FARM SERVICE AGENCY CREDIT PROGRAMS AND USDA NATIONAL APPEALS DIVISION

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I. INTRODUCTION

This Article provides a brief review of several current legal issues in the area of Farm Service Agency (FSA) Farm Credit Programs and the United States Department of Agriculture's (USDA) National Appeals Division (NAD).[1]

II. 1996 FAIR ACT AND FSA CREDIT

The 1996 Federal Agricultural Improvement and Reform Act (1996 FAIR Act) made significant changes to the FSA's major loan-making programs and to FSA's ability to provide loan servicing to borrowers.[2] The following summary lists a few of the most important changes.

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1. For a previous review, see James T. Massey, *Farmers Home Administration and Farm Credit System Update*, 73 NEB. L. REV. 187 (1994).

2. *See* 1996 Federal Agriculture Improvement and Reform Act (FAIR Act), Pub. L. No. 104-127, 1996 U.S.C.C.A.N. (110 Stat.) 888, 1197. For additional summaries of these changes in the law, see Wayne Watkinson & John Sheeley, *The Federal Agriculture Improvement and Reform Act of 1996*, 13 AGRIC. L. UPDATE 4 (1996); Randi Ilyse Roth & Lynn A. Hayes, *The Government Changes the*

A. *Debt Forgiveness and Loan Eligibility*

Many farmers who received debt forgiveness from FSA are no longer eligible for FSA loans.[3] Debt forgiveness for this purpose is defined as reducing or terminating a direct or guaranteed loan in a manner that results in a loss to the Secretary of Agriculture by write-down, write-off, debt settlement, payment of a loss claim on a guaranteed loan, or a discharge in bankruptcy.[4]

B. *Delinquency and Loan Eligibility*

The 1996 FAIR Act eliminated the possibility of FSA direct operating loans to borrowers who are delinquent on either a direct or guaranteed loan.[5] Further, the applicant, and anyone who will execute the promissory note, cannot be delinquent on any federal debt.[6] This restriction will not apply if the federal delinquency is cured on or before the loan closing date.[7]

Rules Mid-Game: An Explanation of the Credit Provisions of the FAIR Act, 11 FARMERS' L. ACTION RPT. pts. I & II (1996).

3. *See* 1996 FAIR Act, Pub. L. No. 104-127, § 648(b), 1996 U.S.C.C.A.N. (110 Stat.) 888, 1104 (to be codified at 7 U.S.C. § 2008h). The Secretary of Agriculture has agreed to seek a congressional change to this limitation. Statement of Agriculture Secretary Dan Glickman on the Introduction of the Agricultural Credit Restoration Act, USDA News Release No. 0124.98, Mar. 19, 1998 (visited Apr. 28, 1998) <http:www.usda.gov/news/releases/1998/03/0124>.

4. The borrower may not have received a write-off or write-down authorized by 7 U.S.C.A. § 2001(M)(1) (West Supp. 1998); compromise, adjustment, reduction or charge off authorized by 7 U.S.C.A. § 1981(b)(4) (West Supp. 1998); loss payment authorized by 7 U.S.C.A. § 2005 (West Supp. 1998); or bankruptcy authorized by 1996 FAIR Act, Pub. L. No. 104-127, § 648(b), 1996 U.S.C.C.A.N. (110 Stat.) 888, 1104. For USDA'S interpretation of these restrictions, see Implementation of Direct and Guaranteed Loan Making Provisions of the 1996 FAIR Act, 62 Fed. Reg. 9351, 9358 (1997) (to be codified at 7 C.F.R. § 1980.175(b)).

5. *See* 1996 FAIR Act, Pub. L. No. 104-127, § 648(b), 1996 U.S.C.C.A.N. (110 Stat.) 888, 1104 (to be codified at 7 U.S.C. § 2008h); Implementation of Direct and Guaranteed Loan Making Provisions of the 1996 FAIR Act, 62 Fed. Reg. 9351, 9358 (1997) (to be codified at 7 C.F.R. § 1980.175(b)); Implementation of the Direct and Guaranteed Loan Making Provisions of the Federal Agricultural Improvement Act of 1996: Correction, 62 Fed. Reg. 28,618, 28,619 (1997) (to be codified at 7 C.F.R. § 1980.175(b)).

6. *See* Implementation of the Direct and Guaranteed Loan Making Provisions of the Federal Agricultural Improvement Act of 1996: Correction, 62 Fed. Reg. 28,618, 28,619 (1997) (to be codified at 7 C.F.R. § 1980.175(b)).

7. *See id*.

C. *Emergency Loans Eligibility*

New FSA regulations say that FSA Emergency Loan (EM) applicants must not be delinquent on any direct or guaranteed FSA loan.[8] Emergency loans are available for victims of natural disasters. This regulation appears not to be required by current federal statute.[9] The 1996 FAIR Act states that the USDA may not make a "direct operating loan under subtitle B to a borrower who is delinquent on any loan made or guaranteed under this title."[10] EM loans are not direct operating loans and are not authorized under subtitle B of the statute.[11] On its face, therefore, the delinquency restriction in the FAIR Act only applies to direct operating loans. It does not apply to EM loans.[12]

Further, the language of the 1996 FAIR Act regarding the delinquency restriction is in direct contrast to the language used in the Act dealing with debt forgiveness.[13] In addition, the 1996 FAIR Act Conference Committee Managers made a similar distinction between the restrictions based on FSA delinquency and FSA debt forgiveness.[14]

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8. *See* Implementation of Direct and Guaranteed Loan Making Provisions of the 1996 FAIR Act, 62 Fed. Reg. 9351, 9356 (1997) (to be codified at 7 C.F.R. § 1945.162(a)).

9. The regulation containing the delinquency restriction is found in a Federal Register action that is described by the agency as being taken to "implement provisions of the Federal Agriculture Improvement and Reform Act of 1996 . . . . This action is required by the 1996 Act . . . ." Implementation of Direct and Guaranteed Loan Making Provisions of the 1996 FAIR Act, 62 Fed. Reg. 9351, 9351 (1997) (Summary).

10. 1996 FAIR Act, Pub. L. No. 104-127, § 648, 1996 U.S.C.C.A.N. (110 Stat.) 888, 1104 (to be codified at 7 U.S.C. § 2008h).

11. *See* 1996 FAIR Act, Pub. L. No. 104-127, § 612, 1996 U.S.C.C.A.N. (110 Stat.) 888, 1078 (to be codified at 7 U.S.C. § 1942).

12. *See* 7 C.F.R. § 1945.162(a) (1997). The main text of this subsection discusses EM eligibility limitations for those who have had FSA debt forgiveness. The eligibility limitation based on delinquency is added as the last sentence in this subsection. It seems possible, therefore, that the agency mistakenly believes that the delinquency restriction on FSA loan eligibility and the debt forgiveness restriction on FSA loan eligibility apply to the same potential borrowers. *See id.*

13. The FAIR Act does not allow FSA to "make or guarantee a loan under this title to a borrower who received debt forgiveness on a loan made or guaranteed under this title." 1996 FAIR Act, Pub. L. No. 104-127, § 648(b), 1996 U.S.C.C.A.N. (110 Stat.) 888, 1104 (to be codified at 7 U.S.C. § 2008h(b)). This broader language—restricting the making or guaranteeing of a loan—does restrict eligibility for EM loans on the basis of past debt forgiveness. If Congress had sought to limit EM loan eligibility based on loan delinquency, it would have used the same language it used when it limited eligibility based on loan forgiveness.

14. In their discussion of the restriction of loan making to delinquent borrowers, the conference managers refer to "farm operating loans to delinquent borrowers." 142 CONG. REC. H2716, H2825 (daily ed. Mar. 25, 1996). The managers follow the distinction found in the Act when they discuss limiting loans to those who have not had FSA debt forgiveness by the agency. When discussing this limitation, the managers refer to "generally prohibiting direct and guaranteed loans to borrowers" whose defaults have resulted in debt forgiveness. *Id.*

Although it is not mentioned in the Federal Register, the agency may have believed that the delinquency restriction on EM loan eligibility is required by the Federal Debt Collection Act. This statute prohibits federal assistance in the form of a loan or loan guarantee to persons with an outstanding debt that is in delinquent status.[15] The statute does not, however, apply to disaster loans.[16]

Finally, even if the statute limited EM loans, FSA could receive a waiver from the restriction.[17] According to the Federal Debt Collection Act, the limitations on loan making to people who are already delinquent on a debt to the federal government may be waived.[18] "The Secretary of the Treasury may exempt, at the request of an agency, any class of claims."[19] The statute does not restrict the character of the waiver. If the agency believed that the restrictions found in the Federal Debt Collection Act limited eligibility for EM loans, the agency could seek an exemption from the restrictions. The 1996 FAIR Act makes farmers who have received debt forgiveness on a direct loan in the past ineligible for future debt forgiveness on other direct loans.[20]

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15. *See* 31 U.S.C.A. § 3720B (West Supp. 1998).

16. *See id*.

17. The Federal Debt Collection Act restrictions found in 31 U.S.C.A. § 3720B do not apply to disaster loans. Omnibus Appropriations Act of Apr. 26, 1996, Pub. L. No. 104-134, § 31001(j)(1), 1996 U.S.C.C.A.N. (110 Stat.) 365 (to be codified at 31 U.S.C. § 3720B). The statute states specifically that "a person may not obtain any Federal financial assistance in the form of a loan (other than a disaster loan) . . . if the person has an outstanding debt . . . ." 31 U.S.C.A. § 3720B (West Supp. 1998). By statute and regulation, EM loans are solely disaster loans. The Secretary is only authorized to make EM loans "where the Secretary finds that the applicants' farming, ranching, or aquaculture operations have been substantially affected by a natural disaster in the United States or by a major disaster or emergency designated by the President under the Disaster Relief and Emergency Assistance Act." 7 U.S.C. § 1961(a) (1994). FSA regulations require that to be eligible for an EM loan the farmer must operate in a disaster area. 7 C.F.R. §§ 1945.20, 1945.162(e) (1997).

18. *See* 31 U.S.C.A. § 3720B (West Supp. 1998).

19. *Id*.

20. *See* 1996 FAIR Act, Pub. L. No. 104-127, § 648(b), 1996 U.S.C.C.A.N. (110 Stat.) 888, 1104 (to be codified at 7 U.S.C. § 2008h) (stating that the USDA may not "provide to a borrower debt forgiveness on a direct loan made under this title if the borrower has received debt forgiveness on another direct loan made under this title"). Guaranteed loan debt forgiveness does not, however, trigger these restrictions. As a result, if the borrower gets debt forgiveness on a guaranteed loan, it still should be possible to get debt forgiveness on a direct loan in the future. Further, if a farmer receives guaranteed loan debt forgiveness, he or she still should be eligible to receive debt forgiveness on a guaranteed loan in the future.

D. *No Leaseback-Buyback, No Net Recovery Buyout*

The 1996 FAIR Act eliminated the farmland leaseback-buyback program.[21] This program offered farmers who had lost their farmland to FSA through foreclosure, bankruptcy, or voluntary conveyance a chance to reacquire that land.[22]

The Act eliminated FSA authority to enter into net recovery buyouts of farm borrowers.[23] This authority was replaced with a current market value buyout program.[24] The Act also changed the formula that FSA will use to measure farmers' cash flow for the purpose of determining loan servicing eligibility.[25]

E. *More Beginning Farmer Loans, More Guaranteed Loans*

The FAIR Act created rules for direct operating and direct farm ownership loans that pushed the program toward beginning farmers.[26] In addition, the Act continued the recent trend of attempting to replace direct loans with guaranteed loans.[27]

F. *Inventory Land Changes*

The 1996 FAIR Act made significant changes to the procedures FSA uses to dispose of farmland in its inventory.[28] The Act eliminated many of the priorities for sale or lease of FSA inventory farmland.[29] The only farmers who will be given priority consideration for purchases of inventory farmland are qualified beginning

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21. *See* 1996 FAIR Act, Pub. L. No. 104-127, § 638, 1996 U.S.C.C.A.N. (110 Stat.) 888, 1093 (to be codified at 7 U.S.C. § 1985).

22. *See* 7 U.S.C. § 1985(e)(1)(A)(i) (1994) (repealed and replaced by 1996 FAIR Act, Pub. L. No. 104-127, § 38, 1996 U.S.C.C.A.N. (110 Stat.) 888, 1094 (to be codified at 7 U.S.C. § 1985(c)).

23. *See* 1996 FAIR Act, Pub. L. No. 104-127, § 645, 1996 U.S.C.C.A.N. (110 Stat.) 888, 1103 (to be codified at 7 U.S.C. § 204).

24. *See* 1996 FAIR Act, Pub. L. No. 104-127, § 645(6), 1996 U.S.C.C.A.N. (110 Stat.) 888, 1103.

25. *See* 1996 FAIR Act, Pub. L. No. 104-127, § 645(1), 1996 U.S.C.C.A.N. (110 Stat.) 888, 1103.

26. *See* 1996 FAIR Act, Pub. L. No. 104-127, § 601, 1996 U.S.C.C.A.N. (110 Stat.) 888, 1084.

27. *See* 1996 FAIR Act, Pub. L. No. 104-127, § 602, 1996 U.S.C.C.A.N. (110 Stat.) 888, 1085.

28. *See* 1996 FAIR Act, Pub. L. No. 104-127, § 638, 1996 U.S.C.C.A.N. (110 Stat.) 888, 1093.

29. *See id*.

farmers and ranchers.[30] If the land is located within an Indian reservation, special rules apply.[31]

G. *Revised Good Faith*

The Act changed the definition of borrower good faith.[32] It is now easier for the government to show that a borrower has failed to act in good faith.

H. *New Financing Arrangements*

The 1996 FAIR Act created several new kinds of financing arrangements, including a line of credit option for operating loans[33] and a special joint financing program for farm ownership loans.[34]

I. *Private Reserve for Borrowers*

The FAIR Act created private reserves for operating loans.[35] These private reserves allow the USDA to reserve a portion of any operating loan and place it in an unsupervised bank account that may be used at the discretion of the borrower for the basic family needs of the borrower and the immediate family.[36]

J. *Crop Insurance Linkage*

Beginning with the 1996 crop year, the farmer seeking either a direct or a guaranteed FSA loan must choose one of two options.[37] The farmer can either: (1)

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30. *See* 1996 FAIR Act, Pub. L. No. 104-127, § 638, 1996 U.S.C.C.A.N. (110 Stat.) 888, 1094.
31. *See* 1996 FAIR Act, Pub. L. No. 104-127, § 638, 1996 U.S.C.C.A.N. (110 Stat.) 888, 1096.
32. *See* Farmer Program Account Servicing Policies, 61 Fed. Reg. 35,929 (1996) (to be codified at 7 C.F.R. § 1951.906).
33. *See* 1996 FAIR Act, Pub. L. No. 104-127, § 614, 1996 U.S.C.C.A.N. (110 Stat.) 888, 1089 (to be codified at 7 U.S.C. § 1946).
34. *See* 1996 FAIR Act, Pub. L. No. 104-127, § 604, 1996 U.S.C.C.A.N. (110 Stat.) 888, 1086 (to be codified at 7 U.S.C. § 1927).
35. *See* 1996 FAIR Act, Pub. L. No. 104-127, § 612, 1996 U.S.C.C.A.N. (110 Stat.) 888, 1088 (to be codified at 7 U.S.C. § 1942).
36. *See* 1996 FAIR Act, Pub. L. No. 104-127, § 612(a), 1996 U.S.C.C.A.N. (110 Stat.) 888, 1088 (to be codified at 7 U.S.C. § 1942).
37. *See* 1996 FAIR Act, Pub. L. No. 104-127, § 193(a)(2), 1996 U.S.C.C.A.N. (110 Stat.) 888, 943 (to be codified at 7 U.S.C. § 1508(b)(7)) (Notice FC-39, FSA-570, Waiver of Eligibility for Emergency Assistance, Exhibit 1); 7 C.F.R. § 400.657 (1997).

get crop "insurance for each crop of economic significance in which the person has an interest" (if such insurance is available);[38] or (2) sign a form that waives "any eligibility for emergency crop loss assistance in connection" with the uninsured crop.[39]

A crop of economic significance is defined as one that accounts for ten percent or more of the total expected value of all crops grown by the producer.[40] Crop insurance is only required if it is available in the area for the crop in question.[41] The 1996 FAIR Act gave producers the option of waiving certain benefits instead of obtaining crop insurance on all crops of economic significance.[42] This option was available for 1996 and all later crop years.[43] Under this option, if the producer wishes to remain eligible for linked USDA benefits—including FSA loans—and the producer does not wish to obtain insurance for all crops of economic significance, he or she must sign a waiver that makes the producer ineligible for emergency crop loss assistance.[44] Any producer who signs the waiver agrees that he or she will not be eligible for emergency crop loss assistance for the crop to which the waiver applies.[45] Limited resource farmers can receive a waiver of the administrative processing fee.[46]

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38. 1996 FAIR Act, Pub. L. No. 104-127, § 193(a)(2), 1996 U.S.C.C.A.N. (110 Stat.) 888, 943 (to be codified at 7 U.S.C. § 1508(b)(7)) (Notice FC-39, FSA-570, Waiver of Eligibility for Emergency Assistance, Exhibit 1); *see* 7 C.F.R. § 400.657 (1997).

39. 1996 FAIR Act, Pub. L. No. 104-127, § 193, 1996 U.S.C.C.A.N. (110 Stat.) 888, 943 (to be codified at 7 U.S.C. § 1508(b)(7)).

40. *See* 7 U.S.C. § 1508(b)(7)(B) (1994). The regulations provide a narrow exception to the definition of economic significance that should only apply to very small operations. If the total expected liability under the insurance policy is equal to or less than the administrative fee required to sign up for insurance, the crop is not considered to be of economic significance. For 1997 and later crop years, see 7 C.F.R. § 400.651 (1997) (defining "crop of economic significance"), and for 1995 and 1996 crop years, see 7 C.F.R. § 400.651(f) (1996).

41. *See* 7 C.F.R. § 400.652(c)-(d) (1997).

42. *See* 1996 FAIR Act, Pub. L. No. 104-127, § 193(a)(2), 1996 U.S.C.C.A.N. (110 Stat.) 888, 944 (to be codified at 7 U.S.C. § 1508(b)(7)).

43. *See id*.

44. *See* 1996 FAIR Act, Pub. L. No. 104-127, §193(a)(2)(A), 1996 U.S.C.C.A.N. (110 Stat.) 888, 944 (to be codified at 7 U.S.C. § 1508(b)(7)).

45. *See* 1996 FAIR Act, Pub. L. No. 104-127, § 193(a)(2)(A), 1996 U.S.C.C.A.N. (110 Stat.) 888, 944 (to be codified at 7 U.S.C. § 1508(b)(7)) (Notice FC-39, FSA-570, Notice from USDA Farm Service Agency, Waiver of Eligibility for Emergency Assistance, Exhibit 1).

46. *See* 7 U.S.C. § 1508(b)(5)(C) (1994); 7 C.F.R. § 400.656(a) (1997) (continuing provisions for 1997 and later crop years); 7 C.F.R. § 400.651 (1997) (defining "limited resource farmer" for 1997 and later crop years).

III. ADMINISTRATIVE OFFSETS OF USDA FARM PROGRAMS BEFORE ACCELERATION

In August of 1997 the FSA issued new regulations governing the administrative offset of farm program payments.[47] The most important change in these regulations is that FSA will now offset prior to acceleration of the debt.[48] FSA intends to seize farmers' Production Flexibility Contract, Conservation Reserve Program, Loan Deficiency Program, and other Farm Program payments by administrative offset prior to acceleration.[49]

A. *Arguably, Federal Statute Prohibits USDA Offset*

An argument can be made that the statutory authority to offset may not extend to some Farm Program payments. The Debt Collection Act provides that the offset provisions of the Act do not apply when there is another statute that prohibits the use of offsets.[50]

Before FSA takes any collection action on a delinquent farmer program loan, FSA must send the borrower a notice giving him or her the opportunity to apply for all primary and preservation loan servicing programs.[51] If the borrower applies for the loan servicing programs within the required time period on the notices, FSA is required by statute to consider him or her for all of these programs.[52] Arguably, if a borrower applies, UDSA is prohibited from collecting by administrative offset until a borrower is given notice and consideration for all loan servicing programs. FSA argues offset is something other than a collection action.[53]

Any FSA farmer-borrower whose security agreement with FSA covers Farm Program payments is entitled to have them released to pay essential living and operating expenses until the farmer's loan accounts are accelerated.[54] If FSA has a vested security interest in the program payments, FSA arguably is prohibited from seizing the payments to the extent the payment is needed for essential family living and farm operating expenses.

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47. *See* Handling Payments from the Farm Service Agency (FSA) to Delinquent FSA Farm Loan Program Borrowers, 62 Fed. Reg. 41,794 (1997).
48. *See id.*
49. *See id.*
50. *See* 31 U.S.C.A. § 3716(e)(2) (West Supp. 1998).
51. *See* 7 U.S.C. § 1981(d) (1994).
52. *See id.* § 1981(e).
53. *See* Handling Payments from the Farm Service Agency (FSA) to Delinquent FSA Farm Loan Program Borrowers, 62 Fed. Reg. 41,974, 41,797 (1997).
54. *See* 7 U.S.C. § 1985(f)(2) (1994).

B. *USDA Can Request Exemption*

The Debt Collection Act also allows a head of an agency to request that the Secretary of Treasury grant an exemption from offsets for some programs.[55] The statute requires that the exemption for non means tested programs be granted pursuant to standards set by the Department of Treasury that "give due consideration to whether administrative offset would tend to interfere substantially with or defeat the purposes of the payment certifying agency's program."[56] The USDA programs in question arguably could meet this criterion. Offset of many types of Farm Program payments will interfere substantially with the purposes of those programs. Four examples, the Emergency Conservation Program,[57] the Livestock Indemnity Program,[58] the Conservation Reserve Program,[59] and Production Flexibility Contract payments,[60] illustrate this point.

First, the purpose of the Emergency Conservation Program (ECP) is to provide cost share assistance to help farmers rehabilitate farmland damaged by natural disasters.[61] To be eligible for ECP, the conservation problem must materially affect the productive capacity of the land or water resources and must be so costly to rehabilitate that federal assistance will be needed to return the land to productive agricultural use.[62] Because the eligibility for this program requires that federal assistance be needed to accomplish the costly rehabilitation, the seizure of these payments will substantially interfere with the purpose of the program. Offset will prevent the conservation rehabilitation from occurring, causing land to remain unproductive for agricultural use.

Second, the purpose of the Livestock Indemnity Program is to provide income to replace livestock lost in a natural disaster in order to help ensure the continuing economic viability of the recipients' farming operations.[63] Seizure of these payments by offset will prevent the farmers from replacing livestock lost in the disasters of last winter and spring. Offset of these program payments will interfere with the purposes of this special disaster assistance program.

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55. *See* 31 U.S.C.A. § 3716(c)(1)(A) (West Supp. 1998).
56. 31 U.S.C.A. § 3716(c)(3)(B) (West Supp. 1998).
57. 16 U.S.C.A. § 2201 (West Supp. 1998).
58. 7 C.F.R. § 701.46 (1997).
59. H.R. REP. NO. 104-462, pt. 1 (1996), *reprinted in* 1996 U.S.C.C.A.N. 611.
60. *Id*.
61. *See* 16 U.S.C.A. §§ 2201-2202 (West Supp. 1998). ECP can be used in two ways. First, it can be used to restore farmlands damaged by wind and water erosion, floods, hurricanes, or other natural disasters. *See* 16 U.S.C.A. § 2201 (West Supp. 1998). Second, ECP can be used to provide water conservation and water enhancement measures during periods of severe drought. *See* 16 U.S.C.A. § 2202 (West Supp. 1998).
62. *See* 7 C.F.R. § 701.47(a) (1997).
63. *See* 7 C.F.R. § 701.46 (1997).

Third, the Conservation Reserve Program's (CRP) purpose is to provide farmers with assistance that will allow them to "protect environmentally sensitive lands, conserve natural resources and make rational farm and land management decisions."[64] If CRP payments are offset, farmers will pull their land out of the program or refuse to sign land into the program. As farmers refuse to participate, the environmental and conservation purposes of the program will be impaired.

Finally, one of the stated purposes of the Production Flexibility Contract (PFC) Program is to "provide certainty to lenders as a basis for extending credit to production agriculture."[65] Offsetting these Farm Program payments when they have been pledged as security to other lending institutions, especially when this pledge was made with the knowledge of FSA, as in the case of a subordination, clearly will interfere with the purpose of providing the type of certainty to agricultural lenders of which Congress spoke. Lenders will not view the PFC payments as providing any certainty of income that could be used to support the loan in any case where the farmer also has FSA credit. Offset of the PFC payments will interfere substantially with at least one of the congressionally-stated purposes of the PFC program.

In the case where FSA is offsetting Farm Program payments to apply them to loans, it is also important to consider the effect that the offset will have on the purpose of the loan programs themselves. FSA loan programs are designed to "foster and encourage the family farm system of agriculture in this country" by providing loans to limited resource, low income and beginning farmers.[66] Congress has emphasized that the loans are to be made and serviced in a manner that places "a high priority on keeping existing farm operations operating."[67] By seizing Farm Program payments through administrative offset when the payments are needed for living and operating expenses, when they are pledged as collateral for loans from other lenders, or before consideration of loan servicing, further stress will be placed on family farms.

IV. LOAN SERVICING FOR GUARANTEED LOANS

As FSA guaranteed loans become more common, the servicing of these loans should become more important as well. Several types of loan servicing are possible for FSA guaranteed loan borrowers as follows: (1) loan consolidation; (2) loan rescheduling and reamortization, which can change the terms of the loan to extend

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64. H.R. REP. NO. 104-462, pt. 1, at 50 (1996), *reprinted in* 1996 U.S.C.C.A.N. 611, 623.
65. H.R. REP. NO. 104-462, pt. 1, at 44 (1996), *reprinted in* 1996 U.S.C.C.A.N. 611, 616.
66. 7 U.S.C. § 2266(a) (1994).
67. 7 U.S.C. § 1921 (1994); *see* 7 U.S.C. § 2001(a)(1) (1994).

repayment; (3) loan deferral; (4) loan write-downs; and (5) interest rate assistance in which FSA contributes four percentage points of interest.[68]

FSA regulations set out eligibility requirements for each type of loan servicing.[69] The extent to which a lender is forced to cooperate with the borrower in seeking out loan servicing is not spelled out in the regulations. FSA approval is required for each of these loan servicing possibilities.[70] The lender's guarantee applies to losses from loan servicing.[71]

A. *Lender Responsibilities for Loan Servicing*

The lender is bound by two types of obligations that may affect the rights of borrowers. First, the lender must meet the obligations found in the loan documents signed by the lender and the borrower.[72] Further, the lender must meet the general legal obligations of lenders.[73] In this sense, FSA guaranteed loans are no different than any other loan from that particular lender.

Second, the lender is obligated to follow certain requirements unique to FSA guaranteed loans. These requirements can be found in several places. The lender likely signed several documents that discuss loan servicing. These documents include the Lender's Agreement,[74] which is signed by the lender and FSA, and either a Loan Note Guarantee,[75] which is used for loans, or a Contract of Guarantee,[76] which is used for lines of credit. In addition, according to the Lender's Agreement, the lender is required to follow the regulations governing FSA guaranteed loans found in the Code of Federal Regulations at the time the agreement is signed.[77] Future amendments to the regulations also bind the lender so long as they are not inconsistent with the Lender's Agreement.[78]

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68. *See* 7 C.F.R. §§ 1980.124, 1980.125 (1997); 7 C.F.R. pt. 1980, subpt. B, exh. D. (1997). For more information on these options and other related issues see FARMERS' LEGAL ACTION GROUP, INC., FARMERS' GUIDE TO GUARANTEED LOAN SERVICING (forthcoming 1998).

69. *See* 7 C.F.R. § 1951.909 (1997); 7 C.F.R. pt. 1951, subpt. S, exh. A (1997).

70. *See id*.

71. *See id*.

72. *See id*.

73. *See id.*

74. *See* 7 C.F.R. pt. 1980, subpt. A, app. B (1997). The Lender's Agreement also incorporates the Loan Note Guarantee. *See id.*

75. *See* 7 C.F.R. pt. 1980, subpt. A, app. A (1997).

76. *See* 7 C.F.R. pt. 1980, subpt. A, app. D (1997).

77. *See* 7 C.F.R. pt. 1980, subpt. A, app. B, § XVIII (1997).

78. *See id*.

B. *Basic Lender Obligations Regarding Loan Servicing*

Regulations covering FSA guaranteed loans provide for at least seven lender obligations regarding loan servicing.[79] First, the lender must service the loan in a reasonable manner.[80] Second, the lender may not be negligent in servicing the loan.[81] The Lender's Agreement, the Loan Note Guarantee, and the Contract for Guarantee state that the lender may not be negligent in servicing the loan.[82] "Negligent servicing is defined as the failure to perform services which a reasonably prudent lender would perform in servicing its own portfolio of loans that are not guaranteed."[83] Third, the Lender's Agreement requires that if the borrower is thirty days past due on a payment or is otherwise in default, the lender must arrange a meeting of the lender, FSA, and the borrower.[84] The purpose of the meeting is to try to resolve the default.[85] Fourth, according to the Lender's Agreement, if the borrower is in default, the lender must negotiate in good faith in an effort to resolve any problem and to permit the borrower to cure the default, where reasonable.[86] Fifth, if the lender believes that a liquidation is imminent, and the farmer does not already have an Interest Assistance Agreement in effect, the lender must do three things.[87] These steps are required by FSA regulations and are a part of the Lender's Agreement and the Loan Note Guarantee and the Contract of Guarantee.[88] If the lender believes that liquidation of the loan is imminent, it must consider the borrower for Interest Assistance and ask FSA to determine if the borrower is eligible for Interest Assistance.[89] If the lender believes that liquidation of the loan is imminent, it may not initiate foreclosure action on the loan until sixty days after a determination has been made.[90] Sixth, where a state has a mediation program, the lender must participate in accordance with the rules of that system.[91] Seventh, according to the Lender's agreement, the lender only may use liquidation if there has

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79. *See* 7 C.F.R. pt. 1980, subpt. A, app. E (1997).
80. *See* 7 C.F.R. pt. 1980, subpt. A, app. E, I, & D (1997).
81. *See id.*
82. *See* 7 C.F.R. pt. 1980.11 (1997).
83. *Id.*
84. *See id.*
85. *See id.*
86. *See id.*
87. *See id.*
88. *See id.*
89. *See id.*
90. *See id.*
91. *See id.*

been a default by the borrower and the default could not be cured within a reasonable time.[92]

C. *FSA's Possible Response if the Lender Does not Service the Loan*

Lenders risk their guarantee payments from FSA if they do not service the loan correctly. For example, the Lender's Agreement says that the FSA will not pay the lender on the guarantee to the extent the lender's loss was caused by negligent servicing.[93] It is FSA, therefore, that has the most power with the lender and can most easily insist that the lender meet its loan servicing requirements.

D. *Borrower Rights to Loan Servicing*

A more difficult question is the extent to which the borrower can claim that he or she has a legal right to loan servicing. Conventional wisdom holds that borrowers do not have a legal right to loan servicing that they can enforce in court. A Sixth Circuit decision in *Parker v. United States Department of Agriculture* concluded that farmers did not have that right.[94] Generally, when a borrower, or any other person, is not a party to a contract, this third party does not have a legal right to demand that the contract be carried out.[95] One exception to this rule, however, would apply if the court concluded that a guaranteed loan borrower was a third party beneficiary of the contract.[96] A third party beneficiary in a guaranteed loan contract could sue in court to force the contract to be carried out.[97] The *Parker* court concluded that the farmer with a guaranteed loan was not legally a third party beneficiary of the Lender's Agreement.[98]

A United States Court of Claims opinion in *Schuerman v. United States* looked at the issue in a somewhat different way.[99] It followed the *Parker* court in concluding that the Lender's Agreement did not create any enforceable rights for the borrower.[100] Unlike the *Parker* court, however, the *Schuerman* court looked closely at the Contract of Guarantee.[101] The Contract of Guarantee is used for lines of credit.[102] A similar document, Loan Note Guarantee, is used for other guaranteed

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92. *See id.*
93. *See id.*
94. *See* Parker v. USDA, 879 F.2d 1362 (6th Cir. 1989).
95. *See id.* at 1366.
96. *See id.*
97. *See id.*
98. *See id.*
99. *See* Schuerman v. United States, 30 Fed. Cl. 420 (1994).
100. *See id*. at 426.
101. *See id.*
102. *See id.*

loans.[103] Essentially, the *Schuerman* court concluded that the borrower was a third party beneficiary of the Contract of Guarantee.[104]

V. GUARANTEED LOAN FSA APPEALS MUST INCLUDE LENDER

The USDA appeals system applies to FSA guaranteed loans.[105] Although it is not required by statute, the USDA requires that a guaranteed loan appeal include the lender. Only adverse decisions regarding an FSA guaranteed loan may be appealed. An adverse decision is defined in USDA regulations quite broadly. It is "as an administrative decision . . . that is adverse to a participant. The term includes equitable relief by an agency or the failure of an agency to issue a decision or otherwise act on the request or right of the participant within time frames specified."[106] The federal statute defines adverse decisions as an administrative decision that is adverse to the participant.[107] Intuitively, one might suspect that an FSA guaranteed loan borrower is a participant in FSA programs and should be eligible to file an appeal if he or she felt wronged by the FSA. However, the 1994 Reorganization Act, which created the NAD system, allowed the Secretary of Agriculture to define a participant.[108] When FSA first proposed a set of USDA regulations to implement NAD, it defined participant to include a guaranteed loan borrower.[109] In the final regulations, USDA defined participant differently. Part of the definition is reasonable. It defined participant as one who "has applied for, or whose right to participate in or receive, a payment, . . . loan guarantee, or other benefit. . . ."[110] The final regulations also required "[w]ith respect to guaranteed loans made by FSA, both borrower and lender jointly must appeal an adverse decision."[111] According to the final regulations, therefore, a guaranteed loan

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103. *See id.* at 423.

104. *See id*. at 433. Several other courts endorse the *Schuerman* approach to third party beneficiary status for government contracts not designed to render a service to the public. *See* Montana v. United States, 124 F.3d 1269, 1273-74 (Fed. Cir. 1997); Maniere v. United States, 31 Fed. Cl. 410, 416-19 (1994); Nat'l Sur. Corp. v. United States, 31 Fed. Cl. 565, 575-76 (1994). *But see* Baudier Marine Elecs., Sales & Serv., Inc. v. United States, 6 Cl. Ct. 246, 249 (1984).

105. *See* 7 U.S.C. §§ 6991-7002 (1994).

106. 7 C.F.R. § 11.1 (1997). The federal statute is also quite broad in its definition. *See* 7 U.S.C. § 6991(1) (1994).

107. *See* 7 U.S.C. § 6991(1) (1994).

108. *See id.* § 6991(9).

109. *See* National Appeals Division Rules of Procedure, 60 Fed. Reg. 27,044 (1995) (to be codified at 7 C.F.R. pt. 11) (proposed May 22, 1995).

110. 7 C.F.R. § 11.1 (1997).

111. *Id.* The prefatory remarks explain this decision by saying that since "any decision to deny a guaranteed loan would affect both the applicant/borrower and the lender USDA agrees that both

borrower or applicant can only appeal an adverse FSA decision if the lender joins the appeal.[112]

VI. FSA DISASTER SET-ASIDE (DSA)

The Farm Services Agency (FSA) Disaster Set-Aside (DSA) program allows FSA borrowers suffering from a disaster to skip an annual installment payment on a direct FSA loan and instead move the payment to the end of the loan repayment period.[113] Farmers must request a disaster set-aside within eight months of the date the disaster was officially designated.[114]

A. *Loans that May be Set Aside*

FSA regulations limit the type of loans that may be set aside.[115] To be eligible for a disaster set-aside, the farmer's FSA farm loan must not already have been accelerated.[116] Only one unpaid installment for each FSA loan may be set aside.[117] If there is an installment still set aside from a previous disaster, the loan is not eligible for disaster set-aside.[118] In general, the installment to be set aside is the first annual installment due immediately after the disaster occurred.[119] If, however, that installment has been paid, the next scheduled annual installment after the disaster may be set aside.[120] FSA will set aside a loan installment only if the term remaining on the loan receiving the set-aside extends at least two years from the due date of the installment being set aside.[121]

B. *Farmer Eligibility*

The following are among the requirements that must be met for a farmer to be eligible for a disaster set-aside.[122] A farmer may be considered for the disaster

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parties must appeal any such adverse decision and the rule has been revised to reflect this requirement." National Appeals Division Rules of Procedure, 60 Fed. Reg. 67,298-67,301 (1995).

112. *See id*.

113. *See* 7 C.F.R. § 1951.952 (1997); FARMERS' LEGAL ACTION GROUP, INC., FARMERS' GUIDE TO DISASTER ASSISTANCE (2d ed. 1997).

114. *See* 7 C.F.R. § 1951.953(b) (1997).

115. *See id.* § 1951.952.

116. *See id.* § 1951.954(a)(7).

117. *See id.* § 1951.954(b)(2).

118. *See id.*

119. *See id.* § 1951.954(b)(5).

120. *See id*.

121. *See id.* § 1951.954(b)(3).

122. *See id.* § 1951.954(a)-(b).

set-aside only once for each disaster.[123] All eligible loans may be set aside at the same time.[124]

C. *Amount of the Set-Aside*

Often, the full amount of the FSA installment will be set aside.[125] It is possible, however, that less than the full installment of an FSA payment may be set aside.[126] If an installment is set aside and then the installment is paid in full by the farmer, another installment on that loan may be set aside.[127] Technically, once the set-aside installment has been paid in full, the set-aside no longer exists, and therefore the loan may be considered for a set-aside in the future.[128]

If an installment is set aside and then canceled through an FSA restructuring, a payment on the restructured loan may not be set aside.[129] Once the set-aside installment is canceled through restructuring, it technically no longer exists.[130]

D. *Which Installments May be Set Aside*

In general, the installment to be set aside is the first annual installment due immediately after the disaster occurred.[131] If that installment has been paid, the next scheduled annual installment after the disaster may be set aside.[132]

E. *Interaction Between Primary Loan Servicing and Disaster Set-Aside*

The disaster set-aside program is not intended to replace or get around regular FSA loan servicing.[133] The two programs interact in the following way. Farmers are not eligible for assistance under both the disaster set-aside program and primary loan servicing.[134] Once a farmer applies for a disaster set-aside, any pending

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123. *See id.* § 1951.953(b).
124. *See id.* § 1951.952.
125. *See id.* § 1951.954(b)(2).
126. *See id.* § 1951.954(b)(4).
127. *See id.* § 1951.954(b)(2).
128. *See id.*
129. *See id.*; 7 C.F.R. § 1951, subpt. S (1997) (describing relevant FSA restructuring regulations).
130. *See* 7 C.F.R. § 1951.954(b)(2).
131. *See id.* § 1951.954(b)(5).
132. *See id.*
133. *See id.* 7 C.F.R. § 1951.952; subpt. S (1997) (describing regulations controlling FSA loan servicing).
134. *See id.* 7 C.F.R. § 1951.957(a)(2).

request the farmer has made for primary loan servicing will continue to be considered by FSA.[135] Once the farmer receives the benefits of one of the programs—either disaster set-aside or primary loan servicing—the application for the program not received will be automatically withdrawn.[136] This withdrawal is not appealable.[137]

VII. DISCRIMINATION IN FARM LENDING AT USDA

A spate of publicity concerning discrimination in USDA lending programs brought attention to the issue in 1996 and 1997. Even USDA officials have acknowledged the problem.[138] Discrimination has been a consistent feature of USDA farm credit programs since their inception more than six decades ago.[139] In 1982, for example, the Director of FmHA's Equal Opportunity Staff stated frankly that his office is "in no position to enforce compliance with civil rights laws,"[140] and in 1990, the Acting Director of USDA's Office of Advocacy and Enterprise acknowledged in writing that FmHA was "frequently in noncompliance with civil rights requirements at the local level."[141]

The situation seems to have changed very little of late. Farmers of color and women continue to believe that discrimination is common.[142] USDA still lacks an effective system of investigating complaints and remedying them.[143]

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135. *See id*.

136. *See id*.

137. *See id*.

138. *See* Mary Beausoleil, *U.S. Farm Agency Acknowledges Bias: Black Groups Plans Protest in Washington*, RICHMOND TIMES, Nov. 30, 1996, at A1 (quoting Farm Service Agency Administrator Grant Buntrock).

139. *See generally* UNITED STATES COMM'N ON CIVIL RIGHTS, EQUAL OPPORTUNITY IN FARM PROGRAMS (1965) (discussing racial discrimination in USDA farm credit programs); UNITED STATES COMM'N ON CIVIL RIGHTS, THE DECLINE OF BLACK FARMING IN AMERICA 14 (1982) (discussing the decline of black-operated farms and how racial discrimination has been a contributing factor).

140. UNITED STATES COMM'N ON CIVIL RIGHTS, THE DECLINE OF BLACK FARMING IN AMERICA 151 (1982).

141. *Decline of Minority Farming in the United States*, *Hearing Before the Subcomm. on Gov't Info., Justice, & Agric. of the Comm. on Gov't Operations*, 101st Cong. 252 (1990).

142. During USDA Civil Rights Action Team sponsored listening sessions "hundreds of minority farmers voiced concerns, as they have for decades, that they are still being denied equal access to the USDA's programs." CIVIL RIGHTS ACTION TEAM, USDA, CIVIL RIGHTS AT THE U.S. DEP'T OF AGRIC. 6 (1997).

143. For a summary of current civil rights problems at USDA, see CIVIL RIGHTS ACTION TEAM, USDA, CIVIL RIGHTS AT THE U.S. DEP'T OF AGRIC. (1997).

A. *Equal Credit Opportunity Act (ECOA)*

Litigation is an option. The Equal Credit Opportunity Act (ECOA) provides possibly the best avenue of approach.[144]

The core of the ECOA is the provision that it is "unlawful for any creditor to discriminate against any applicant with respect to any aspect of a credit transaction" on a prohibited basis.[145] Prohibited bases are race, color, religion, sex, marital status, age (provided the applicant has the capacity to contract), the applicant's receipt of income from any public assistance program, and the applicant's exercise, in good faith, of any right under the Consumer Protection Act, which includes the ECOA.[146]

To discriminate against an applicant means to "treat an applicant less favorably than other applicants."[147] Discrimination on a prohibited basis is a violation of the ECOA whether or not the discrimination was intentional or conscious.[148]

B. *Ways to Prove Lending Discrimination Under the ECOA*

In general there are three ways to prove lending discrimination under the ECOA as follows: (1) overt discrimination; (2) disparate treatment; and (3) disparate impact.[149]

1. *Overt Discrimination*

Overt discrimination occurs "when a lender openly discriminates on a prohibited basis."[150] In the rare case when evidence establishes that a creditor

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144. *See* Equal Credit Opportunity Act of 1974, Pub. L. No. 93-495, tit. V, 88 Stat. 1521 (codified at 15 U.S.C. § 1691(a)-(f)). For basic information on the ECOA, see Equal Credit Opportunity (Regulation B), 12 C.F.R. pt. 202 (1997); Policy Statement on Discrimination in Lending, 59 Fed. Reg. 18,266 (1994); Letter from Deval L. Patrick, Assistant Attorney General, to Joe Belew, Consumers Bankers Ass'n et al., Dep't of Justice Interpretation of Interagency Statement on Discrimination in Lending (Feb. 21, 1995) *in* RITA GORDON PERERIA, NATIONAL CONSUMER LAW CTR., CREDIT DISCRIMINATION 176-80 (1997 Cumulative Supp.); JONATHAN SHELDON, NATIONAL CONSUMER LAW CTR., CREDIT DISCRIMINATION (1993); THOMAS P. VARTANIAN ET AL., FAIR LENDING GUIDE (1997); RALPH C. CLONTZ, JR., EQUAL CREDIT OPPORTUNITY MANUAL (4th ed. 1988); RALPH C. CLONTZ, JR., EQUAL CREDIT OPPORTUNITY MANUAL (Cumulative Supp. No. 1 1994).

145. Equal Credit Opportunity Act of 1974, Pub. L. No. 93-495, tit. V, § 701, 88 Stat. 1521 (codified at 15 U.S.C. § 1691(a)).

146. *See id*.

147. 12 C.F.R. § 202.2(n) (1997).

148. *See* Evidence of Disparate Treatment, 59 Fed. Reg. 18,268, 18,268 (1994).

149. *See* Policy Statement on Discrimination in Lending, 59 Fed. Reg. 18,267, 18,268 (1994).

150. *Id*.

openly discriminates against an individual on a prohibited basis, it is not necessary to apply other formulas used to establish an inference of discrimination.[151]

2. *Disparate Treatment*

Disparate treatment arises when a lender "treats a credit applicant differently based on one of the prohibited bases."[152] There are three basic steps in making a claim of disparate treatment. First, the plaintiff must present a prima facie case of credit discrimination on a prohibited basis.[153] Second, the burden shifts to the

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151. *See id.*

152. *Id*.; s*ee* Moore v. USDA, 55 F.3d 991, 995 (5th Cir. 1995) (citing Title VII cases); TransWorld Airlines, Inc. v. Valentec Kisco, Inc., 964 F.2d 723, 728 (8th Cir. 1992).

153. *See* McDonnell Douglas Corp. v. Green, 411 U.S. 792, 802 (1973). The plaintiff must "present facts from which one can infer that the actions taken by the defendants, if unexplained more likely than not were the result of unlawful discrimination." Gross v. United States Small Business Admin., 669 F. Supp. 50, 53 (N.D.N.Y. 1987); THOMAS P. VARTANIAN ET AL., FAIR LENDING GUIDE 6-22 (1997); Texas Dep't of Community Affairs v. Burdine, 450 U.S. 248, 252-53 (1981) (sex discrimination). In *Furnco Construction Corp. v. Waters,* the United States Supreme Court elaborated on the disparate treatment inquiry:

> A prima facie case . . . raises an inference of discrimination only because we presume these acts, if otherwise unexplained are more likely than not based on the consideration of impermissible factors. . . . And we are willing to presume this largely because we know from our experience that more often than not people do not act in a totally arbitrary manner, without any underlying reasons, especially in a business setting. Thus, when all legitimate reasons for rejecting an applicant have been eliminated as possible reasons for the employer's actions, it is more likely than not the employer, who we generally assume acts only with *some* reason, based his decision on an impermissible consideration such as race.

Furnco Constr. Co. v. Waters, 438 U.S. 567,577 (1978). The prima facie burden generally is summarized as having four steps. To meet the burden of presenting a prima facie case involving disparate treatment in credit the plaintiff must prove the following: (a) the plaintiff is a member of a protected class; (b) the plaintiff applied for and was qualified for credit; (c) despite the plaintiff's qualifications, the application for credit was denied; and (d) applicants who do not belong to the protected class were given credit or were treated more favorably than the plaintiff in the application process. *See* THOMAS P. VARTANIAN ET AL., FAIR LENDING GUIDE 6-7 (1997) (citing Gross v. United States Small Business Admin., 669 F. Supp. 50, 53 (N.D.N.Y. 1987)). This method is taken directly from *McDonnell Douglas Corp. v. Green,* 411 U.S. 792 (1973). Notably missing in the four-step presentation of a prima facie case is any requirement of direct proof of the intent to discriminate. Still, the most common view is that a disparate treatment analysis requires a showing that the creditor intentionally discriminated. *See* THOMAS P. VARTANIAN ET AL., FAIR LENDING GUIDE 6-8 (1997). Technically, disparate treatment probably should be seen as occurring when similarly-situated applicants are treated differently and a prohibited basis is a factor motivating the different treatment. If this view of the proof required is met, disparate treatment does not exist unless a creditor has decided to treat similarly-situated applicants differently and a prohibited basis can be shown to be a factor in the decision. *See* THOMAS P. VARTANIAN ET AL., FAIR LENDING GUIDE 6-8 (1997). The requirement of proof of intent is not as onerous on the plaintiff as it may seem. The central point of a disparate treatment analysis is that the fact finder can infer discrimination and the intention to discriminate from the way applicants are treated. As the Policy Statement observes, there is no requirement to make a "showing

defendant to articulate a legitimate, nondiscriminatory reason for the actions of which the plaintiff complains.[154] Third, if the defendant is able to offer such an explanation, the burden shifts back to the plaintiff, who must offer evidence sufficient to demonstrate that the explanation offered by the defendant in reality was a pretext for discrimination.[155]

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that the treatment was motivated by prejudice or conscious intention to discriminate against a person beyond the difference in treatment itself." Policy Statement on Discrimination in Lending, 59 Fed. Reg. 18,266, 18,268. According to this view, disparate treatment is intentional discrimination because no credible, nondiscriminatory reason explains the difference in treatment on a prohibited basis. The Federal Reserve Board's Regulation B—which has the force of law—arguably takes a view more favorable to the plaintiff regarding proof of intentional discrimination. It holds that "[d]isparate treatment on prohibited basis is illegal whether or not it results from a conscious intent to discriminate." Official Staff Interpretations, 12 C.F.R. pt. 202, Supp. I, § 202.4 (1997). If the means of showing intent to discriminate is properly understood there may be little practical difference between the Regulation B view and the more restrictive view, particularly if this portion of Regulation B is taken only to affect "conscious" efforts to discriminate. *See* Mercado-Garcia v. Ponce Fed. Bank, 779 F. Supp. 620 (D.P.R. 1991); Moore v. USDA, 993 F.2d 1222 (5th Cir. 1993); Miller v. American Express Co., 688 F.2d 1235, 1239 (9th Cir. 1982); Williams v. First Fed. Sav. & Loan Ass'n, 554 F. Supp. 447 (N.D.N.Y. 1981), *aff'd,* 697 F.2d 302 (2d Cir. 1982); Gross v. United States Small Bus. Admin., 669 F. Supp. 50, 53 (N.D.N.Y. 1987); Policy Statement on Discrimination in Lending, 59 Fed. Reg. at 18,268; Official Staff Interpretations, 12 C.F.R. pt. 202, Supp. I, § 202.4 (1997).

154. *See* McDonnell Douglas Corp. v. Green, 411 U.S. 792, 802 (1973). The defendant must articulate a "legitimate, nondiscriminatory reason" for its actions. *See id.* (referring to employment discrimination); St. Mary's Honor Ctr. v. Hicks, 509 U.S. 502 (1993); Texas Dep't of Community Affairs v. Burdine, 450 U.S. 248, 252-53 (1981); Furnco Constr. Corp. v. Waters, 438 U.S. 567, 578 (1978). Examples of ECOA cases using the approach include Gross v. United States Small Bus. Admin., 669 F. Supp. 50, 53 (N.D.N.Y. 1987); Williams v. First Fed. Sav. & Loan Ass'n, 554 F. Supp. 447, 449 (N.D.N.Y. 1981), *aff'd*, 697 F.2d 302 (2d Cir. 1982) (stating that in an ECOA case if the prima facie burden had been met, burden would have shifted); THOMAS P. VARTANIAN ET AL., FAIR LENDING GUIDE 6-22 to 6-23 (1997). If this burden is met the presumption raised by the plaintiff's prima facie case essentially disappears, and the plaintiff is left with the ultimate burden of proving that the defendant intentionally discriminated. *See St. Mary's Honor Ctr.*, 509 U.S. at 507 (referring to employment discrimination); Moham v. Steego Corp., 3 F.3d 873, 875 (5th Cir. 1993) (referring to employment discrimination). Typically the creditor argues that its actions were undertaken for business reasons and were not the result of unlawful discrimination. *See* THOMAS P. VARTANIAN ET AL., FAIR LENDING GUIDE 6-22 (1997). The creditor has the burden of proving that the practices which create the disparate impact or the policy of disparate treatment have a manifest relationship to the creditworthiness of the applicant. The Policy Statement explains the process of rebutting the prima facie disparate treatment case from the perspective of federal agencies investigating lending discrimination: "If a lender has apparently treated similar applicants differently on the basis of a prohibited factor, it must provide an explanation for the difference in treatment. If the lender is unable to provide a credible and legitimate nondiscriminatory explanation, the agency may infer that the lender discriminated." Policy Statement on Discrimination in Lending, 59 Fed. Reg. 18,269, 18,269 (1994).

155. *See McDonnell Douglas Corp*., 411 U.S. at 804; *Texas Dep't of Community Affairs*, 450 U.S. at 252-53; Mercado-Garcia v. Ponce Fed. Bank, 779 F. Supp. 620, 628 (D.P.R. 1991); Official Staff Interpretations, 12 C.F.R. pt. 202, Supp. I, § 202.4 (1997); Policy Statement on Discrimination in Lending, 59 Fed. Reg. 18,269, 18,269 (1994). For examples of burden shifting analysis in disparate treatment cases, see Mercado-Garcia v. Ponce Fed. Bank, 979 F.2d 890 (1st Cir. 1992); Sayers v.

The central point of the disparate treatment analysis is that direct evidence of bias is rare in discrimination cases.[156] In fact, one of the reasons for the whole burden-shifting framework is that there often is no smoking-gun evidence of discrimination.[157]

a. *The Prima Facie Case of Disparate Treatment.* The first step in the disparate treatment theory of proof requires the plaintiff to establish a prima facie case of credit discrimination.[158] In doing so, the plaintiff is essentially using inference to make the case. The plaintiff must "present facts from which one can infer that the . . . actions taken by the defendants, if unexplained, more likely than not were the result of unlawful discrimination."[159]

In general, finding of a prima facie case of credit discrimination under the ECOA should be appropriate if a person: (1) is in a protected class; (2) applied for an FSA Farm Credit program service of some kind; (3) was wrongly denied—even if only temporarily while an appeal was made and ultimately won; and (4) other applicants received the same services during that time.[160]

b. *Rebutting the Prima Facie Case of Disparate Treatment—Legitimate Nondiscriminatory Reasons*. Once a prima facie case of credit discrimination on a prohibited basis is established through a disparate treatment analysis, the burden of proof shifts to the defendant.[161] The defendant must articulate a "legitimate, nondiscriminatory reason" for its actions.[162]

c. *Plaintiff's Response to Defendant's Attempt to Articulate a Legitimate, Nondiscriminatory Reason*. If the defendant is able to offer a legitimate, nondiscriminatory reason for its actions, the burden shifts back to the plaintiff, who must offer evidence sufficient to demonstrate that the explanation offered by the defendant in reality was a pretext for discrimination.[163]

3. *Disparate Impact and the Effects Test*

Even if a creditor is not directly treating applicants differently on prohibited bases, the effect of the creditor's policies and practices may be adversely affecting a protected class. A disparate impact analysis—sometimes referred to as a disparate

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General Motors Acceptance Corp., 522 F. Supp. 835, 839-40 (W.D. Mo. 1981); Gross v. United States Small Bus. Admin., 669 F. Supp. 50, 53 (N.D.N.Y. 1987); Moore v. USDA, 55 F.3d 991, 995 (5th Cir. 1995); and *In re* DiPietro, 135 B.R. 773, 776-77 (Bankr. E.D. Pa. 1992).

156. *See* Price Waterhouse v. Hopkins, 490 U.S. 228, 271-72 (1989).

157. *See id.* at 271.

158. *See McDonnell Douglas Corp*., 411 U.S. at 802.

159. *Gross*, 669 F. Supp. at 53.

160. *See McDonnell Douglas Corp*., 411 U.S. at 802; *Texas Dep't of Community Affairs*, 450 U.S. at 252.

161. *See McDonnell Douglas Corp*., 411 U.S. at 802.

162. *Id*. at 802.

163. *See id*. at 802-03.

effect analysis or the effects test—can be used to prove a violation of the ECOA.[164] A disparate impact analysis assumes that the practices in question have been applied neutrally to all.[165]

The steps required to prove discrimination under the disparate impact method are different from the method used to prove disparate treatment. In general, there are three steps required in a disparate impact analysis. First, the plaintiff must establish that the policy or practice has a disparate impact on a prohibited basis.[166] Second, the defendant may defend the policy or practice as justified by business necessity.[167] Third, the practice or policy may be justified by business necessity.[168] It is discriminatory if an alternative policy or practice could serve the same purpose

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164. *See* A.B. & S. Auto Source, Inc. v. South Shore Bank, 962 F. Supp. 1056, 1060 (N.D. Ill. 1997).

165. *See* International Bhd. of Teamsters v. United States., 431 U.S. 324, 335 (1977); Gross v. United States Small Bus. Admin., 669 F. Supp. 50, 53 (N.D.N.Y. 1987); THOMAS P. VARTANIAN ET AL., FAIR LENDING GUIDE 6-22 (1997); *Texas Dep't of Community Affairs*, 450 U.S. at 252-53.

166. *See* Connecticut v. Teal, 457 U.S. 440, 446 (1982); Policy Statement on Discrimination in Lending, 59 Fed. Reg. 18,269, 18,269 (1994); Official Staff Interpretations, 12 C.F.R. pt. 202, Supp. I, § 202.6(a) (1997). A disparate impact analysis focuses on the effect of a creditor's "policy or practice." One way of establishing a disparate impact is by statistical comparison. Policy Statement on Discrimination in Lending, 59 Fed. Reg. 18,269, 18,269 (1994). Statistical proof alone can make out a prima facie case of disparate impact. *See* JONATHAN SHELDON, NATIONAL CONSUMER LAW CTR., CREDIT DISCRIMINATION 155 (1993); Policy Statement on Discrimination in Lending, 59 Fed. Reg. 18,269, 18,269 (1994). In fact, statistical comparisons of the representation of the protected class in the applicant pool with representation in the group actually accepted from the pool are the conventional method for a disparate treatment analysis. If the statistical disparity is significant, the plaintiff is generally deemed to have established a prima facie case of discrimination. *See* THOMAS P. VARTANIAN ET AL., FAIR LENDING GUIDE 6-16 (1997). Some care must be taken in determining exactly how statistical comparisons are used. Courts are unlikely to find persuasive statistics that merely show the percentage of a protected class that is turned down for a loan is higher than that of the general population. Instead, the courts will look at the percentage of qualified members of a protected class that were denied a loan. *See* JONATHAN SHELDON, NATIONAL CONSUMER LAW CTR., CREDIT DISCRIMINATION 155 (1993 & 1995 Supp.); *see also* Albermarle Paper Co. v. Moody, 422 U.S. 405 (1973) (discussing employment discrimination with analogous facts). Although disparate impact arguments are often disparate impact claims on behalf of a group, they also may be individual plaintiffs. *See* Sayers v. General Motors Acceptance Corp., 522 F. Supp. 835, 839 (W.D. Mo. 1981).

167. *See* Watson v. Fort Worth Bank & Trust, 487 U.S. 977, 980 (1988). There is some dispute regarding the exact nature of the business justification that will be allowed under a disparate impact analysis. According to the Policy Statement, the second step usually involves the justification of a business necessity. *See* Policy Statement on Discrimination in Lending, 59 Fed. Reg 18,269 (1994). When the Department of Justice uses a disparate impact analysis, it also looks to see whether there is a "business necessity for the apparently neutral standard or practice." RITA GORDON PEREIRA, CREDIT DISCRIMINATION, 177 (1997 Cumulative Supp.). Regulation B does not explain with any precision what the lender must show in this regard. The Official Staff Commentary endorses a "legitimate business need" standard. The Commentary also implies that the business necessity defense may be required. *See* 12 C.F.R. § 202.6(a) (1997).

168. *See Watson*, 487 U.S. at 980.

with a less discriminatory effect.[169] It is generally accepted that proof of discriminatory intent is not necessary in an ECOA disparate impact analysis.[170]

C. *FSA as Defendant*

ECOA law does not change significantly simply because the federal government is the lender. In *Gross v. United States Small Business Administration*, the court agreed that the Small Business Administration (SBA) was a creditor within the meaning of the Act.[171] In *Moore v. United States Department of Agriculture*, the Farmers Home Administration (FmHA) was the creditor.[172] In this case, the court would have applied the standard burden shifting approach to FmHA had the court not decided that it was unnecessary, because there was direct evidence of discrimination.[173]

D. *ECOA Damages*

The ECOA states that "any creditor who fails to comply with any requirement imposed under this subchapter shall be liable to the aggrieved applicant for any actual damages sustained by such applicant . . ."[174] Intangible losses also

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169. *See id*.; JOHNATHAN SHELDON, NATIONAL CONSUMER LAW CTR., CREDIT DISCRIMINATION 157 (1993 & 1995 Supp.); 12 C.F.R. § 202.6(a) (1997); Policy Statement on Discrimination in Lending, 59 Fed. Reg. 18,269 (1994). According to the Regulation B Official Staff Commentary, the creditor practice in question must meet a legitimate business need that "cannot reasonably be achieved as well by means that are less disparate in their impact." 12 C.F.R. § 202.6(a) (1997).

170. *See Watson*, 487 U.S. at 980; Sayers v. General Motors Acceptance Corp., 522 F. Supp. 835, 835 (W.D. Mo. 1981); Green v. Rancho Santa Margarita Mortgage, 33 Cal. Rptr. 2d 706 (Ct. App. 1994); William R. Naeher, *Recent Developments under the Equal Credit Opportunity Act*, PROB. & PROP. Jan.-Feb. 1996, at 44. Congress has rejected efforts to change this standard. *See* Thomas P. Vartanian et al., *Disparate Impact Discrimination: Fair Lending at a Crossroads*, CONSUMER FIN. L.Q. REP. 76, 78 (1995). The statute itself is conspicuous in not requiring a showing of intent, and Congress seems to have intended that a disparate impact claim could be proved without a showing of intent. In addition, according to the Policy Statement: "[E]vidence of discriminatory intent is not necessary to establish that a policy or practice adopted or implemented by a lender that has a disparate impact is in violation of the . . . ECOA." Policy Statement on Discrimination in Lending, 59 Fed. Reg. at 18,269. The Federal Reserve Board's Official Staff Commentary on Regulation B expressly states that it is not necessary for a plaintiff to show that a defendant has acted with intent to discriminate to prevail on a disparate impact claim; a facially neutral practice may violate the ECOA and Regulation B "even though the creditor has no intent to discriminate." 12 C.F.R. § 202.6(a) (1997).

171. *See* Gross v. United States Small Bus. Admin., 669 F. Supp. 50, 52 (N.D.N.Y. 1987); 15 U.S.C. § 1691a(e)-(f) (1994).

172. *See* Moore v. USDA, 55 F.3d 991, 992 (5th Cir. 1995).

173. *See id*. at 995.

174. 15 U.S.C. § 1691e(a) (1994).

constitute actual damages.[175] In litigation against the government, punitive damages are not available.[176]

VIII. NATIONAL APPEALS DIVISION (NAD): *LANE V. USDA*

In *Lane v. USDA*, the Eighth Circuit ruled that the Administrative Procedure Act (APA) and the Equal Access to Justice Act (EAJA) apply to National Appeals Division (NAD) hearings.[177] Under this ruling, successful appellants may claim costs and attorneys fees from the government.[178]

EAJA provides that a party who successfully challenges or defends against government action can recover fees and expenses incurred if the adjudicating officer finds that the government's position was not substantially justified.[179] EAJA provides that claims for costs and fees may be made for any adjudication brought under the federal APA.[180] The APA establishes procedures and requirements for "on the record" adjudications by federal agencies.[181] USDA contended that the APA and EAJA do not apply to NAD appeals.[182] Only parties to adjudications conducted under section 554 of the APA are eligible for EAJA fee reimbursements.[183] There are three requirements for a government proceeding to come under section 554 of the APA as follows: (1) the proceeding must be an adjudication; (2) there must be statutory opportunity for a hearing; and (3) the hearing must be on the record.[184] The Eighth Circuit found that NAD hearings meet all three requirements for APA and EAJA applicability.[185]

IX. NAD SYSTEM IN CONTROVERSY

In the last two years the NAD system has come under increasing criticism—particularly in the popular agriculture press. Critics point out that the NAD director is reversing a high percentage of NAD appeal hearing officer decisions which favor

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175. *See* 15 U.S.C. § 1691e(b) (1994).
176. *See id*.
177. *See* Lane v. USDA, 120 F.3d 106, 108 (8th Cir. 1997); Karen R. Krub, *Attorneys' Fees in NAD Hearings*, 15 AGRIC. L. UPDATE 1 (Nov. 1997) (summarizing this case).
178. *See Lane*, 120 F.3d at 110.
179. *See* 5 U.S.C. § 504(a)(1) (1994).
180. *See id.* § 554(a).
181. *See Lane*, 120 F.3d at 108.
182. *See id*.
183. *See id*.
184. *See id*.
185. *See id*.

the farmer and reversing very few of the hearing officer decisions that favor the USDA.[186]

X. LOOMING SHARED APPRECIATION AGREEMENTS

Many FSA borrowers who received loan servicing in the 1980s signed shared appreciation agreements.[187] These agreements changed somewhat over the years.[188] In general, the shared appreciation agreements provide that under certain conditions, if the value of the borrower's real estate increases over the next ten years, the borrower may be required to pay back some part of the original loan write-down.[189]

A. *What Triggers the Repayment Provisions*

The repayment provisions of the shared appreciation agreement can be triggered in one of several ways. Recapture can be triggered if the real estate is conveyed, if the original loan or line of credit that was written down is repaid,[190] or the borrower stops farming.[191] In addition, the end of the agreement triggers recapture.[192] Agreements can last for up to ten years.[193] For some borrowers the ten year trigger is coming soon.

B. *Amount the Borrower Must Pay if the Agreement is Triggered*

The amount of the write-down that must be paid back out of the shared appreciation varies depending on several factors. In general, repayment calculations are based on the appreciation of the real estate.[194] A shared appreciation agreement will never require that the borrower repay more than the amount of the original write-down.[195] The amount that must be repaid is usually either fifty percent or seventy-five percent of the value of the appreciation in the real estate.[196] Seventy-

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186. *See, e.g.*, Patricia Klintberg, *Farmers' Court: In Disputes with USDA, Farmers are Guilty Until Proven Innocent*, FARM J., July-Aug. 1997 (discussing the infrequency of NAD appeal decisions in favor of farmers).

187. *See* 7 U.S.C. § 2001(e)(1)-(5) (1994).

188. *See* 7 C.F.R. § 1980.125(c) (1997); 7 C.F.R. pt. 1980, subpt. B, Exhibit F (1997) (discussing current examples of regulations and an example of the agreement).

189. *See* 7 C.F.R. § 1980.125(c)(2) (1997).

190. *See id*. § 1980.125(c)(3).

191. *See id*.

192. *See id.*

193. *See id*. § 1980.125(c)(1).

194. *See id*.

195. *See id*. § 1980.125(c)(5).

196. *See id*. § 1980.125(c)(2).

five percent of the appreciated value of the real estate must be repaid if the shared appreciation agreement is triggered within four years of the write-down.[197] Fifty percent of the appreciated value of the real estate must be repaid if the share appreciation agreement is triggered after four years from the write-down.[198]

XI. USDA DELAYS BEFORE THE 1996 FAIR ACT: POSSIBLE LEGAL STRATEGIES

Numerous farmers applied for various FSA credit programs and services before the 1996 FAIR Act passed. Had these applications been considered and acted upon in a timely fashion, many farmers would have been eligible for the programs for which they applied. Once the 1996 FAIR Act passed, however, the restrictive nature of the credit title made many of the farmers ineligible under the terms of the new statute. Often, the time limit for FSA to act on an application was set by statute.[199]

These farmers face difficulty in finding legal relief. First, the statutes controlling FSA lending programs do not provide a private right of action.[200] Second, potential borrowers probably do not have a constitutional property interest in a future loan.[201] Even if a property right could be established, individual USDA officials may be immune from a *Bivens*-type action.[202] Third, in actions under the Federal Tort Claims Act (FTCA),[203] in which the plaintiff is permitted to sue the government, the plaintiff will have difficulty establishing that the statutorily mandated deadlines actually create a duty.[204] Courts indicate that the federal government's duty in such a case must originate in state law—not federal regulation.[205] Fourth, farmers will typically be hard pressed to establish that a contract for a future loan or future loan servicing actually existed. Other equitable arguments, perhaps based on reliance, seem possible, although at least one court has noted that in order to estop the government, "a private party must allege more than mere negligence, delay, inaction, or failure to follow an internal agency

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197. *See id*.
198. *See id*.
199. *See* 7 U.S.C. § 1983(a)(1) (1994).
200. *See* DeJournett v. Block, 799 F.2d 430, 431 (8th Cir. 1986).
201. *See id.* at 432.
202. *See* Bivens v. Six Unknown Named Agents, 403 U.S. 388, 396 (1971); Ashbrook v. Block, 917 F.2d 918, 924 (6th Cir. 1989); McBrice v. Taylor, 924 F.2d 386, 390 (1st Cir. 1991); Arcoren v. Peters, 829 F.2d 671, 676 (8th Cir. 1987).
203. Federal Tort Claims Act, 28 U.S.C. § 2674 (1994).
204. *See* Nichols v. Block, 656 F. Supp. 1436, 1444-46; Love v. United States, 60 F.3d 642, 644 (9th Cir. 1995).
205. *See Nichols*, 656 F. Supp. at 1444-46; *Love*, 60 F.3d at 644.

guideline."[206] FSA's failure to act in a timely fashion might, however, prove useful as an affirmative defense to an FSA collection action. This approach has had some success in attempting to force the Farm Credit System to honor the rights of creditors granted in federal statute but seemingly otherwise unenforceable.[207]

206. Fano v. O'Neill, 806 F.2d 1262, 1265 (5th Cir. 1987).

207. *See, e.g.*, Federal Land Bank v. Overboe, 404 N.W.2d 445, 448-49 (N.D. 1987); Federal Land Bank v. Bosch, 432 N.W.2d 855, 858-59 (N.D. 1988).