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My name is Karen R. Krub. I am a Senior Staff Attorney with Farmer's Legal Action Group (FLAG) in Saint Paul, Minnesota. Thank you for the opportunity to present this testimony regarding the USDA Farm Loan Programs (FLP). I appreciate the opportunity to give a voice to the programs' farmer and rancher borrowers. The concerns I raise here today have been developed in coordination with the National Family Farm Coalition and others dedicated to improving access to credit for family farmers and ranchers.

FLAG's Work on Behalf of FLP Borrowers

Farmers' Legal Action Group, Inc. (FLAG) is a nonprofit, public interest law center that provides legal education, training, and support to family farmers and ranchers and their lawyers and advocates across the country. Over the past two decades, FLAG has provided legal assistance to thousands of small and mid-sized family farmers throughout the nation who participate in USDA's agricultural credit programs and the administrative review processes for these programs.

FLAG has worked for 20 years to improve the accessibility of the USDA credit and disaster assistance programs and help farmers understand their rights and obligations under those programs. FLAG attorneys have traveled all over the country conducting training sessions for farmers and ranchers and their advocates about the USDA credit and disaster programs. FLAG has also produced many volumes of farmer-friendly legal education materials that analyze and explain these programs and distributed them nationwide. These include: four editions of Farmers' Guide to FmHA; Farm Survival Handbook; Farmers' Guide to Getting a Guaranteed Loan; five editions of Farmers' Guide to Disaster Assistance; and scores of articles in our quarterly newsletter, Farmers' Legal Action Report.

As part of this effort, FLAG has monitored changes to the FLP programs over the past 20 years and has submitted extensive comments to the Farm Service Agency (FSA) (formerly the Farmers Home Administration, or FmHA) regarding the Agency's implementation of statutory changes and adoption of regulatory and policy changes. In recent years, FLAG's comments related to the Farm Loan Programs have addressed:[1]

- Several proposed rules affecting the Guaranteed Loan Program, including extensive proposed changes to the Interest Assistance Program.
- Changes to FSA's internal appeal procedures and required notice to program participants, including FLP applicants and borrowers.
- Proposed "streamlining" of the direct loan component of FLP, involving a comprehensive rewriting of program regulations and elimination of more than 90 percent of the regulatory language.
- Appraisal requirements for direct FLP loans.
- Implementation of the credit provisions of the 2002 Farm Bill.

FLAG attorneys also field hundreds of calls, letters, and email messages every year from farmers and ranchers and their attorneys and advocates across the country. Through these conversations we receive a great deal of information about how FSA is implementing its loan programs in various parts of the country.

The USDA Farm Loan Programs

Through the Farm Loan Programs, USDA acts as the lender of last resort for creditworthy family farmers and ranchers who are unable to obtain financing from commercial sources at reasonable rates and terms.[2] Despite the clearly articulated congressional policy of supporting the family farm system of agriculture through these credit programs, FSA (like its predecessor, FmHA) has a history of implementing the programs in such a way as to unduly limit their effectiveness and the benefits the programs are intended to bring to farmers and ranchers and their rural communities.

In the 1980s, administration of the USDA agricultural credit programs reached its nadir, seeing tens of thousands of borrowers forced to liquidate and federal courts around the country ruling that FmHA's procedures were unlawful. During this period, FLAG attorneys were counsel to FmHA borrowers in Coleman v. Block, representing a nationwide class of almost 250,000 farmers. In that lawsuit, the court found that FmHA's foreclosure and liquidation procedures violated the statutory directives and borrowers' due process rights. Congress addressed many of the issues raised in that litigation through the passage of the Agricultural Credit Act of 1987.

In the most general terms, the mandates of the 1987 Act reflect a few core principles related to the USDA loan programs: borrowers must receive full, timely information about the loan programs they participate in; it is in everyone's best interest for a financially distressed farmer to continue farming if a restructuring would leave the government no worse off than liquidation; decisions in individual

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1 The full text of FLAG comments on agency rulemaking can be found on FLAG's Web site at www.flaginc.org/topics/fedreg/comments/index.php.

2 See 7 U.S.C. §§ 1922, 1941, 2001.

cases must reflect uniform criteria; and borrowers must be treated fairly by the Agency. These principles are reflected in specific mandates, such as required notice of loan servicing programs and a period to consider the options before the Agency can accelerate a delinquent loan; a range of loan servicing tools; specific timeframes for the Agency to respond to loan applications and loan servicing requests; and a duty on the Agency's part to provide assistance to any farmer or rancher who seeks to make a loan application or servicing request.

Systemic Problems Continue to Pervade the Farm Loan Programs

Based on the observations FLAG has made in the work described above, we have identified several continuing problems with FSA's implementation and administration of the Farm Loan Programs. Some are legal problems embedded in the regulations and Agency policies that ignore or contradict statutory directives; some are guiding principles, not made explicit but nonetheless shaping Agency actions; and some are local problems resulting from confusion and/or bias.

In summary, these concerns are:

(1) <u>A general disregard for borrowers' interests.</u> The Agency's attitude about borrowers manifests itself in efforts to limit borrower and public input into the programs, interpreting policies as narrowly as possible against borrowers (sometimes narrower than even arguably permissible), behaving as if the Agency is not accountable for meeting program requirements, treating borrowers as a necessary evil rather than the ones for whom the programs exist, abdicating oversight duty in the guaranteed loan program, and delaying implementation of statutory and policy changes that benefit borrowers while implementing restrictions almost immediately.

> <u>Examples</u>:
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> Agency decision-makers are increasingly missing statutory deadlines for making determinations on loan applications and loan servicing requests. There are many instances where farmers have spent a decade or more in limbo because of Agency delays, and delays often cause people to lose rights as the rules change. At the same time, farmers are held to rigid timeframes, without exception.
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> We are hearing reports that local offices are increasingly failing to issue written decisions on loan applications and servicing requests, despite a statutory mandate to do so within 10 days of making a decision. If there is no written notice, borrowers don't learn of appeal rights.
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> The Agency has issued terse rejections of requests to clarify proposed rule language, even when commenters point out that local FSA office personnel are confused and are telling farmers the wrong information.
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> The Agency uses atypically short public comments for proposed and interim FLP rules, even for massive regulatory initiatives. In at least one case, the Agency refused to reopen or extend the comment period even when the original notice contained an error in the Agency contact information.

It sometimes takes years for the Agency to implement statutory changes that enhance eligibility or otherwise benefit borrowers. For example, the "debt forgiveness" restriction on eligibility for new FLP loans generally covers all forms of reducing or terminating a loan that cause a loss to USDA. The 2002 Farm Bill, however, provides that debt forgiveness specifically does not include any write-down of FSA debt received as part of the resolution of a discrimination complaint against the Secretary of Agriculture. FSA has not yet implemented this change by rule, though other 2002 Farm Bill changes were implemented in 2003; and the Agency omitted this exception from the 2004 proposed recodification of the direct loan program.

There is an increasing marginalization of borrowers in the Guaranteed Loan Program, made evident in an August 15, 2005, proposed rule where the Agency refers to guaranteed lenders as its "customers."[3] In that rule, the Agency proposed to relax a lender's maximum loss ratio for events beyond the lender's control.[4] The prefatory remarks to the proposed rule state that, in the six-year period that the Preferred Lender classification has been used, "an average of less than one lender a year" has had its PLP status revoked due to excessive loss ratio. Thus, based on the experience of what can be no more than five lenders, the Agency took the initiative to propose a rule change. There is nothing objectionable for borrowers about this proposal, but it reveals the lengths the Agency will go to on behalf of a handful of lenders while placing no obligation on lenders to provide similar leeway for borrowers. All of the exculpatory examples in the proposed change are events that would increase losses for lenders because they would threaten borrowers' viability. But where, borrowers reasonably ask, is the parallel language directing lenders to allow borrowers a grace period after a local freeze or economic downturn, a drop in local land values, a change in area industries, loss of market access, or biological or chemical damage?

Guaranteed loan borrowers and their advocates have repeatedly urged FSA, as part of the on-going effort to improve the guaranteed loan program, to consider more consistent and definite requirements for guaranteed loan servicing that ensure lenders have an incentive to make full use of their tools to avoid liquidation and losses, whether to borrowers or the government. When lenders unreasonably shift costs to borrowers or reject viable restructuring opportunities, the result is reduced program participation, higher default and liquidation rates, higher costs to the government, and more expensive credit for family farmers and ranchers—all of which are directly contrary to the purpose of the program. These changes could affect hundreds of borrowers every year and would further the fundamental purpose of the program, yet there has been no suggestion of consideration on the Agency's part. Instead, we see a proposed change that the Agency acknowledges would affect "an average of less than one lender a year."

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3 70 Fed. Reg. 47,730-47,733 (August 15, 2005).

4 Proposed § 762.106(g)(2)(ii)(A) provides examples of events which would be considered beyond the control of the lender and could therefore excuse exceeding the maximum loss ratio. These examples are: "a freeze with only local impact, economic downturn in a local area, drop in local land values, industries moving into or out of an area, loss of access to a market, and biological or chemical damage." 70 Fed. Reg. 47,732 (2005).

Another aspect of FSA personnel having lost perspective about the Farm Loan Programs is the extent to which borrowers report local personnel "taking things personally." This is manifested in experiences where borrowers are told by local personnel "you'll never get a loan here, quit trying," or where, instead of working with a borrower in financial distress to avoid liquidation and minimize losses to the borrower and the government, the local Agency personnel become focused on forcing a borrower out to "teach them a lesson."

Changes to Shared Appreciation Agreement (SAA) valuations, subtracting the value of capital improvements made during the SAA term from the calculation of "appreciation," were not implemented until eight months after the policy change was announced and after many, if not most, borrowers were unable to benefit from the change.[5]

(2) Removal of substantive provisions from regulations to internal handbooks. The Agency's current initiative to move program provisions from regulations to internal handbooks violates the Administrative Procedures Act mandate that rules affecting program rights be subject to notice-and-comment rulemaking, marks a return to the pre-1987 Act system where farmers lack a reliable method of knowing what that applicable program requirements are, and forces farmers in a potentially adversarial relationship with FSA to nonetheless rely on FSA to provide all applicable information when asked, and to be right about the answer.

FSA local offices also need clear direction to implement FSA loan programs. It is essential for clear information about the handling of loan applications and servicing requests to remain part of the rule so that each applicant and borrower is treated appropriately. For a farmer facing a hostile local office and no place else to go for the credit needed to keep an operation going, it is absolutely necessary that there be clear, objective regulations setting out the terms of the interaction between the two sides in the lending relationship. The reality is that some farmers still have to rely on regulatory language to get a fair consideration of their credit requests.

FSA's 2004 FLP "streamlining" proposal would replace some 1500 pages of current regulations with less than 100 pages. The stated intent of the proposed rule – to allow the general public, including loan applicants and borrowers, to "more easily find needed information" – is belied by the removal of significant substantive provisions from the rule language and the Agency's overt plan to rely heavily on internal handbooks for program administration. Although the Agency's prefatory remarks state that only procedures having "no impact on loan applicants and borrowers" were removed from the reorganized rule, this is simply not true. The reality is that the proposal removes and leaves unaddressed several areas of program administration that involve critical, substantive provisions.

Understanding that borrowers are generally unfamiliar with administrative processes and need assistance from FSA regarding information and procedural issues, it is imperative that FSA provide adequate information in the regulations to facilitate a good working relationship with

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5 The final rule on deduction of capital improvements, issued by FSA and effective on August 18, 2000, was based on a proposed rule published in the Federal Register in November 1999 and implemented a policy first announced by Secretary Glickman in March 1999. 65 Fed. Reg. 50,401 (2000).

borrowers and assure that borrowers are treated fairly. Removing important information from the regulations is counterproductive to these goals and will result in confusion and poor working relationships with borrowers, and leaves applicants and borrowers subject to the vagaries of presumptions, politics, and personality.

(3) Reintroducing broad Agency personnel discretion in loan decisions. The Agency's 2004 proposed rule for FLP "streamlining" would vest broad discretion with local office employees. In particular, language in the proposed eligibility requirements for loan servicing is subjective, susceptible to abuse, and likely to be the subject of many challenges. The history of abuse of such discretion in the Agency should make it unnecessary to point out why this is bad policy. Borrowers already report widespread disparity among who gets treated well and who gets pushed around or excluded; the intent to introduce still more subjective criteria is very troubling. This is particularly true given that there is still no meaningful process for investigation and resolution of allegations of discrimination made by applicants and borrowers about FSA decision-makers.

Like the detail of the current direct loan program regulations, a lack of discretion for Agency staff under the direct loan program has a historical context, which must not be forgotten: chronic abuses of discretion resulting in extensive litigation and the need for recurring congressional action.[6] Borrowers and loan applicants are justifiably wary of policy changes that would reopen areas of discretion that have been narrowed due to prior abuse. It is imperative that the Agency set meaningful parameters on any discretion. The Agency should be concerned with perceived differences as well as actual inconsistencies and should set out objective standards against which an employee's exercise of discretion in the direct loan programs can be measured. As the court in Harris v. Marsh observed,[7]

> Particularly when vague, subjective standards are given to a large number of individuals to be applied in a wholly discretionary manner, with no systematic review to ensure fairness, the chances are substantial that conscious or unconscious racial bias on the part of some of those individuals will infect the selection process.

Concerns about unfettered discretion on the part of local office employees also relate to the fact that African-American farmers who prevailed in the Pigford claims process and who were supposed to see a new opportunity to participate in the FLP credit programs have not seen that opportunity realized because they are back at the offices where the problems occurred.

(4) Refusal to implement National Appeals Division (NAD) determinations that are favorable to farmers. The Agency has a long history of attempting to insulate its FLP decisions from review and refusing to implement review determinations that find Agency error.

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6 See, e.g., Coleman v. Block, 580 F. Supp. 194, 200 (D.N.D. 1984) ("The FmHA concedes that the liquidation decision rarely turns on whether the farmer is delinquent...Instead, the decision rests on a host of highly subjective factors....").

7 679 F. Supp. 1204, 1299 n. 154 (E.D.N.C. 1987).

The creation of an independent NAD as part of the Department of Agriculture Reorganization Act of 1994 was a product of failings in the internal appeals processes of FSA's predecessors – FmHA and ASCS. One of the most problematic issues for program participants was obtaining implementation of a favorable appeal decision. Aware of this problem, Congress included language in the new NAD statute specifically addressing implementation, requiring that

> [o]n the return of a case to an agency pursuant to the final determination of [NAD], the head of the agency shall implement the final determination not later than 30 days after the effective date of the notice of the final determination.[8]

The NAD statute defines "implement" to mean

> those actions necessary to effectuate fully and promptly a final determination of [NAD] not later than 30 calendar days after the effective date of the final determination.[9]

Furthermore, the law requires that "[i]f an application for a loan ... is disapproved by the Secretary" but the disapproval is reversed or revised in an administrative appeal or lawsuit, "the Secretary shall act on the application...within 15 days."[10] Within those same 15 days, the Secretary must provide the loan applicant with "notice of the action." FLP applicants by definition have no other source of credit and are requesting credit that is necessary for their operations. Congress was clearly concerned that wrongfully denied loan applicants should not face further delays after a successful loan denial appeal and intended for these applicants to have essentially immediate relief.

Agency regulations ignore these statutory mandates and purport to allow the Agency to demand what is in effect a new application when an Agency's FLP decision is reversed. The Agency also believes that it need merely initiate implementation within the 30 days after an appeal determination is made. These positions are simply not permitted under the statutes.

One example of this is a farmer who submitted a loan servicing request in 2002, has since won three NAD appeals related to the request, and who is still awaiting implementation by the Agency. Each time a NAD appeal determination is rendered, the Agency insists on having new information. The farmer has met every deadline and provided all requested information and still cannot get any relief.

Because NAD lacks enforcement authority, when the Agency refuses to implement a NAD determination favorable to a borrower, the borrower's only recourse is the cost and delay of federal litigation (no small expense for the government, either) in order to obtain benefits that should be available as a matter of course. Those who cannot afford to litigate must accept the Agency's unlawful behavior, and so the Agency's "policy" of ignoring NAD determinations that it doesn't like succeeds by attrition.

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8 7 U.S.C. § 7000 (emphasis added).
9 7 U.S.C. § 6991(8) (emphasis added).
10 7 U.S.C. § 1983a(c).

In addition to implementation problems, the Agency's failure to provide adequate notice of appeal rights is a continuing problem. In some instances this is a failure at the local level and represents a training or management issue, in other instances, this is a national policy of thwarting appeal rights. For example, in the proposed FLP "streamlining" rule, FSA proposed to omit notice of appeal rights from restructuring offers and to instead "consolidate" the borrower's appeal rights in the subsequent notice of intent to accelerate. This proposal is contrary to law and reflects an innate disregard on the Agency's part for borrowers' rights to prompt, clear notice of appeal options.

Yet another way FSA attempts to insulate its decisions from review is by adopting an unreasonably narrow view of what of its decisions are appealable. Although NAD ultimately has the authority to decide what adverse decisions can be appealed, and takes a much broader view than FSA does, borrowers are informed of their appeal rights by FSA, not by NAD. Some NAD officials have estimated that non-appealability pronouncements by the Agency reduce appeals by 90 percent.

(5) <u>Unduly restrictive criteria without a reasonable policy justification.</u>

By requiring a lien on all property owned by borrowers whose direct FLP loans are restructured, FSA cripples these borrowers' ability to obtain future credit and improve their financial circumstances. Not only is the requirement excessive by any reasonable financial standards, it is burdensome and demeaning to the borrower to have to "beg FSA to subordinate" in order to obtain any other credit. In the words of a long-time advocate, "It's not right." The Emergency Loan program policy of requiring security valued at up to 150% of the loan amount should be more than adequate in these cases.

Another example of overreaching to the detriment of broad federal policy is the Agency's insistence on using "highest and best use" appraisals in loan servicing, rather than agricultural use appraisals. In the SAA context, FSA took a policy position not mandated by statute which actually forced otherwise successful operations to liquidate and convert to nonagricultural use, in violation of statutory mandates to utilize loan servicing programs "to the maximum extent possible" to facilitate keeping borrowers on the farm or ranch[11] and to avoid federal policies which drive the conversion of farmland to other uses.[12]

(6) <u>Refusal to make program information available.</u>

Borrowers continue to report difficulty obtaining access to and/or copies of their FLP files. Sometimes a borrower is given only one document and told "that's the whole file"; sometimes borrowers are told they can't have anyone with them when they look at their file. For guaranteed loans, borrowers often find themselves caught between the lender's and FSA's assertions that the file information can only be obtained from the other party.

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[11] 7 U.S.C. § 2001(a).
[12] 7 U.S.C. §§ 4201 et seq.

Local FSA personnel often resist or even refuse to make Agency policies, handbooks, and other information available to borrowers, or any member of the public, though there is an explicit national policy, as there must be, that these are to be provided upon request.

The Agency has refused to make available to the public the comments submitted in response to the FLP "streamlining" proposal, telling one requester that the comments cannot be released until a final rule is issued. This is counter to the E-Government Act of 2002, which requires that agencies "shall make publicly available online…all submissions" under APA notice-and-comment rule making, to the extent practicable.[13] Several other agencies within USDA, for example, the Agricultural Marketing Service and Natural Resources Conservation Service, have concluded that it is practicable to post comments received during the rulemaking process on their Web sites, and have in fact posted public comments. NRCS posted the literally thousands of comments it received on the proposed rule for the Conservation Security Program.

FSA also routinely refuses to provide public access to proposed forms that are the subject of information collection notices published in the Federal Register as required under the Paperwork Reduction Act. Although comments on the forms are requested, meaningful comment is impossible without access to the form language itself, and so the purpose of the Act is thwarted.

(7) Inability or refusal to recognize that successful agriculture can have many faces, sizes, etc. Farmers have experienced that there is little if any recognition by the Agency of the value of a diversity of agriculture, the value of allowing farmers to differentiate their operations to find a niche and be successful in different ways, despite the need for farmers to create new opportunities for themselves and adjust their expenses in the face of consistently low prices for the major commodities.

Smaller farmers continually report being told that they can only get financing if they expand their operations. Farmers wanting relatively small loans can't get them. The Agency and guaranteed lenders seem convinced that only big operations are desirable borrowers, whatever an applicant's actual financial situation. This is particularly a concern when the bigger loans quickly consume available funding. Paired with this are continuing concerns that the guaranteed loan funds are being used by lenders to move their existing borrower base to "safer" loans, while not providing any new credit availability in the marketplace. In particular, there are concerns that the "family farm" eligibility requirement is not enforced for guaranteed loans, so that the funds are used up by large-sum borrowers whose eligibility is questionable at best.

FSA seems to be making little effort to promote the guaranteed loan program and Interest Assistance Program among lenders in underserved areas, particularly lenders with high numbers of borrowers who would be considered "socially disadvantaged applicants," and helping those lenders to understand and participate in the programs.

(8) Lack of program information. There has been no real implementation of the transparency and reporting provisions of the 2002 Farm Bill that were intended to show who is benefiting from

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[13] 107 Pub. L. No. 347, § 206(d)(2)(A); 116 Stat. 2899 (2002) (codified at 44 U.S.C. § 3501 note).

the FLP programs. If the information doesn't get out, it becomes almost impossible to know whether the Agency is really serving the people the programs are intended to benefit.

Thank you again for the invitation to testify and for your concern for proper implementation of the Farm Loan Programs. At a time when increasing interest rates, high fuel and other input costs, and stagnant or dropping prices are impacting access to agricultural credit across the country, it is important for oversight by this Committee and action by the Agency to ensure loan availability and proper servicing under USDA's Farm Loan Programs.

Respectfully submitted,

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