



## **An Agricultural Law Research Article**

### **Rabobank Offer to Purchase FCS of America**

by

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### Background

On July 30, 2004, Farm Credit Services of America (FCSAmerica) notified the Farm Credit Administration (FCA) that the FCSAmerica Board had resolved to terminate its status as a Farm Credit System institution and become a wholly-owned subsidiary of Rabobank.<sup>1</sup>

*The parties.* FCA is “an independent agency in the executive branch of the U.S. Government. It is responsible for the regulation and examination of the banks, associations, and related entities that collectively comprise what is known as the Farm Credit System (System).”<sup>2</sup> FCSAmerica is the Agricultural Credit Association that serves Iowa, Nebraska, South Dakota, and Wyoming. Rabobank, headquartered in the Netherlands, operates in 34 countries<sup>3</sup> and is the world’s 15<sup>th</sup> largest banking organization in terms of assets.<sup>4</sup>

*The proposal.* The Rabobank proposal includes an offer to purchase all shares of FCSAmerica for \$600 million.<sup>5</sup> FCA regulations<sup>6</sup> require that an exit fee estimated at \$800 million be paid out of the FCSAmerica accumulated assets that would go to the Farm Credit System Insurance Corporation and would likely lower insurance fees for remaining system institutions for some time.<sup>7</sup>

*The competing proposal.* Soon after the Rabobank proposal became public, AgStar, a neighboring Agricultural Credit Association serving parts of Minnesota and Wisconsin, offered a

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<sup>1</sup> Farm Credit Administration, *FCA Receives Termination from Farm Credit System Association*, press release (August 3, 2004), available at <http://www.fca.gov/newsr.nsf/74c88db99e512b6885256e160078abdf/ecaa2c13c5bdc36a85256ee60051cb42?OpenDocument>.

<sup>2</sup> Farm Credit Administration, *About FCA*, available at <http://www.fca.gov/About-FCA.htm> (last visited Sep. 16, 2004).

<sup>3</sup> Rabobank, *Profile*, available at <http://www.rabobank.com/content/rabobank/profile.jsp> (last visited Sep. 16, 2004).

<sup>4</sup> Dr. Neil E. Harl, *Rabobank Buyout of FCSAmericamerica*, AG LENDER, 12 (Aug. 2004), available at <http://www.econ.iastate.edu/rabobankbuyout/aglender.pdf>.

<sup>5</sup> *Rabobank & FCSAmericamerica Fact Sheet*, available as a link on FCSAmerica website at <http://www.FCSAmericamerica.com/transaction.htm> (last visited Sep. 16, 2004).

<sup>6</sup> Termination of System Institution Status, 6 C.F.R. §§ 1250, 1255 (2004).

<sup>7</sup> Neil E. Harl, *The Exit Fee*, included in *Frequently Asked Questions* and available at <http://www.econ.iastate.edu/rabobankbuyout/faq.htm#faq3> (last visited Sep. 16, 2004).

competing bid for FCSAmerica of \$650 million.<sup>8</sup> No termination fee is required in the AgStar offer because FCSAmerica would remain in the Farm Credit System by merging with another System institution.

*Pros and cons.* Proponents of the Rabobank proposal assert that the acquisition would have a number of benefits, including increasing the number of financial products available, broadening the geographic scope for borrowers who also do business outside of the FCSAmerica geographic area, paying out accumulated FCSAmerica capital to stockholders, and no longer being restricted by the requirements of the Farm Credit Act, the law that regulates Farm Credit System institutions.<sup>9</sup> Critics point out that many of these goals could be met by simply changing the way the bank is managed.<sup>10</sup> Critics also raise concerns that the Rabobank offer may undervalue FCSAmerica<sup>11</sup> and that the acquisition might cause a complete unraveling of the Agricultural Credit Associations within the Farm Credit System.<sup>12</sup>

### **The Law Affecting Termination of a FCS Institution**

The Farm Credit Act of 1971 provides FCA with the authority to approve the termination of FCSAmerica.<sup>13</sup> The Act and FCA regulations require a number of things to occur before a termination is final:

1. FCSAmerica must notify FCA and equity holders that the FCSAmerica Board has adopted a resolution to commence the termination process;
2. FCA must approve the termination application;
3. FCSAmerica stockholders must approve the Rabobank transaction; and
4. FCA must provide final approval.

*Notice of commencement of termination process.* FCA regulations provide that within five days of adopting the resolution to commence the termination process, FCSAmerica must notify FCA and send an “announcement to all equity holders stating that [FCSAmerica is] taking steps to

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<sup>8</sup> *AgStar Announces Five-Point Proposal to Preserve and Strengthen Farm Credit Services of America* (Aug. 18, 2004), available at <http://www.agstar.com/Default.aspx?pageid=268>.

<sup>9</sup> Farm Credit Services of America, *Better Together*, available at <http://www.FCSAmericamerica.com/transaction.htm> (last visited Sep. 16, 2004); Neil E. Harl, *Why Sell the Bank? Options for FCSAmerica Members*, included in *Frequently Asked Questions* and available at <http://www.econ.iastate.edu/rabobankbuyout/faq.htm#faq2b> (last visited Sep. 16, 2004).

<sup>10</sup> Peter J. Barry, *FCS of America's Organizational Choices: Sale to Rabobank, Merger with AgStar, or Status Quo?* (Sep. 1, 2004), available at <http://www.farmdoc.uiuc.edu/finance/publications/FCSAmerica%20Rabobank%20Agstar%20choices.pdf>; Neil E. Harl, *Why Sell the Bank? Options for FCSAmerica Members*, included in *Frequently Asked Questions* and available at <http://www.econ.iastate.edu/rabobankbuyout/faq.htm#faq2b> (last visited Sep. 16, 2004).

<sup>11</sup> Robert W. Jolly, *How are Financial Institutions Sold* (Sep. 2, 2004), included in *Frequently Asked Questions* and available at <http://www.econ.iastate.edu/rabobankbuyout/faq.htm#faq2a>.

<sup>12</sup> Dr. Neil E. Harl, *Rabobank Buyout of FCSAmericamerica*, AG LENDER, 13 (Aug. 2004), available at <http://www.econ.iastate.edu/rabobankbuyout/aglender.pdf>.

<sup>13</sup> Section 5.17(2)(a) of the Farm Credit Act of 1971 (12 U.S.C. § 2252(2)(a)) provides FCA its enumerated powers, including the power to “approve mergers and any related activities as provided for in title VII.” Title VII of the Act, Chapter 4, section 7.10 (12 U.S.C. § 2279d) provides for the termination of system institutions.

terminate Farm Credit status<sup>14</sup> and describing the process of termination, the expected effects of termination on equity holders, and the type of charter the successor institution will have. The notice of commencement statement is distinct from the “information statement,” which is more detailed and is provided to equity holders after FCA preliminarily approves the termination. In any case, anyone related to FCSAmerica is prohibited from making any “untrue or misleading statement of material fact, or fail to disclose any material fact, about the termination to a current or prospective equity holder.”<sup>15</sup>

*Termination Application.* At least 30 days after filing the notice of commencement, FCSAmerica must provide FCA with a “termination application.”<sup>16</sup> The termination application primarily includes the plan of termination and information statement that will be provided to current and prospective equity holders. The Act states that “prior to submission to the voters . . . of the institutions involved, such plan shall be submitted to the Farm Credit Administration Board.”<sup>17</sup> FCSAmerica may not submit the termination plan to the voters until FCA approves the plan.<sup>18</sup> This requirement raises the possibility that FCA may deny a termination application that the stockholders of FCSAmerica never actually had the opportunity to review.

*FCA review of the termination application.* FCA has sixty days to either approve or reject the application.<sup>19</sup> Proponents of the termination might assert that FCA does not actually have the power to look at the substance of the plan; rather they might argue that FCA’s job is only to check the accuracy before the plan is sent out to the stockholders. However, a reading of the statute as a whole indicates otherwise. FCA regulations do provide two express situations where the FCA may reject the application: where the viability of other system institutions is at risk<sup>20</sup> and where the application follows too quickly after notice.<sup>21</sup> Arguably, because of its broad language, the Act also provides FCA with room to rely on justifications beyond those expressly provided in regulation to reject the termination application. The termination power granted in both the Act’s section that lists the Board’s enumerated powers and in the section dealing specifically with terminations does not provide restrictions on the Board’s authority.<sup>22</sup> That is, the section dealing with termination states that one of many things that must occur for a System institution to terminate is FCA Board approval.<sup>23</sup> The

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<sup>14</sup> Termination of System Institutions, 12 CFR § 611.1210(b).

<sup>15</sup> 12 CFR § 611.1215(a).

<sup>16</sup> 12 CFR § 611.1221(a).

<sup>17</sup> Farm Credit Act of 1971, § 7.11(a)(1), (12 U.S.C. § 2279e(a)(1)).

<sup>18</sup> 12 U.S.C. § 2279e(a)(2).

<sup>19</sup> 12 CFR § 611.1230(a).

<sup>20</sup> 12 CFR § 611.1230(b).

<sup>21</sup> 12 CFR § 611.1221.

<sup>22</sup> Section 5.17(2)(a) of the Farm Credit Act of 1971 (12 U.S.C. § 2252(2)(a)) provides FCA its enumerated powers, including the power to “approve mergers and any related activities as provided for in title VII.” Title VII of the Act, Chapter 4, section 7.10 (12 U.S.C. § 2279d) provides for the termination of system institutions.

<sup>23</sup> 12 U.S.C. § 2279d(a):

(a) Conditions

A System institution may terminate the status of the institution as a System institution if--

section does not say that the FCA Board must approve the termination if certain other things happen.<sup>24</sup>

Thus, in deciding whether to approve the application, FCA might consider whether the termination would frustrate the policy and objectives of the Act. The express goals of the Act state:

(a) It is declared to be the policy of the Congress, recognizing that a prosperous, productive agriculture is essential to a free nation and recognizing the growing need for credit in rural areas, that the farmer-owned cooperative Farm Credit System be designed to accomplish the objective of improving the income and well-being of American farmers and ranchers by furnishing sound, adequate, and constructive credit and closely related services to them, their cooperatives, and to selected farm-related businesses necessary for efficient farm operations.

(b) It is the objective of this chapter to continue to encourage farmer- and rancher-borrowers participation in the management, control, and ownership of a permanent system of credit for agriculture which will be responsive to the credit needs of all types of agricultural producers having a basis for credit, and to modernize and improve the authorizations and means for furnishing such credit and credit for housing in rural areas made available through the institutions constituting the Farm Credit System as herein provided.<sup>25</sup>

If FCA chooses to look at the broader policies of the Act in reviewing FCSAmerica's termination application, it will have the task of determining whether the Rabobank proposal furthers the goals of improving farm income by providing the agricultural sector with sound, reliable credit and continues to encourage farmer and rancher control of a permanent system of credit for agriculture.

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(1) the institution provides written notice to the Farm Credit Administration Board not later than 90 days prior to the proposed termination date;

(2) the termination is approved by the Farm Credit Administration Board;

(3) the appropriate Federal or State authority grants approval to charter the institution as a bank, savings and loan association, or other financial institution;

(4) the institution pays to the Farm Credit Assistance Fund, as created under section 2278b-5 of this title, if the termination is prior to January 1, 1992, or pays to the Farm Credit Insurance Fund, if the termination is after such date, the amount by which the total capital of the institution exceeds, 6 percent of the assets;

(5) the institution pays or makes adequate provision for payment of all outstanding debt obligations of the institution;

(6) the termination is approved by a majority of the stockholders of the institution voting, in person or by written proxy, at a duly authorized stockholders' meeting, held prior to giving notice to the Farm Credit Administration Board; and

(7) the institution meets such other conditions as the Farm Credit Administration Board by regulation considers appropriate.

<sup>24</sup> *Id.*

<sup>25</sup> 12 U.S.C. § 2001.

*FCA conditions on proposal.* FCA also has the authority to change the termination plan. After listing specific actions that a termination applicant must take before FCA approval, the Act provides that FCA will grant final approval only after “the institution meets such other conditions as the Farm Credit Administration Board by regulation considers appropriate.”<sup>26</sup> The regulations echo this open-ended requirement.<sup>27</sup> These conditions are limited only by FCA’s seemingly broad statutory authority. Depending on FCA’s conditions, this raises the possibility that FCA could essentially halt the deal without actually having to reject the termination application. FCA could do so by including conditions that make the proposal much less attractive to the parties or to stockholders.

One condition clearly spelled out in the regulations is that the termination plan may not “require that a waiver of contractual borrower rights provisions as a condition of borrowing from and owning equity in the successor institution.”<sup>28</sup> This means that Rabobank would need to honor the borrower rights provisions in loan documents originated with FCSAmerica. For instance, the Act requires that borrowers have the right to have their loan considered for restructuring should the loan become distressed.<sup>29</sup> An integral part of this borrower’s right is that the System institution must have a detailed “restructuring policy” that is consistent with the Act and that has been approved by FCA.<sup>30</sup> Assuming that this right is a “contractual borrower’s right,”<sup>31</sup> this raises the issue of whether FCA would or could require Rabobank to have a restructuring policy that was materially the same as a System institution.

*Stockholder approval.* If FCA provides preliminary approval of the application, FCSAmerica must hold a meeting to vote on the termination within sixty days of FCA’s approval.<sup>32</sup> FCSAmerica must provide at least 30 days’ notice to the stockholders before the meeting.<sup>33</sup> The vote must be conducted by an independent third party and is confidential except that the tabulator must “be able to verify . . . that the stockholder voted against the termination” in the case where a voter wants to exercise dissenter rights.<sup>34</sup> Stockholder approval requires “a majority of the stockholders of the institution voting, in person or by written proxy.”<sup>35</sup> Those who own FCSAmerica stock and either are

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<sup>26</sup> 12 U.S.C. § 2279d(a)(7).

<sup>27</sup> 12 CFR § 611.1255(c).

<sup>28</sup> 12 CFR § 1290.

<sup>29</sup> 12 U.S.C. § 2202a; see also 12 C.F.R. § 617.7500 to 617.7525.

<sup>30</sup> 12 U.S.C. § 2202a(g).

<sup>31</sup> The author does not have an example of a FCSAmerica loan document on file, but § 4.13(a)(6) (12 U.S.C. § 2199(a)(6)) of the Act requires System institutions to provide “meaningful and timely disclosure not later than the time of the loan closing of . . . (6) a statement . . . with an explanation of the terms and borrowers’ rights that apply to each type of loan.” Whether the borrower’s rights are contractual will depend on the loan documents and the nature of the notice provided.

<sup>32</sup> 12 CFR § 611.1240(a).

<sup>33</sup> 12 CFR § 611.1240(c).

<sup>34</sup> 12 CFR § 611.1240(d).

<sup>35</sup> 12 U.S.C. § 2279(d)(6).

current borrowers or did not pay off their debts before 1998 are eligible to vote.<sup>36</sup> If the majority votes to approve the merger, voting stockholders can seek reconsideration of the vote with a petition signed by 15 percent of the voting stockholders presented to FCA within 35 days after the stockholders received notice that the termination was approved.<sup>37</sup>

*Dissenting Stockholders.* A dissenting stockholder has the right, but not the obligation, to “require a terminating institution to retire the stockholder’s equity interest in the terminating institution.”<sup>38</sup> A dissenting stockholder is one who: “(1) was eligible to vote on the termination resolution and voted against termination; (2) was an equity holder on the voting record date but was not eligible to vote; or (3) became an equity holder after the voting record date.”<sup>39</sup> The FCA has the authority to require the terminating institution to value the dissenter’s share in an equitable manner.<sup>40</sup> This means that one who votes for the approval of the termination does not have the right to demand that his or her stock be liquidated, while those who voted no or did not have an opportunity to vote do have the right to demand the stock be liquidated.

## **Conclusion**

FCA and the stockholders of FCSAmerica are plowing new ground in deciding the fate of FCSAmerica. If approved, the proposal will certainly have ramifications on the agricultural credit environment of the Midwest and may have a ripple effect throughout the rest of the rural lending community.

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<sup>36</sup> Neil E. Harl, *Voting on the Resolution to Terminate System Status*, included in *Frequently Asked Questions* and available at <http://www.econ.iastate.edu/rabobankbuyout/faq.htm - faq4> (last visited Sep. 16, 2004) (stating that FCSAmerica’s termination announcement stated that payout would be to those who were borrowers between 1999 and 2004).

<sup>37</sup> 12 CFR § 611.1245(b).

<sup>38</sup> 12 CFR § 611.1280.

<sup>39</sup> 12 CFR § 611.1280(a).

<sup>40</sup> 12 CFR § 611.1280(c).