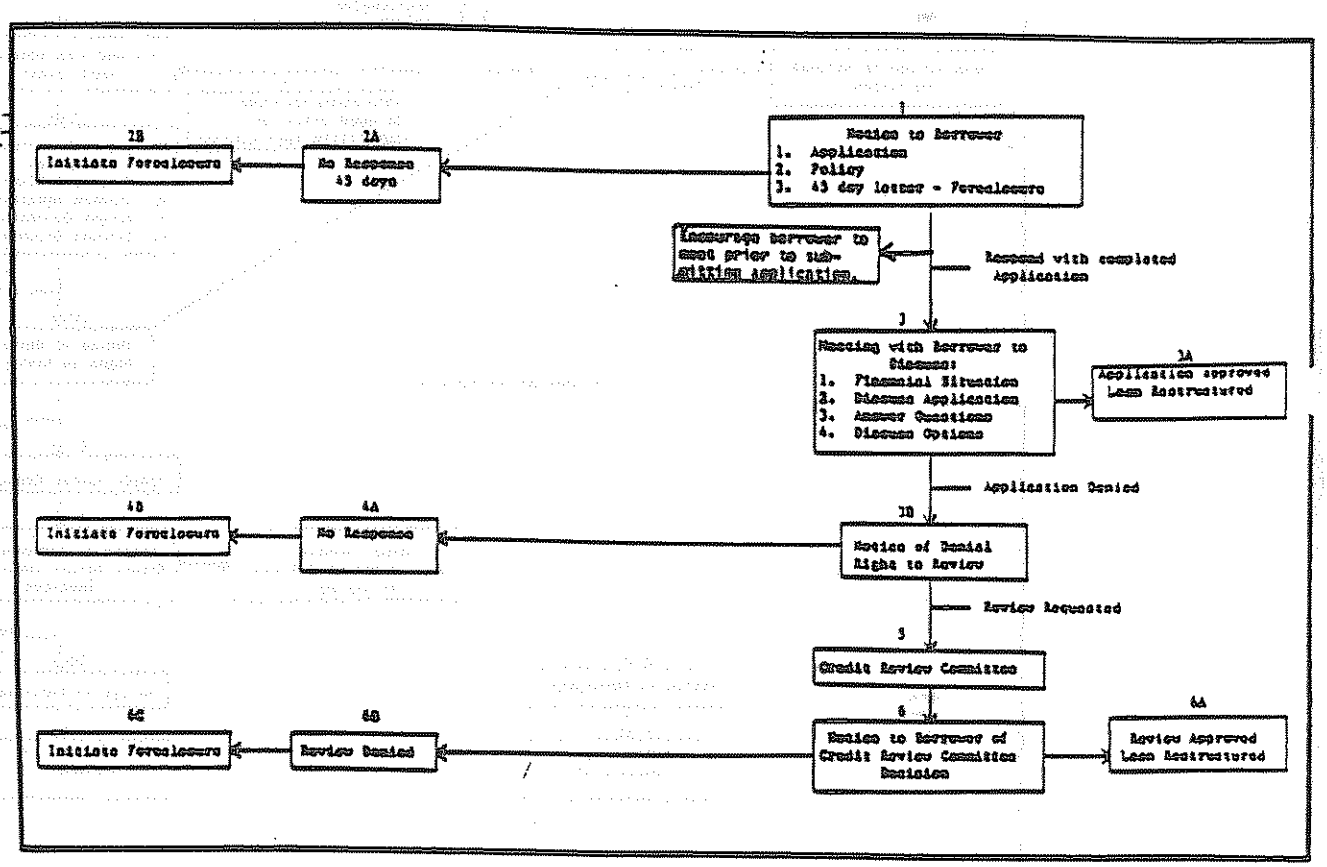
STEP 1	A distressed loan notice (application and policy) will be promptly sent to the borrower. The notice does not contain a time frame for response; however, the district may decide upon a reasonable response time.
STEP 2A	If the borrower doesn't respond to the notice, it will be determined if the loan is delinquent or in default.
STEP 2B	If the loan is delinquent, the lender shall decide what action, if any, is appropriate.
STEP 2C	If the loan is in default, the lender will send a 45-day foreclosure notice to the borrower.
STEP 3	If there is no response to the foreclosure notice, the lender may proceed to Flowchart #2, Distressed Loan, In Default (Concurrent Notice).
STEPS 4&5	If the borrower responds with a completed application, a meeting will be arranged with the borrower.
STEP 5A	If the application is approved, the loan shall be restructured.
STEP 5B	If the application is denied, a denial notice with a right to review will be sent to the borrower. If there is no response to the denial notice, the lender may return to Step 2A and proceed as indicated.
STEP 6	If a response requesting a review is received, a credit review committee meeting will be held.
STEP 7	A notice of the credit review committee's decision shall be sent to the borrower.
STEP 7A	If the review is approved, the loan shall be restructured.

SECTION	SUBJECT
FLOWCHARTS	Distressed Loan, Not In Default



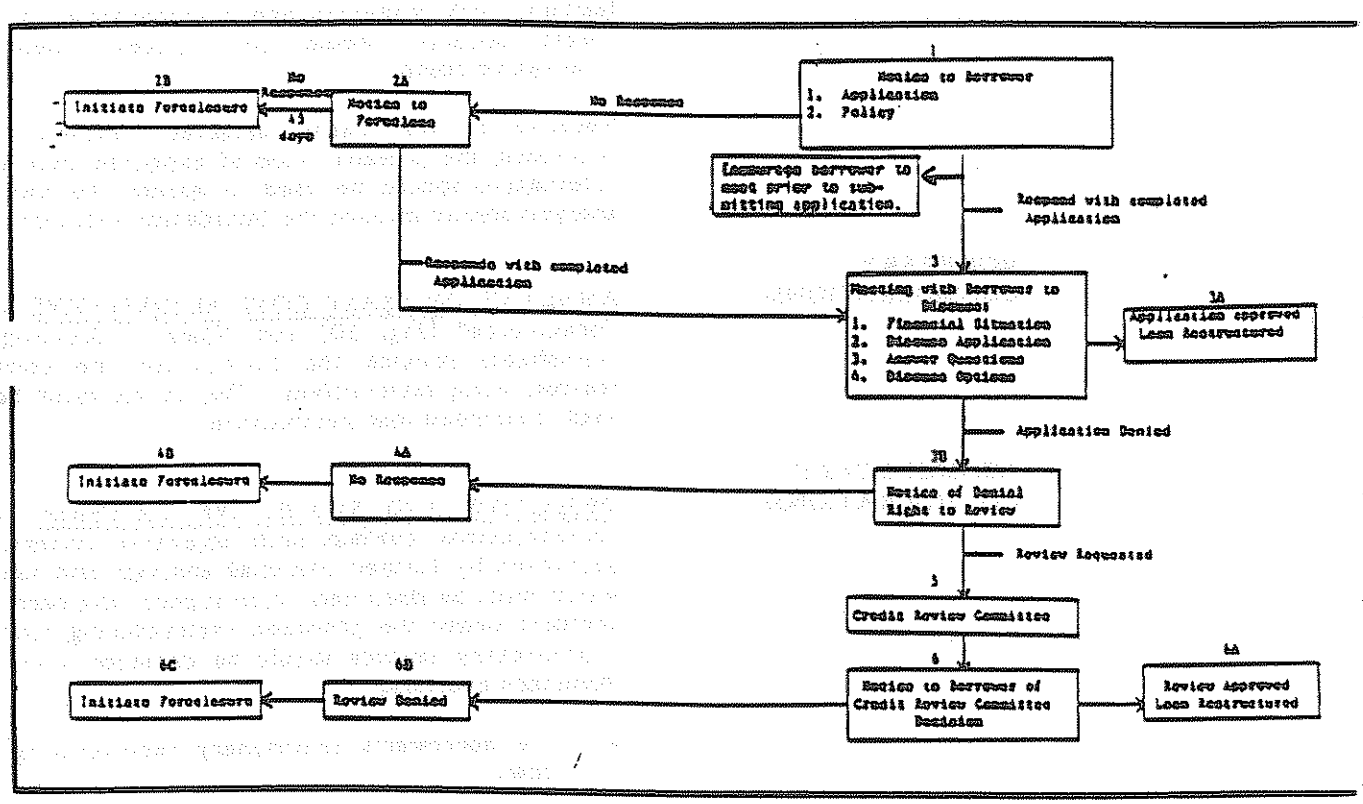
Restructuring Flow Chart — Distressed Loan, Not in Default
Page 1 of 1

SECTION	SUBJECT
FLOWCHARTS	Distressed Loan, In Default (Concurrent Notice)



Restructuring Flow Chart — Distressed Loan, in Default (Concurrent Notice)
Page 1 of 1

SECTION	SUBJECT
FLOWCHARTS	Distressed Loan, In Default (Non-Concurrent Notice)



Restructuring Flow Chart — Distressed Loan, In Default (Non-Concurrent Notice)

DISTRESSED LOAN RESTRUCTURING	SECTION STEP-BY-STEP TO RESTRUCTURING
	SUBJECT Least Cost Analysis

SUMMARY:

The district policy requires a distressed loan to be restructured if the cost of restructuring to the lender is less than or equal to the potential cost of foreclosure. All relevant factors, both monetary and nonmonetary, to making a sound credit decision should be included when analyzing the alternative costs.

Because of the many variables inherent in restructuring proposals, the present value of expected cash flows from each alternative should be used to assess the various costs. The analysis should include the liquidation value of the loan.

MONETARY CONSIDERATIONS:

ANALYSIS OF LEAST COST ALTERNATIVE — The "Cost of Foreclosure" (Fig. 30) and "Cost of Restructure" (Fig. 31) worksheets provide the format for the comparison of the restructuring alternatives. The forms must be completed on each distressed loan restructure.

NONMONETARY CONSIDERATIONS:

OBJECTIVE AND SUBJECTIVE CRITERIA — Nonmonetary considerations contain both objective criteria that must be supported by further financial analysis and subjective criteria which must be documented to support the borrower's ability to perform under the proposed restructuring plan. Th following nonmonetary factors should be considered in addition to the monetary analysis.

- The borrower's preliminary restructuring plan and cash flow.
- The borrower's willingness to apply income from all sources over and above necessary and reasonable living and operating expenses to the payment of primary obligations.
- Assets to be pledged.
- The probability that orderly debt retirement will occur as a result of the proposed restructure.
- The borrower's current and complete financial statements and supporting information.
- The borrower's financial capacity and management skills to protect the collateral from diversion, dissipation, or deterioration.

THE TIME TO ACQUIRED TITLE to the collateral through foreclosure would be six to nine months. Legal and other related costs should be $2,000.

LIQUIDATION — The property could be liquidated 10 to 12 months after acquisition.

- A distressed sales allowance of 15% would be necessary for a quick sale.
- Commissions and other selling costs are estimated to be 6% of the selling price.

TAXES — There are delinquent property taxes totaling $7,500 that must be paid within 90 days. Future taxes are $2,500 per year.

RENT — The property can be cash rented to a neighboring farmer for $11,000 per year.

THE LENDER'S COST OF FUNDS is currently 10.75%.

DEFICIENCY JUDGEMENT -- The borrower has no other material assets to cover a deficiency judgement.

MISCELLANEOUS MAINTENANCE COSTS should be $600 per year. There are no insurance requirements.

EXAMPLE - RESTRUCTURE PROPOSAL:

The borrower has submitted a restructuring application with the following terms.

- All debt exceeding $275,000 would be forgiven immediately.
- The remaining loan term would be extended to 25 years.
- The interest rate would be fixed at 9.0% for five years, then revert to the normal rate.
- The delinquent property taxes, future taxes, and miscellaneous maintenance costs would be paid by the borrower.
- Annual installments for the first three years would be interest only, and equal $24,750 per year at 9.0% interest.

COST OF FORECLOSURE WORKSHEET

BASIC DATA:

Cost of funds (0.0000)	0.1075
Principal balance (including stock)*	279,415

*Remaining after any immediate principal payments

CASH INFLOWS:	Year 1	Year 2	Year 3	Year 4	Year 5
Appraised value of collateral		250,000			
Less distressed sales allowance					
Less prior liens (balance at time of sale)					
Less decrease in collateral value					
Subtotal	0	250,000	0	0	0
Misc. income					
Misc. income		11,000			
Total Cash Inflows	0	261,000	0	0	0
CASH OUTFLOWS:					
Estimated costs - existing collateral:					
Payments on prior liens					
Delinquent taxes and taxes due	10,000	2,500			
Maintenance and insurance costs	600	600			
Attorney's fees, court costs, etc.	2,000				
Commissions and other selling costs		15,000			
Misc. other costs					
Other funds advanced					
Subtotal ("hard costs")	12,600	18,100	0	0	0
Cost of funds to bank/association	30,037	31,382	0	0	0
Total Cash Outflows	42,637	49,482	0	0	0
SUMMARY OF INVESTMENT:					
Investment at beginning of period	279,415	282,015	0	0	0
Addition to (reduction in) investment	12,600	-211,508	0	0	0
Investment at end of period	282,015	80,507	0	0	0

COST OF FORECLOSURE:	Cash In	Cash Out	Net Cash Flow
Year 1	0	42,637	-42,637
Year 2	261,000	49,482	211,508
Year 3	0	0	0
Year 4	0	0	0
Year 5	0	0	0

Present value - net cash flows	133,592
Total debt less stock (current status)*	-309,595
Cost of Foreclosure	-176,003

*Remaining after any immediate payments (enter negative number)

Cost of Foreclosure Worksheet
Page 1 of 1

Appendix C

COSTS ASSOCIATED WITH FLB/PCA FORECLOSURE

Legal

I. Attorney fees and expenses

a. recoverable
b. non-recoverable - assume Chapter 7 bankruptcy to extinguish deficiency judgment

II. Court costs

a. trial
b. appellate

Time Elapsed

I. Time period between commencement of action to final judgment: _____ to _____

II. Time period between final judgment and foreclosure sale: _____ to _____

Land

I. Out-of-pocket costs during litigationand holding period before resale:

a. appraisal fee

b. title examination costs

c. survey costs

d. insurance premiums

e. taxes - overdue, current, and future

f. erosion control expenses including costs of planting cover crop

g. improvement repair and maintenance

1. fences

2. dwellings

3. outbuildings

4. roads

5. wells

6. drainage, watercourses, and ponds

7. labor

8. equipment and materials

9. water

10. electricity

11. natural gas

h. "clean-up"

i. farm management services including the costs of procuring tenants and negotiating leases

j. administrative costs

k. protection against vandalism

l. other costs

II. Lost Earnings

a. estimated depreciation during litigation period

b. estimated loss of interest during litigation period

c. estimated depreciation during holding period

d. estimated loss of interest during holding period

e. amount charged to the allowance for loan losses

f. estimated resale price

g. anticipated sale terms and interest rate

h. will there be a stock purchase requirement?

III. Other Factors - assume sales will be timed to avoid market saturation and increased depreciation

a. how many other parcels (and acreage) are held by FLB and/or PCA in market area

b. when are they scheduled to be sold

c. how many other parcels does FLB and/or PCA anticipate acquiring in the next two years in market area

d. will your taking this property into inventory affect the anticipated sale dates of those properties. If so, describe

e. if so, what is the estimate of depreciation and lost earnings for each parcel whose sale is delayed

f. to what extent will land prices be decreased by the taking of this land into inventory

IV. Equipment - assume requirement of a commercially reasonable resale under U.C.C. applies

a. cost of recovery including hauling to storage site

b. appraisal fees

c. auction or other sale costs

d. storage costs

e. depreciation during holding period

f. repair and refurbishing costs

g. anticipated sale dates, sale methods, and sale location

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Umbaugh Pole Building Co., Inc. v. Scott, 58 Ohio St. 2d 282, 390 N.E.2d 320 (1979)

Stone v. Davis, 66 Ohio St. 2d 74, 419 N.E.2d 1094, cert. denied, 454 U.S. 1081 (1981)

Walters v. First National Bank of Newark, 69 Ohio St. 2d 677, 433 N.E.2d 608 (1982)

Jacobson v. Western Montana Production Credit Association, 643 F. Supp. 391 (D. Mont. 1986)

PCA of Lancaster v. Croft, 473 N.W.2d 544 (Ws. Ct. App. 1988)

Federal Land Bank of St. Paul v. Asbridge, 414 N.W.2d 596 (N.D. 1987)

Knox National Farm Loan Association v. Phillips, 300 U.S. 194 (1937)

Rhodes v. Little Falls Dairy Co., Inc., 230 App. Div. 571, 245 N.Y.S. 432, aff'd 256 N.Y. 559, 177 N.E. 140 (1931)

Snyder v. Colwell Cooperative Grain Exchange, 231 Iowa 1210, 3 N.W.2d 507 (1942)

Barrett v. Bank of America, 183 Cal. App. 3d 1362, 229 Cal. Rptr. 16 (1986)

Lash v. Cheshire County Savings Bank, 474 A.2d 980 (N.H. 1984)

Federal Land Bank of St. Paul v. Overboe, 404 N.W.2d 445 (N.D. 1987)

Benson Cooperative Creamery v. First District Association, 151 N.W.2d 422 (Minn. 1967)

VI. FARM CREDIT SYSTEM BORROWER RIGHTS

G. Right of First Refusal

Martinson v. Federal Land Bank of St. Paul, No. A2-88-31 (D.N.D. April 21, 1988); appeal filed, No. 88-5202 MD (8th Cir. May 20, 1988)

Leckband v. Naylor, No. Civ. 3-88167 (D. Minn. May 17, 1988); appeal filed, No. 88-5301 MN (8th Cir. July 18, 1988)

VII. JUDICIAL REVIEW OF RESTRUCTURING DENIALS

Federal Land Bank of Wichita v. Read, 703 P.2d 777 (Kan. 1985)

Tuepker v. FmHA, 708 F.2d 1329 (8th Cir. 1983)

Continental Federal Savings and Loan Ass'n v. Fetter, 564 A.2d 1013 (Okla. 1977)

Precision Inst. Mfg. Co. v. Automotive M. M. Co., 324 U.S. 806 (1945)

Deweese v. Reinhard, 165 U.S. 386 (1897)

Federal Land Bank of St. Paul v. Overboe, 404 N.W.2d 445 (N.D. 1987)

Farmers Production Credit Association of Ashland v. Johnson, 24 Ohio St. 2d 69, 493 N.E.2d 946 (1986)

Troutman v. Federal Land Bank of Spokane, No. CV88-762-PA (D. Ore. Sept. 15, 1988)

Note: The annual reports of the Farm Credit Administration generally list, by case name, the current litigation against the FCA.

THOUGHTS, COMMENTS, AND A ROUGH CHECKLIST ON FCS LOAN RESTRUCTURING FROM THE BORROWER'S PERSPECTIVE

This outline is intended to supplement the course materials entitled "Litigation Against the Farm Credit System" dated September 15, 1988.

I. GOALS:

A. Primary: Lender acceptance of a restructuring proposal that the borrower can perform. Unrealistic borrower cash flows may gain lender acceptance, but inability to perform may preclude subsequent loan restructuring.

B. Secondary: Because judicial review of a restructuring denial ultimately may be sought, documentation of any procedural irregularities or other arbitrary and capricious behavior on the part of the lender should be a continuing consideration throughout the process. See Federal Land Bank of St. Paul v. Overboe, 404 N.W. 2d 445 (N.D. 1987). However, borrowers and their counsel should be mindful that judicial intervention in the restructuring process is likely to be to be very limited and, in some circumstances or jurisdictions, nonexistent. See Troutman v. Federal Land Bank of Spokane, No. CV88-726-PA (D. Or. Sept. 15, 1988) (order denying preliminary injunction); Kramer v. Federal Land Bank of St. Paul, No. Civ. 3-88-297 (D. Minn. Sept. 16, 1988) (order denying preliminary injunction); see also Tuepker v. FmHA, 708 F.2d

1329, 1332 (8th Cir. 1983) (declining to review an FmHA loan denial in the absence of a claim "alleging 'a substantial departure from important procedural rights, a misconstruction of governing legislation, or some like error going to the heart of the administrative determination.'"); Woodsmall v. Lyng, 816 F.2d 1241, 1245 (8th Cir. 1987) (denial of FmHA loan on the grounds that the applicant was not creditworthy was not reviewable because the federal courts "are not equipped to undertake such a task, for in these matters we have neither the training nor the experience of an FmHA loan officer.")

II. ELIGIBILITY FOR RESTRUCTURING:

A. Definition of distressed loan:

"The term 'distressed loan' means a loan that the borrower does not have the financial capacity to pay according to its terms and that exhibits one or more of the following characteristics:

A. The borrower is demonstrating adverse financial and repayment trends.

B. The loan is delinquent or past due under the terms of the loan contract.

C. One or both of the factors listed in subparagraphs (a) and (b), together with inadequate collateralization, present a high probability of loss to the lender."

12 U.S.C.A. Sec. 2202a(a)(3)(West Supp.1988). The regulations provide that the lender has discretion in

determining if the borrower has the financial capacity to repay the loan. 53 Fed. Reg. 35427, 35453 (1988) (to be codified at 12 C.F.R. Sec. 614.449 (e)).

B. What does a borrower do when he believes that his loan is a "distressed loan" eligible for consideration for restructuring, but the lender disagrees?

1. Creating a monetary default to "get the attention" of the lender is rarely, if ever, advisable. The lender may deem the default "voluntary" and continue to maintain that the loan is not distressed. Moreover, a "voluntary default" may result in the borrower being ineligible for the right of first refusal. "Previous owner", for purposes of the right of first refusal, is limited to prior record owners who "did not have the financial resources, as determined by the institution, to avoid foreclosure...." 53 Fed. Reg. 35427, 35456 (1988) (to be codified at 12 C.F.R. Sec. 614.4522 (a)(2)).

2. A better alternative would be to prepare a cash flow that both illustrates that the borrower faces the prospect of being unable to pay the original loan according to its terms and also demonstrates that the borrower could repay a restructured note that would meet the criteria for mandatory loan restructuring. The lender may be more willing to consider the loan a distressed loan if the borrower also presents to the lender an acceptable restructuring proposal with his request for a determination that the loan is distressed.

C. What does a borrower do if he has created a "voluntary default" and now desires to backtrack to avoid a foreclosure without the opportunity to be considered for restructuring? The best alternative may be to cure the default. Lenders may not enforce acceleration for monetary default "after a borrower has made all accrued payments of principal, interest, and penalties...." 12 U.S.C.A. Sec. 2202d (a)(West Supp. 1988); 53 Fed. Reg. 35427, 35454-55 (1988)(to be codified at 12 C.F.R. Sec. 614.4514)

D. Is a borrower who has converted collateral eligible for restructuring?

1. Conversion of a FCS lender's collateral is a federal criminal offense. 18 U.S.C.A. Sec. 658 (West 1976).

2. Conversion may prevent the borrower from avoiding acceleration by paying all accrued principal, interest, and penalties. 53 Fed. Reg. 35427, 35454-55 (1988)(to be codified at 12 C.F.R. Sec. 614.4514).

3. Conversion or the dissipation, destruction, or deterioration of collateral may also excuse the lender from having to provide the 45 day notice of the availability of restructuring prior to commencing foreclosure proceedings. 12 U.S.C.A. Sec. 2202a(j) (West Supp. 1988); 53 Fed. Reg. 35427, 35455-56 (1988) (to be codified at 12 C.F.R. Sec. 614.4519). However, even though the 45 day notice is excused, the loan theoretically is still eligible for restructuring if it is a distressed loan. 12 U.S.C.A. Sec. 2202a(b)(1) (West Supp. 1988). As a practical matter, a

conversion will probably provide a sufficient basis to deny restructuring, and the prior replevin or foreclosure of the collateral will have substantially impaired the borrower's ability to "cash flow" a restructured loan. The availability of restructuring may have practical significance only if the borrower can somehow excuse the loss or deterioration of the collateral and can file for bankruptcy relief prior to the replevin or foreclosure seizure. Of course, in such a case, the failure to excuse the conversion may result in the debt not being discharged. 11 U.S.C.A. Sec. 523(a)(4)(West 1979).

E. If the lender began foreclosure proceedings but did not complete those proceedings (according to state law) prior to January 6, 1988, the effective date of the Agricultural Credit Act of 1987, the loan is still eligible for restructuring. See 53 Fed. Reg. 35427, 35428 (1988); Harper v. Federal Land Bank of Spokane, No. CV88-449 JU (D. Or. May 5, 1988) (order granting preliminary injunction), appeal filed, No. 88-4033 (9th Cir. July 26, 1988); see also Federal Land Bank of Omaha v. Engleken, No. C85-2062 (N.D. Iowa Aug. 25, 1988).

F. So long as a reorganization plan has not been confirmed, a borrower in bankruptcy appears to be eligible for consideration for restructuring. E.g., In the Matter of Dilsaver, 86 Bankr. 1010 (Bankr. D. Neb. 1988) (appeal pending); Stainback v. Federal Land Bank of Jackson, No. GC 88-25-NB-O (N.D. Miss. Feb. 5, 1988) (order granting

preliminary injunction) (set for trial); In the Matter of Kraus, No. BK 86-2677 (Bankr. D. Neb. May 20, 1988).

III. APPLYING FOR RESTRUCTURING:

A. Notification by a lender to the borrower of elibility for loan restructuring consideration:

1. When lender determines loan is distressed (12 U.S.C.A. Sec. 2202a(b)(1) (West Supp. 1988); 53 Fed. Reg. 35427, 35455 (1987) (to be codified at 12 C.F.R. Sec. 614.4516)); or

2. 45 days prior to the commencement of foreclosure proceedings (12 U.S.C.A. Sec. 2202a(b)(12) (West Supp. 1988); 53 Fed. Reg. 35427, 35455-56 (1988) (to be codified at 12 C.F.R. Sec. 614.4518)).

B. Suit on the note or debt instrument is probably not a foreclosure proceeding. 12 U.S.C.A. Sec. 2202a(4)(West Supp. 1988); 53 Fed. Reg. 35427, 35454 (1988) (to be codified at 12 C.F.R. Sec. 614.4512 (e)(1) and (2)).

C. Notification must include a copy of the district restructuring policy and all materials necessary to enable the borrower to submit an application. 12 U.S.C.A. Sec. 2202 a(b)(1) (West Supp. 1988); 53 Fed. Reg. 35427, 35455 (1988)(to be codified at 12 C.F.R. Sec. 614.451 (a)).

D. What should the borrower do upon receipt of the notification?

1. Immediately assemble financial records and obtain expert assistance in developing and exploring cash flow potentials and possibilities. If necessary, explore

farm reorganization alternatives. Good cash flow projections take time to prepare. The borrower's financial data, including cash flow alternatives, will be the most significant information under consideration in most cases.

2. Consider requesting additional information from the lender. In the seminar materials is a sample letter (sometimes referred to as the "Kelley letter" because of its previous use in modified form by numerous borrowers with the resulting recognition by lenders in various districts of the remarkable similarity in language among the letters) requesting the following information:

(a) the computational formula that the lender will use to determine and compare cost of foreclosure with the cost of restructuring;

(b) the known costs of foreclosure, i.e. attorneys fees, disposition costs, etc.; and

(c) the appraised value of the collateral.

3. If a "Kelley letter" is sent but not answered, send another one bearing in mind the secondary goal listed under the first heading, "Goals", above. Stress that restructuring is designed to produce a "win-win" result, requiring good faith and full disclosure by both lender and borrower. See 53 Fed. Reg. 35427, 35433 (1988) ("A reading of the statute and regulation, [sic] indicates that both parties must put forth a good faith effort and work together.") Restructuring is not a poker game - it involves a major business decision by both parties, each having

legally enforceable duties to the other. In that regard, not all of the lender's duties arise from the Farm Credit Act, state cooperative law imposes overlapping and additional duties of good faith and full disclosure. Those duties are briefly outlined in the seminar materials.

4. Remember that all expenses and income considered in the cost of foreclosure and cost of restructuring are present-valued. Knowledge of the lender's discount rate is essential. Borrowers must be aware that in most districts the proposed restructured note will be discounted to reflect its present value.

5. Borrowers should also consider applying for a lower interest rate during the 45 day period. See 12 U.S.C.A. Sec. 2199(b) (West Supp. 1988); 53 Fed. Reg. 35427, 35452 (1988) (to be codified at 12 C.F.R. Sec. 614.4368). The required written response by the lender may identify problem areas with the loan that can be addressed in the restructuring proposal.

6. Consider meeting with the loan officer before submitting the restructuring proposal. 12 U.S.C.A. Sec. 2202a(c)(West Supp. 1988); 53 Fed. Reg. 35427, 35455 (1988)(to be codified at 12 C.F.R. Sec. 614.4516 (b)). Document all requests for information, responses, and other discussions at such a meeting.

7. Consider using any available mediation proceedings to obtain information from the lender. A provision of the

1987 Act, U.S.C.A. Sec. 5103(b) (West 1988), requires that FCS lenders:

(a) "cooperate in good faith with requests for information or analysis of information made in the course of mediation...." and

(b) "to present and explore debt restructuring proposals advanced in the course of such mediation." See 53 Fed. Reg. 35427, 35456 (1988) (to be codified at 12 C.F.R. Sec. 614.4521).

8. Remember to provide all the information requested by the lender in submitting the borrower's applications for restructuring. This may include balance sheets, income tax returns, projected cash flow, production records, etc.

9. The application must be accompanied by a proposal for the restructuring of the loan. Federal Land Bank of Omaha v. Christensen, No. 22641 (Buena Vista Co. Dist. Ct., Iowa, July 6, 1988) (order granting plaintiff's motion for summary judgment on the grounds that an application for restructuring unaccompanied by a plan was fatally defective).

10. Consider "packaging" the application and plan in "brochure" form or as an extended letter beginning with a discussion of the background of the borrower, the nature of the borrower's farming operation, and the reasons for the default. Then, discuss in detail the proposed plan and justify it with specific references to the projected cash flow. Also include an analysis of the cost of foreclosure

and the cost of restructuring, including the necessary computations. Do not assume that there will be considerable negotiation. Put the best plan the borrower can propose on the table. The lender has a right to the "least cost alternative" (12 U.S.C.A. Sec. 2202a(f) (West Supp. 1988), and the borrower may not be well served by a proposal that does not reflect that the borrower "is applying all income over and above necessary and reasonable living and operating expenses to the payment of primary obligations." 12 U.S.C.A. Sec. 2202a(d)(1)(B)(West Supp. 1988). Remember that the burden of justifying restructuring is ultimately borne by the borrower.

IV. CREDIT REVIEW COMMITTEE PROCEEDINGS:

A. The borrower must receive prompt written notice of a denial and the reasons for the denial. 12 U.S.C.A. Sec. 2201 (b)(West Supp. 1988); 53 Fed. Reg. 35427, 35455 (1988) (to be codified at 12 C.F.R. Sec. 614.4518).

B. Insist on lender disclosure of all "critical assumptions and relevant information" (whatever that means) prior to the credit review committee meeting. 53 Fed. Reg. 35427, 35444 (1988) (prefatory comments to the regulations).

C. Remember that the review process is just that, a review; most credit review committees will not consider new proposals at the committee meeting. 53 Fed. Reg. 35427, 35436 (1988).

D. The loan officer who made the initial denial of the restructuring proposal may participate in the review meeting

by providing information and answering questions, but he may not vote or participate in the committee's deliberations. 53 Fed. Reg. 35427, 35436 (1988); see also 12 U.S.C.A. Sec. 2202 (a)(2)(West Supp. 1988); 53 Fed. Reg. 35427, 35453 (1988) (to be codified at 12 C.F.R. Sec. 614.4442).

E. Borrowers may obtain "independent" appraisals of collateral. Agricultural Technical Corrections Act of 1988, H.R. 3980, 100 Cong. 2d Sess., 134 Cong. Rec. S10798, 10801 (daily ed. Aug. 3, 1988).

F. The board member serving on the committee must be a member of the board of the lender having ultimate authority over the loan. 53 Fed. Reg. 35427, 35453 (1986) (to be codified at 12 C.F.R. Sec. 614.4442). Where the review is a consolidated one involving both a FLB loan and a PCA loan, a board member from each entity must be present, unless the district Farm Credit Bank has the ultimate authority over both loans. In that case, only one board member from the Bank would be necessary.